Budgeting, Reporting and Monitoring: Part 1 Budget

Educational Resource Packet # 25

The Standards for Excellence Institute

1500 Union Avenue, Suite 2500 | Baltimore, Maryland 21211

Phone: (410) 727-1726 | standardsforexcellenceinstitute.org

Preamble

Nonprofit organizations in the United States help the public and are essential to our society. They help improve communities around the country and make our lives better in art, science, economics, health, culture, human services, civil rights, religion, the environment, education, and many other fields.

Public support and confidence are essential to the success of nonprofit organizations. People, businesses, foundations, and government at all levels support nonprofits by giving resources, time, and money.

The Standards for Excellence Institute ("Institute") works to improve the accountability, transparency, and effectiveness of all nonprofit organizations to help them be excellent and earn public trust. The Institute has a code with step-by-step guidelines to help nonprofit organizations be well-managed and responsible.

The code has six Guiding Principles and 26 areas for ethical, responsible, and effective organizations. It is based on the legal foundations of how nonprofit organizations are run and governed. The code emphasizes values such as honesty, integrity, equity, fairness, respect, trust, compassion, responsibility, and transparency. The Institute encourages all nonprofit organizations to follow the code and work to be excellent in their management, governance, and operations.

Standards for Excellence – Guiding Principles

1. Mission, Strategy, and Evaluation

Nonprofits are created to achieve a specific goal for the public. A nonprofit has a clear mission statement that describes its purpose. A nonprofit's programs help it achieve that mission. The organization's leaders focus their efforts on achieving the mission using a shared vision. These leaders try to make a positive impact in a fair, equitable, and ethical way, considering the needs of the community and those impacted by the organization's work. The organization's leaders make sure that the organization's resources are used to achieve its stated purpose.

2. Leadership: Board, Staff, and Volunteers

Nonprofits need good leadership to achieve their goals. Nonprofits often rely on their employees and volunteers to achieve their mission. Strong leadership is a team effort between the board and management (whether paid or volunteer). The organization decides the best leadership approach for its work. Understanding and figuring out these shared and complicated parts of leadership are important for the organization to succeed.

Standards *for* Excellence

Board members are trusted to make sure the organization's resources are used for its mission. Board members care about the mission and represent and understand the community they serve. The board decides the organization's mission; creates a culture of fairness, equity, and inclusion; adopts policies and procedures for management; makes sure there are enough people and money to operate effectively; and evaluates how the organization uses its resources to achieve its mission and support the community.

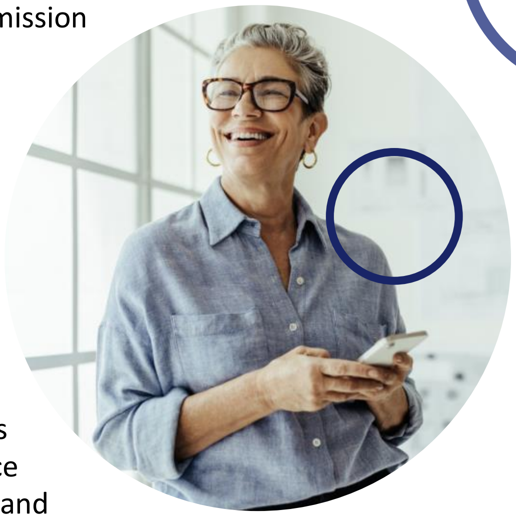
Nonprofits have leaders who do the everyday work of the organization, ensure the organization is sustainable, and give information to the board. The organization's human resource policies consider both paid workers and volunteers. The human resource policies are fair and clear, include helpful performance evaluations, and create a thriving and inclusive culture for everyone.

3. Ethics and Legal Compliance

Nonprofits depend upon public support and confidence and must follow laws and regulations. Leaders make sure their organizations understand and follow the laws, including special types of laws (such as regulatory and fiduciary). Nonprofits also have a responsibility to do more than just follow the laws; they must work in ethical and equitable ways. Acting legally and ethically helps nonprofits build trust and reduces misconduct. When laws are unjust, nonprofits can work to change them. Nonprofits have policies in place to make sure people taking actions are doing so in the nonprofit’s best interest and avoid actions that might cause a conflict of interest.

4. Finance and Operations

Nonprofits have sound financial and business systems and make sure their recordkeeping is correct. They use their financial and other resources to help achieve their mission, uphold their values, and serve the community. They also check their accounting systems regularly to make sure they are accurate and transparent and to protect the integrity of the reporting systems. They also engage in risk management to protect the nonprofit’s mission and operations.



5. Resources and Development

Nonprofits need resources to do their important work in the community. Both the board and staff are responsible for securing these resources. Most nonprofits get financial support from many different sources. The way a nonprofit raises money is truthful, transparent, and responsible. The organization's resource development policies support its mission, fit with its capabilities, and respect the people it serves, while also involving donors, prospective donors, and others in the community.

6. Public Awareness, Engagement, and Advocacy

Nonprofits understand and represent the diverse needs of the people they serve by educating the public and advocating for public policies and by encouraging the board, staff, volunteers, and partners including other nonprofits and supporters to be involved in the community's public affairs. Being active in community affairs and elections can help an organization further its mission. Public policies are better when the interests of communities and the nonprofits that serve them are shared and considered. To do this, nonprofits communicate effectively to educate, inform, and involve the public.

About the Standards of Excellence Institute

> The mission of the Standards for Excellence Institute is to promote the highest standards of ethics and accountability in nonprofit governance, management, and operations, and to facilitate adherence to those standards by all nonprofit organizations.

The Standards for Excellence Institute is a national membership organization, which was created by, and is now an operating division of, Maryland Nonprofits. The Institute's Standards for Excellence program is a structured approach for nonprofits to use to build capacity, accountability, and sustainability in their organizations.

The centerpiece of the program is a set of nonprofit best practices: the Standards for Excellence: An Ethics and Accountability Code for the Nonprofit Sector. The Standards for Excellence Code is available to all nonprofits.

The Institute provides member organizations with a comprehensive system of educational tools and support to allow them to implement the benchmarks and practices in The Standards for Excellence Code. Standards for Excellence accreditation is available to individual nonprofit organizations through a rigorous professional and peer review process.
Standards for Excellence Licensed Consultants are independent consultants with the knowledge, skills, and tools necessary to assist nonprofit organizations as they embrace excellence using the program's resources. The Standards for Excellence Institute has partners across the country that provide the Standards for Excellence program resources to their members and the nonprofits they serve.

For more information about joining the Standards for Excellence Institute or to learn more about the ways the Institute serves nonprofits, visit our website at www.standardsforexcellence.org.

Table of Contents

Financial Budgeting, Reporting, and Monitoring

As the Standards for Excellence: An Ethics and Accountability Code for the Nonprofit Sector states:

The board approves the organization's budget before the start of each fiscal year. The budget lines up with the organization's mission, values, goals and objectives. The organization follows this budget in its work.

Introduction

Every nonprofit organization has a ***financial structure***, whether it has an annual operating budget of $300 or $3 million dollars. The simple act of doing the work requires people and resources. These people and resources have value. Even in all-volunteer organizations or organizations that rely on a large amount of donated (in-kind) items, there are still things that need to be paid for and there are still requirements to keep track of the value of the resources.

The way an organization acquires resources, how it plans to use them over time, and what it actually uses them for are an organization's ***financial structure***. This is also referred to as the *business model.* An organization's *financial systems and processes* are the tools that allow it to do the financial planning and monitoring that are critical to operating effectively and efficiently.

A key responsibility of nonprofit staff and the board of directors is understanding an organization's financial structure, monitoring the current financial health of the organization, and planning for future financial needs. This is their *fiduciary responsibility*, a term described in more detail in *Standards for Excellence educational resource packet Budgeting, Reporting, and Monitoring Part 3: Financial Stewardship (packet #27).*

To effectively fulfill this responsibility, organizations rely on the following financial tools:

- **An operating budget**: A forward-looking plan that estimates financial activity for a set period of time in the future (traditionally a 12-month fiscal year for most organizations)

- **Financial statements**: Regularly updated documents used to (1) monitor actual financial progress against planned budgets, (2) provide updated projections when things vary from what the budget estimated, and (3) assess the current and future financial health of the organization

- **An annual audit**: A review conducted by a Certified Public Accountant (CPA) evaluating the integrity of the financial systems and processes an organization has in place. It is generally backward-looking and evaluates an organization's accounting practices and results against the Generally Accepted Accounting Principles (GAAP)

25.1 Organizational Budgets

General Overview

Budgets are critical parts of any organization's planning and assessment. Budgets are the primary tool staff and members of the board have to support their fiduciary roles. (See *Standards for Excellence educational resource packet Budgeting, Reporting, and Monitoring Part 3: Financial Stewardship (packet #27)* for more details about this fiduciary role). As mentioned in the introduction, the simple act of doing the work of the organization requires resources, all of which have value and some of which require money to pay for.

Budgets and financial reports are the bridges that connect this day-to-day work and the needed resources with the financial transactions that capture the flow of value (usually money) in and out of the organization. Together, they create a constant cycle in which *budgets* serve as the planning tool that projects into the future and *financial reporting* serves as the assessment tool that captures what actually happens, supporting future planning and the next budgeting cycle.

Preparing and adopting budgets allows staff and members of the board to plan for an organization's future activities while maintaining focus on its mission, values, and financial well-being. Budgets help people understand (1) what is really required to effectively deliver programs that fulfill the mission; (2) the ways in which the organization generates financial and in-kind resources; (3) the timing and flow of money in and out of the organization; and (4) the current financial health and viability of the organization.

Once approved by the board, budgets become benchmarks moving forward. As the fiscal year progresses, staff and members of the board monitor how the actual day-to-day work of the organization aligns with the predictions embedded in the budget. For more information on monitoring financial performance and general financial oversight, refer to *Standards for Excellence educational resource packets Budgeting, Reporting, and Monitoring Part 2: Financial Reporting (packet #26)* **and** *Budgeting, Reporting, and Monitoring Part 3: Financial Stewardship (packet #27).*

Types of Budgets

In the nonprofit sector, organizations have two types of budgets – an *operating budget* and a *capital budget*.

> **Operating Budget**: The operating budget is a financial picture of how an organization will operate over a set period of time. It predicts the amount and timing of revenue and expenses required to support both the actual work of the organization and the infrastructure that will be in place for the specified budget timeframe. Technically it is a forecast of the cashflow that will result from the planned activities for the period of time the budget covers.
>
> Determining the period of time a budget covers is a management decision of the organization. The most common timeframe is a 12-month snapshot that corresponds to the organization's *fiscal year**. Organizations may have reasons to create operating

budgets that cover a longer period of time – 18 to 24 months – in order to plan further into the future. Many organizations receive grants and other annual funds which have funding cycles that do not match the organization's fiscal year. Expanding the operating budget to 18 or 24 months allows people to see a fuller picture of the total revenue and expenses that are tied to these different funding sources and cycles. When an organization opts to create a budget that spans more than 12 months, it will need the ability to provide funders with a version of an annual operating budget that corresponds to the funders' requests.

(*A *fiscal year* may be different from the calendar year which starts January 1st and ends December 31st. Many organizations have fiscal years that correspond to the fiscal years used by either local or federal government – often starting on the first of the month in late summer or early fall. An organization's fiscal year is determined when the organization receives tax exempt status and is based on what is included in the initial Internal Revenue Service (IRS) Form 1023 application. The fiscal year is the 12-month period that will be used for reporting tax Form 990 and completing annual audits. To change an organization's fiscal year, paperwork must be filed with the IRS.)

Capital Budget: The capital budget provides a picture of an organization's financial position at a future point in time. The capital budget illustrates the accumulated financial assets of an organization - the collection of all the things that have positive financial value to an organization (property, cash in the bank, money owed to the organization, promised donations, etc.). It also captures financial liabilities - the collection of all the things that have negative financial value to an organization (outstanding bills, mortgage payments, payroll obligations, etc.).

> **Special Note about Capital Budgets** (also referenced *in Standards for Excellence educational resource packet Budgeting, Reporting, and Monitoring Part 3: Financial Stewardship (packet #27))*. It is uncommon for organizations to create an annual projected capital budget in the same way that they do for the operating budget. However, these two budgets do relate to each other. For example, if the operating budget projects a surplus at the end of the year, it is reasonable to expect that the organization's financial assets will be larger at the end of that year. In this way, a capital budget is less of a guide for actual activity in the way the operating budget is. Instead, it provides a reference point for what the organization's financial position will likely be at the conclusion of the proposed operating budget year.
>
> Having a capital budget that projects the financial position of the organization at the close of the proposed operating budget fiscal year is an important part of the budgeting process. For smaller organizations, a simple projected year-end

Statement of Position may be enough to show that the organization will end the year with enough assets to be sustainable moving forward.

As organizations begin to make plans for replacing equipment, paying for repairs, acquiring or building new facilities, growing reserves or endowments, or expanding programming in the future, a detailed multi-year capital budget becomes a critical guide for ensuring that the organization has the required assets in place for those plans. This version of a capital budget often includes a listing of what is needed, the rationale, the cost (including other costs directly related to the purchase), and the expected income to be derived (such as rent), if any. It may also show the predicted sources of funding (donor contributions, program revenue, etc.) that are required to meet the future asset goals.

25.1.1 Steps in the Budget Process

Budgeting is a process that involves planning, goal setting, and forecasting. The budget process begins once the organization has developed both its programmatic and financial goals and objectives for the coming budget cycle (most commonly the upcoming fiscal year). Using these plans, organizations estimate likely revenues and expenditures for that time period.[1] Dropkin and LaTouche point out that "careful attention to the budgeting process will lead to greater financial stability, operational effectiveness, efficiency, and responsiveness to organizational needs and priorities."[2]

Budgeting is often an inclusive and ongoing process that brings together information from program staff, the board, and management. In some organizations, individuals from all levels of the organization have a role in the budgeting process. Organizations benefit from considering who is affected by budget decisions, who holds important budget information, and how best to engage those individuals in the process.

Orgforward describes the process as follows:

> "What we are really doing when we draft a budget is build up confidence, and comfort, about a set of assumptions, forecasts, and guesses we employ to predict the future. It is not that we have confidence in the actual numbers that show up in a budget spreadsheet, it is that we have confidence in the thinking (meaning assumptions) that produced those predictions. So much confidence, in fact, that we are willing to bind ourselves to those predictions as the basis for financial accountability for the duration of the fiscal year. This process helps bolster our sense of stability - a feeling most people crave - by illuminating what we can expect well out into the future."[3]

---

[1] Hankin, Seidner, and Zietlow. *Financial Management for Nonprofit Organizations*, 1998.

[2] Dropkin, Murray and LaTouche, Bill, *The Budget-Building Book for Nonprofits*, San Francisco: Jossey Bass, 1998.

[3] Orgforward, *YIKES! It's Budget Time :: Understanding Budgeting in Uncertain Times*, 2020, https://orgforwardopine.blogspot.com/2020/04/yikes-it-budget-time-understanding.html

Before launching into the budgeting process, establish guidelines that clarify the purposes of developing an operating budget, how it will be used in the future, and timelines for budget development revision. Below is a five-step example of a budget development process.[4]

Step 1 – Establish a Consistent Budget Structure that Aligns with Accounting Software

Use the same standard budget format for all programs. The budget is divided into programmatic activities (columns) and line-item categories (rows). The structure of the activities and line-item categories is referred to as a chart of accounts and remains constant no matter what specific program the budget is developed for. An organizational budget identifies each project/department budget and combines them together to form the overall annual operating budget.

The order and appearance of the chart of accounts is the same in both the budget and the financial Statement of Activities to facilitate financial monitoring and oversight.[5] Often the chart of accounts will display numeric codes used by the accounting software to identify the types of revenues and expenses most appropriate to the needs of the organization. This combination of activities and account categories make up the budget.

At a minimum, budgets contain the categories found in the organization’s IRS Form 990 (annual information return form).

Step 2 – Gather Key Planning and Projection Inputs

Determine the work plan and financial models for the fiscal year, gathering relevant data linking mission goals to what is required to accomplish those goals. Data can be from sources such as strategic plans, work plans, past budgets, financial statements, borrowing data, or other sources. Typically, organizations also collect year-to-date (YTD) actuals, current year-end projections, and information on labor costs, charitable giving, fundraising costs, gifts-in-kind, and capital project projections from management and program staff, depending on established budget guidelines.

Step 3 - Forecasting

Use the above collected data to create a forecast that includes the types, timing, and amounts of revenue and expenses expected during the budget fiscal year.

Revenue lines typically found in an operating budget include:

- Contributions from the general public
- Membership/dues revenue
- Grants/awards broken down by funding source with time and purpose restrictions, if applicable
- Revenues from fundraising activities

[4] The basic steps were drawn from the “Developing and Improving your Budgeting Process” in Hankin, Seidner, and Zietlow. *Financial Management for Nonprofit Organizations*, 1998, p. 150-164.

[5] Coe, Charles K. *Nonprofit Financial Management: A Practical Guide.* 2002. John Wiley & Sons, Inc.

- Sales of goods or services by specific type (if more than one)
- Interest on investments

Budgets may contain both funds *with donor restriction* and funds *without donor restriction*. Funds with donor restrictions may include, to name a few, an endowment or a grant that is given for a specific initiative or project. Funds without restriction do not carry any donor-imposed requirements. It is critical to designate whether funds have restrictions in the budget to ensure proper cash management during the fiscal year.

While preparing the expense portion of the budget, be sure to look at inflationary increases, changes in the environment, anticipated program changes, additional resource needs, and labor cost issues. Typical expenses included in budgets:

- Operating expenses in detail (such as salaries, fringe benefits, rent, insurance, maintenance, service fees, etc.)
- Program specific expenses (such as salaries, benefits, supplies, services, etc.)
- Fundraising expenses
- Debt payments

This forecasting is a negotiated process among the people with relevant experience and knowledge and considers different potential scenarios in order to provide sufficient flexibility and allow the organization to adapt to potential changes in actual revenues or expenses that could occur. Additionally, the draft budget identifies and allocates indirect costs across program areas. See below, *Allocating Costs.*

Step 4 - Budget Review

Once completed, a detailed draft budget is reviewed by the board (generally by a designated finance committee or working group). Those reviewing the draft may ask for underlying assumptions and detailed cost analysis information to ensure the budget is reasonable and aligned with the organization's mission and values. Once comfortable with the budget draft, it is sent to the full board for final review and approval.

Step 5 – Monitoring & Management

Throughout the fiscal year, staff and board review progress against the budget. This allows the board to review the organization's activities and corresponding revenue and expenses as these relate to the proposed budget. This ensures the organization remains aligned with its mission and goals, controls fiscal activities, and re-allocates resources as needed. Internal financial statements (Statement of Cash Flows, Statement of Activities, and Statement of Position)[6] are generally used for periodic review and are prepared monthly and presented to the board at least quarterly.

---

[6] Financial Statements are addressed *in Standards for Excellence educational resource packet Budgeting, Reporting, and Monitoring Part 2: Financial Reporting (packet #26).*

It is important to remember that the budget is a guide and may need to be adjusted during the year. Many organizations revisit the budget on, or about, the mid-point of their fiscal year and determine if adjustments are required. The board leadership and executive leadership work together to provide guidance on when to come back to the full board with changes. For example, changing a small line item and moving budgeted money from *supplies* to *postage* is not significant and will generally not require board review. However, significant shifts (both positive and negative) in anticipated revenue and expenses that affect strategy and priority setting will need to be brought to the board for review and approval.

Once the Audit, Financial Statements, and Form 990 have been generated for the year, they are presented to the board for review.

25.1.2 Who is involved in the budgeting process

Annual budgets touch on all aspects of the organization. It is easy to mistakenly see the budget as a set of numbers in a spreadsheet that need to be balanced. Each number in a budget corresponds to either a resource or an activity the organization relies on to conduct day-to-day operations. While it is easy to understand that quantitative value of the numbers, the organization will also need to understand the qualitative resources or activities that those numbers correspond to. This is what allows the organization to determine whether a given number is realistic or appropriate.

When considering whom to involve in building the budget, key first questions that guide the budget process include:

- What key strategies do we need to pursue during this fiscal year?
- What program activities advance those strategies?
  - What resources (including staff) are required to deliver these programs effectively?
  - What do these resources cost?
- What operational functions and infrastructure are required to support program delivery?
  - What do these things cost?
- What revenue activities will be used during the fiscal year?
  - How much revenue can realistically be expected from those activities and when will the revenue be received?
  - What does it cost to engage in these revenue activities?
- What capital expenditures are planned for this fiscal year?
- What other financial considerations need to be considered as part of this year's budget?

The knowledge and expertise needed to answer these questions will likely be spread across different people in the organization. When building the budget, include the necessary time and processes to allow contributions from those with the needed knowledge. It may be that one person knows "what it takes" to deliver the program, while another may have to determine what those things "cost." For smaller organizations, this may be as simple as holding a meeting of key staff to answer these questions. For larger organizations, planning teams may need to meet; budget templates may need to be completed by program teams; and contracts may need to be negotiated with external funders or partners. Organizations need to consider these factors when determining how long to allow for the budget building process and whom to include.

Budgets ultimately affect everyone in the organization and need to be both realistic and reasonable for the organization. So, while not everyone will be intimately involved in the budgeting process, ideally no one will be surprised by the final budget or feel that the numbers don't reflect the reality of what it will take to execute the work plan covered by the budget.

25.2 Financial Projections in a Budget

As noted in the above section, there are many areas where the question of "how much is that?" comes up. The reality of budgeting is that organizations have to answer that question with as realistic a prediction as possible. In some areas determining "how much" is relatively straightforward. In others, organizations may be relying on assumptions and "what ifs" that may reduce confidence in a given answer.

In general, expenses are easier to determine. Once the organization has mapped out what is required to deliver programs and what organizational infrastructure is needed, researching those costs is all that is required. Referring back to past expenses for items will provide the initial basis for a projection going forward. In these cases, organizations can consider what factors could change the cost and adjust appropriately. Factors could include inflation, changes in quantity needed, employment rates and the labor market, and fee increases. If the work is new or unfamiliar, the organization may be able to find industry comparisons. Finding similar programs or similar organizations that are willing to share budget information can be helpful in determining costs.

Revenue can be much more challenging to project. It is hard to know exactly what grants the organization may get, how much donors will give, how many people will buy tickets, what government reimbursement rates will be, etc. There is a larger amount of unknowns when it comes to revenue.

As with expenses, looking at past revenue patterns can be helpful. Consider the revenue strategies of the past and how well they have worked. Ask if the strategies are still relevant for the upcoming fiscal year and whether there is any reason to think that the results may vary. Look to agencies that research donor and funder trends in the organization's region. Talk with program officers or grants administrators to determine likelihood of future funding. If the organization relies on government contracts, talk with legislators and other government watchdog agencies to determine how government revenue and spending may be changing in the next year or two.

When determining the actual projections for both revenue and expenses, be sure to clarify the assumptions are being made – the organization will need to be able to clearly explain why organization leaders think the numbers will be what they are AND what factors could affect them moving forward. This is a critical step in the overall financial planning process. It can also be helpful to provide several different budget scenarios that include different revenue and expense projections based on alternative assumptions or contingencies.[7]

Once a fiscal year begins, it is highly unlikely that the expenses and revenue will end up being exactly what was guessed at the time of formalizing the budget. When variances do occur, organization leaders will want to determine if they are just minor cost/revenue adjustments or if the underlying assumptions used to make the predictions are not turning out as expected. If the former, no significant changes may be needed. However, if reality is turning out to not align with the assumptions used to plan the budget, changes in programming and/or operations may be needed.

25.2.1 Allocating Costs

Today's nonprofit organizations are complex. It takes a lot of different things to deliver programs effectively. Understanding how expenses contribute to organizational operations and to achieving an organization's mission is important. For this reason, expenses are allocated to specific programs and organizational operations.

A nonprofit organization is designed to deliver programs. If it is not delivering programs, there is no need for any administrative organizational structure - so, there wouldn't be any "administrative expenses." This illustrates that all expenses actually contribute to program delivery in one way or another.

However, it is helpful to make some distinctions between expenses so that it can determine why they are necessary and whether they are reasonable and worthwhile. The industry often uses the terms *direct* and *indirect*. *Direct* expenses are the things that can clearly connect directly to program delivery (staff compensation, supplies, special licensing, etc.). *Indirect* expenses support the systems and structures that need to be in place to operate the organization but may not be part of direct program delivery (fundraising, financial services, personnel management, rent, utilities, insurance, etc.). Indirect does not mean unnecessary.

It is standard accounting practice to designate expenses as either *direct* (assigned directly to a specific program) or *indirect* (assigned to administrative or fundraising functions). This allows for a more reasonable way to capture expenses during the year. However, *indirect* expenses are actually in service to program delivery, so organizations need to spread the indirect expenses out across all the programs. For this reason, organizations develop *allocation* policies which determine how much of the indirect costs will be attributable to each program.

Allocation policies (the actual formula used to determine how much of the indirect expenses is allocated to each program) are an internal management tool. Whatever formula is used, it will need to be consistent and reasonable. Some types of work require more "administrative" infrastructure than others and it is important for the board and staff to understand why.

---

7 Orgforward, *YIKES! It's Budget Time :: Understanding Budgeting in Uncertain Times*, 2020, https://orgforwardopine.blogspot.com/2020/04/yikes-it-budget-time-understanding.html

While there isn't a specific standard formula, using distribution of labor across programs is a common practice. In this model, an organization tracks how much time (labor) is spent by all staff on each program. The indirect allocation formula is then based on the distribution of overall time across all programs. So, if one program takes 50% of the organization's labor, it is allocated 50% of the indirect expenses.

Using an allocation policy, *direct* and *indirect* expenses are combined to represent what it actually takes to do the work needed to achieve an organization's mission. In short, the true cost of delivering a program. A clear grasp of what it truly takes for the organization to deliver a program is an important managerial benchmark to have in place.

External funders make their own choices about how much *indirect* support they will provide. A funder's perspective may not reflect the organization's internal budget and indirect allocation formula. Most experts do not recommend using a funder-determined indirect or cost reimbursement rate as the basis for the organization's internal allocation formula.

Be Honest, the Allocation of Funds is Important

As the organization grows, additional scrutiny of the budget will take place. Staff timesheets will need to include hours spent on each program. Organization expenses may be allocated to multiple grants. The budget process may become more complicated. The organization's grantors may require more specific reports than what the organization is used to producing.

Having integrity and consistency in the organization's budget is critical. Fiscal management policies and procedures, addressed in *Standards for Excellence educational resource packet Financial Policies (packet #29)*, are crucial to the financial health of the organization. Allocation criteria need to be documented and applied consistently. External auditors will request this calculation and methodology and specifically disclose its application in the notes to the audit report.

25.2.2 Resources Spent on Program, Administration, and Fundraising

There is a longstanding mythology about a nonprofit's "program to administration expense ratio." The assumption was that smaller "administrative" expenses as a percentage of the overall organizational expenses was better. The reasoning was that "administrative" expenses were not focused on delivering the outcomes to the people the organization serves. There are a lot of opinion pieces about why this is an incorrect position.

Accepting the fact that fundraising and administration costs are necessary for running an effective and efficient nonprofit organization, assessing the relationship of program expenses to other expenses can be helpful. Many variables impact the percentages spent on programs, administration, and fundraising. A few of these variables include: age of the organization, size of the organization, popularity of the organization's purpose, the nature of the work the organization does, licensing and regulatory compliance, and different accounting procedures. A single standard for all organizations is not appropriate in the nonprofit sector given the diversity of the programs and services offered.

Instead, each organization monitors and sets its own goals for percentages spent on programs, administration, and fundraising. The *Standards for Excellence: An Ethics and Accountability Code for the Nonprofit Sector* does not set specific percentage benchmarks but recommends that the board annually review them. It's appropriate to benchmark against organizations of similar size and in similar areas of concentration. Such reviews are documented in the organization's board minutes.

Program, administration, and fundraising cost percentages may vary from year to year. For example, if the organization is looking at a growth pattern and determines it needs to hire a Director of Development (Fundraiser), it is possible that an initial investment in this type of position will skew its fundraising expense percentage for the particular year. Donors may be inclined to ask why the percentage is higher. Disclosing the reasons behind major shifts is advisable in order to explain major changes.

Resources spent on program, administration, and fundraising costs will appear on the organization's Statement of Functional Expenses, a financial statement that places all expenses from the organization's chart of accounts (COA) into three distinct categories: Program Service Expenses, Management and General Expenses, and Fundraising Expenses. It is prepared when receiving an audit or financial review. In turn functional expenses by program are detailed based on source of revenue.

25.2.3 Grants and Contracts Budgeting and Monitoring

It is common for funders and government to require specialized budgets as part of the application or contracting process, especially if the funding is restricted to a specific program or organizational function. Many grantors require their own budget template or budget justifications (written detail for how that funding will be spent) and funders are likely to have their own timeframe for payment and definitions for what is considered a direct or indirect expense.

Frequently, grants or contracts that cover a year of funding will have a cycle which does not align with the organization's fiscal year. For example, a grant funds a project from March through February while the organization's fiscal year runs from January through December. It is important to consider these timing differences when determining cash flow for an upcoming budget.

Funders will often provide the entire revenue for a grant at the beginning of the grant cycle, meaning the organization will get the money BEFORE incurring the expenses for the work related to the grant. There will be a large amount of revenue in one fiscal year to cover both expenses for the fiscal year the grant was received and the next fiscal year the grant work extends into. For government contracts, the opposite is true. These are generally reimbursable contracts which means the organization does the work first and then invoices the funder AFTER. Therefore, the organization will need to have its own funds available to do the work before being repaid.

In both instances, organizations will need to pay attention to how the funders payment practices will affect overall cash flow. Organizations need to consult with a financial professional who is familiar with nonprofit accounting to determine the best way for the organization to account for grant and contract revenue which spans multiple fiscal years.

Other guidelines: Always start the grant/contract budgeting process from the organization's own internal management budget using the chart of accounts and program categories. Remember that the budget will be capturing the revenue, expenses, and indirect allocations that represent what it truly takes to deliver a program. Review the funder's budget template and map the budget to theirs. Pay close attention to the funder's parameters as it is possible that they define direct and indirect expenses differently than the organization does or explicitly exclude expenses that are included in the budget. It is also common for funders to assign an *indirect cost reimbursement rate*. In these cases, the funder will determine the amount of indirect expenses it will cover as a percentage of the direct expenses (often between 10-20%) as opposed to asking for the actual allocation of indirect expenses to the program.

Typically grants/contracts will cover a portion of the cost of a specific program. If this is the case, the organization may not be able to include the entire cost of the program into a specific grant budget. It is best that organization not realign the organization's internal management budget with the funder's parameters. It is critical that the organization always understands the difference between what a funder chooses to pay for and what the organization has determined it truly costs to deliver a program. If a funder does not fully cover the cost of delivering a program, additional revenue resources will be required to fill the gap.

For grants that do not fully cover the cost of a program, organizations can determine the specific percentage that is covered and allocate all account categories using that percentage. For example, if the organization is applying for an after-school program grant for $75,000 but the full program costs $100,000, 75% of the Program Director's salary, taxes, supplies for the program, etc., for that program will be attributed to the grant. Other funding related to the after-school program will need to come from either another grant or unrestricted funds.

It is important to check the reporting requirements for each grantor. Some funders may ask for reports on a quarterly basis and reimburse for the amount spent in a specific quarter. Others will provide a percentage of the funding upfront and ask to report on that money spent before sending an additional check. Whatever the case, the organization will need to track money spent specifically related to that program and be able to provide justification for how to spend the money. It is important that organizations not be caught on the backend and know what the organization's grantors requires upfront.

Standards *for* Excellence

Selected Resources for Financial Budgeting, Reporting, and Monitoring: Part 1 Budget

Books, Articles, and Websites

American Institute of Certified Public Accountants (AICPA), *Audit and Accounting Guide, Not-for-Profit Entities, March 1, 2014*

Nonprofit Finance Fund found at www.nff.org

Nonprofit Accounting Basics found at www.nonprofitaccountingbasics.org

Shim, Jae K.; Siegal, Joel G.; Simon, Abraham J., *Handbook of Budgeting for Nonprofit Organizations*, Englewood Cliffs: Prentice Hall. 1996.

Budgeting for Nonprofits, The National Council of Nonprofits: https://www.councilofnonprofits.org/tools-resources/budgeting-nonprofits

Orgforward Blogs, *YIKES! It's Budget Time :: Understanding Budgeting in Uncertain Times* (https://orgforwardopine.blogspot.com/2020/04/yikes-it-budget-time-understanding.html), 2020; *Your Budget is a Translator – Not a Translation: A Rosetta Stone Approach to Budgets Can Make Strategic Thinking Easier* (https://orgforwardopine.blogspot.com/2018/03/your-budget-is-translator-not.html), 2018

Attachments

- Attachment 25A: Glossary of Terms Associated with Financial Planning and Monitoring, Standards for Excellence Institute
- Attachment 25B: Sample Budget

Attachment 25A: Glossary of Terms Associated with Financial Planning and Monitoring

Audit

A financial audit, or more accurately, an audit of financial statements, is the verification of the financial statements of a legal entity by an independent auditor. Such verification is usually expressed in an audit opinion intended to provide reasonable assurance, but not absolute assurance, that the audited financial statements present fairly, in all material respects, the financial position of the institution, as of a certain date, and in accordance with generally accepted accounting principles in the USA (GAAP-see below).

Budget

Plan of the organization stated in terms of money. The operating budget outlines planned revenues and expenses resulting from operations and for a set amount of time. The capital budget shows planned purchases of fixed assets or capital acquisitions of major items with a useful life of at least five years (such as land, buildings, equipment, vehicles, etc.).

Certified Public Accountant (CPA)

The statutory title of qualified accountants in the United States who have passed the Uniform Certified Public Accounting Examination and have met additional state education and experience requirements for membership in their respective professional accounting bodies and certification as a CPA. In most U.S. states, only CPAs who are licensed are able to provide opinions on financial statements. (The exceptions to this rule are Arizona, Kansas, North Carolina and Michigan).

Chart of Accounts

A numbered structure of the accounts that are arranged in order of appearance in the financial statements[8]. It typically contains accounting codes and is designed to meet the needs of the organization. These account categories and codes will make up the budget.

Compilation

The statement that a CPA must include in any compilation of financial statements, explains its nature: “A compilation is limited to presenting, in the form of financial statements, information that is the representation of management. We have not audited or

[8] Coe, Charles K. *Nonprofit Financial Management: A Practical Guide.* 2002. John Wiley & Sons, Inc.

reviewed the accompanying financial statements, and, accordingly, do not express an opinion or any other form of assurance on them."

Deficiency in Internal Control

Term used by auditors to describe a deficiency in internal control over financial reporting occurring when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.

FASB Accounting Standards Codification (FASB-ASC)

Released on July 1st, 2009, the FASB-ASC is now the only source of authoritative Generally Accepted Accounting Principles (GAAP) recognized by the Financial Accounting Standards Board (FASB) to be applied to nongovernmental entities. It simplified user access by codifying all authoritative US GAAP in one spot, and by updating them as Accounting Standards Updates are released.

FASB 116

Historical name of statement number 116 from the Financial Accounting Standards Board from 1993, now included in FASB-ASC, which is the primary guidance relating to the recording and presentation of contribution revenue by nonprofit organizations. This statement introduced the terms "restricted revenue" and "net assets," and requires that nonprofits record all unconditional contributions as revenue when notification of the contribution is received. This can cause significant fluctuations in the net assets of a nonprofit. For example, if it receives $1,000,000 grant to be paid in five yearly installments, the nonprofit would have to record the entire $1,000,000 in year 1, causing a large increase in net assets. However, as the funds are spent in years 2-5, the net assets would show a decrease. These fluctuations can make it difficult to properly budget and are often confusing to the readers of financial statements and Forms 990.

FASB 117

Historical name of statement number 117 from the Financial Accounting Standards Board from 1993, now included in FASB-ASC, which is the primary guidance relating to the financial statement presentation for nonprofits. It also mandated "functional reporting" of expenses (requiring nonprofits to show expenses based on the functions they benefit). FASB 117 requires all nonprofits to prepare the following four financial statements: 1) Statement of Financial Position (Balance Sheet); 2) Statement of Activities (Income Statement/Profit & Loss Statement); 3) Statement of Cash Flows (for institutions reporting on an accrual basis); and 4) Statement of Functional Expenses (for voluntary health and welfare organizations).

Financial Flexibility

Term used to describe the ability of a nonprofit organization to respond to unexpected needs and opportunities. It is usually assessed by examining the ratio between cash holdings and the total annual budget.

Fiscal Year

A *fiscal year* may be different from the calendar year and refers to a 12-month time period associated with the budget. It is selected when the organization receives tax exempt status and is noted in initial IRS paperwork.

Statement of Functional Expenses (found in Part IX of the IRS Form 990)

The Statement of Functional Expense is a financial statement that places all expenses from your chart of accounts (COA) into three distinct categories: Program Service Expenses, Management and General Expenses, and Fundraising Expenses.

GAAP

Generally Accepted Accounting Principles (pronounced "gap"), as apply to nongovernmental entities and now included in FASB-ASC (see above), have a specific meaning for accountants and auditors. The American Institute of Certified Public Accountants (AICPA) Code of Professional Conduct prohibits members from expressing an opinion or stating affirmatively that financial statements or other financial data "present fairly… in conformity with GAAP." if such information contains any departures from the accounting principles included in FASB-ASC.
GAAP included in FASB-ASC attempt to standardize and regulate accounting definitions, assumptions and methods. Because of them it can be assumed that there is consistency from year to year in the methods used to prepare an institution's financial statements.
In October 1999, the AICPA Council designated the Federal Accounting Standards Advisory Board (FASAB) as the body that establishes GAAP for federal reporting entities. FASAB publishes and constantly updates a Handbook identifying the "GAAP hierarchy" for federal reporting entities. This "hierarchy" lists the sources of accounting principles that are generally accepted, categorizing them in descending order of authority.

Key Performance Indicator (KPI)

Key Performance Indicators or KPIs are generally calculated for nonprofits based on figures found in their IRS Form 990. Such KPIs, may include ratios like fundraising efficiency, ratios on fundraising/administration/program expenditures. KPIs are based on how the organization codes or categories expenses throughout the year. Nonprofits are often evaluated by outside organizations based on their KPIs.

Liquidity

Is a measure of the extent to which an organization has cash (or assets that can be quickly converted into cash) to meet immediate and short-term obligations. Higher ratios of current assets to current liabilities denote greater liquidity.

Material Weakness

Is an auditing term indicating that there is a deficiency, or a combination of deficiencies, in internal control in financial reporting, such that there is a reasonable possibility that a material misstatement of the institution's annual or interim financial statements will not be prevented or detected on a timely basis.

Net Assets

Assets are the numerical net of what the organization owns less what it owes. The assets minus the liabilities are the net assets.
Assets-Liabilities=Net Assets

Review

A review of financial statements by a CPA implies more than a Compilation (see above). It is an assurance engagement, and needs to be planned and performed to obtain a limited level of assurance that the financial statements are free of material misstatement. A review engagement requires the accumulation of review evidence that will provide the CPA with a basis for obtaining reasonable assurance that there are no material modifications that should be made to the financial statements to be in accordance with the applicable financial reporting framework. That compares with an auditor's objective, which is to accumulate greater evidence to obtain a high level of assurance. Limited assurance can generally be obtained by performing analytical and inquiry procedures while an audit contemplates much greater testing through inspection, observation, confirmation and the examination of source documents.

SAS 114

Is one of the Statements on Auditing Standards issued by the American Institute of Certified Public Accountants (AICPA), now included in FASB-ASC, and it refers to the auditor's communication with those charged with governance.
It establishes standards and provides guidance in relation to an audit of financial statements, describing the role of communication, legal considerations, those who are charged with governance, management, matters to be communicated, the communication process, and the documentation. The auditor directly informs the audit committee, the finance committee or the Board of certain matters, including qualitative aspects of the

organization's significant accounting practices; significant difficulties, if any, encountered during the audit; uncorrected misstatements, if any; disagreements with management, if any; other findings and issues, if any; material corrected misstatements, if any; representations the auditor is requesting from management; and, management consultations with other accountants, if any.

Significant Deficiency

Is an auditing term referring to a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those responsible for oversight of the institution's financial reporting. It adversely affects the institution's ability to initiate, authorize, record or process financial data reliably and in accordance with GAAP, such that there is more than a remote likelihood that a consequential misstatement in the financial statements will not be prevented or detected.

Statement of Activities

It used to be called the Income Statement and shows the nonprofit organization's revenue and expenses for a specific period of time. Its result shows a surplus or a deficit, affecting the organization's net assets.

Statement of Cash Flows

The primary purpose of this financial statement is to provide information about receipts and payments of an organization during a period of time. The focus of the statement of cash flows is on cash inflows and outflows over the course of the year, or during a set period of time. It also provides information about the organization's ability to generate cash to meet obligations and other financial needs, while classifying cash effects into those arising from operations, investing and financing transactions.

Statement of Financial Position (sometimes called balance sheet)

Although for nonprofits the name for the balance sheet was changed into statement of financial position, the basic concept remained the same: this statement shows the overall financial position of a nonprofit organization at a given time. It shows the accumulated results of all the years of the organization's operations put together. It describes and summarizes the assets, liabilities and net assets, under the equation shown above (under Net Assets).

Attachment 25B: Sample Budget

Restricted Funding

Unrestricted Funding

Chart of Accounts

ABC Nonprofit
Budget Overview: FY 2020 by Class
July 2019 - June 2020

	Program 1 After School	Program 2 Summer Program	Program 3 Fall Program	Program 4 Winter Program	Total Program Budget	UnRestricted Funding not tied to program	TOTAL BUDGET
Income							
4000 Recurring Individual Contr					*0.00*	*15,000.00*	*15,000.00*
4003 Non Profit Income					*0.00*	*100,000.00*	*100,000.00*
4010 Grants and Foundations					0.00		0.00
4011 Baltimore City Grant 1	15,000.00	15,000.00			30,000.00		30,000.00
4012 Foundation 1	4,000.00		6,000.00		10,000.00		10,000.00
4013 Foundation 2	25,000.00				25,000.00		25,000.00
4014 State Grant 1	1,000.00			3,000.00	4,000.00		4,000.00
Total 4010 Grant/Fundation Funding	*45,000.00*	*15,000.00*	*6,000.00*	*3,000.00*	*69,000.00*	*0.00*	*69,000.00*
4070 Fundraising Events Income					*0.00*	*25,000.00*	*25,000.00*
4110 Church Giving							0.00
4111 Church 1	1,000.00		1,000.00		2,000.00		2,000.00
4112 Church 2		2,000.00			2,000.00		2,000.00
4113 Church3				500.00	500.00	500.00	1,000.00
Total 4110 Church Total	*$ 1,000.00*	*$ 2,000.00*	*$ 1,000.00*	*$ 500.00*	*4,500.00*	*$ 500.00*	*5,000.00*
4200 Earned Income Revenue							
4210 Sublet Rental					0.00	$ 12,000.00	12,000.00
4220 Equipment Rental			$ 15,000.00		15,000.00		15,000.00
4230 Social Entreprenuership Income					0.00	$ 6,000.00	6,000.00
Total 4200 Earned Income Revenue	*$ 0.00*	*$ 0.00*	*$ 15,000.00*	*$ 0.00*	*$ 15,000.00*	*$ 18,000.00*	*33,000.00*
Total Income	$ 46,000.00	$ 17,000.00	$ 22,000.00	$ 3,500.00	$ 88,500.00	$ 158,500.00	$ 247,000.00
Gross Profit	$ 46,000.00	$ 17,000.00	$ 22,000.00	$ 3,500.00	$ 88,500.00	$ 158,500.00	$ 247,000.00
Expenses					0.00		0.00
5000 Salaries - Admin	500.00	100.00	100.00	100.00	800.00	14,000.00	14,800.00
5000 Salaries - Fundraising					0.00	45,000.00	45,000.00
5000 Salaries - Prog	38,000.00	12,000.00	13,000.00	1,000.00	64,000.00	16,000.00	80,000.00
5020 Pension 403b Expenses	2,022.80	500.00	550.00	100.00	3,172.80	1,000.00	4,172.80
5100 P/R Taxes - Admin					0.00	2,000.00	2,000.00
5100 P/R Taxes - Fundraising					0.00	5,000.00	5,000.00
5100 P/R Taxes - Program	2,000.00	500.00	550.00	100.00	3,150.00	5,000.00	8,150.00
5150 Director and Officer Insurance Premium					0.00	3,000.00	3,000.00
5160 Workers Compensation - Expense	150.00	150.00	150.00	150.00	600.00	1,000.00	1,600.00
5170 Insurance	150.00	150.00	150.00	150.00	600.00	2,500.00	3,100.00
5201 HEALTH Care	150.00	150.00	150.00	150.00	600.00	2,000.00	2,600.00
5202 Payroll service - expense					0.00	1,600.00	1,600.00
5203 Contractual Program Providers	150.00	0.00	0.00		150.00		150.00
5204 Online Donation Charge					0.00	500.00	500.00
5208 Form 990 Filing Fee - 16					0.00	1,000.00	1,000.00
5211 Telephone	10.00	10.00	10.00	10.00	40.00	1,200.00	1,240.00
5212 Rent	150.00	150.00	150.00	150.00	600.00	24,000.00	24,600.00
5214 Web Hosting Monthly Fee					0.00	2,000.00	2,000.00
5215 Supplies	500.00	1,000.00	500.00	500.00	2,500.00	3,500.00	6,000.00
5216 Postage & Shipping - 15	25.00				25.00	1,000.00	1,025.00
5217 Computer Software					0.00		0.00
5218 Computer, Camera & Electronic Hardware	100.00				100.00	1,000.00	1,100.00
5219 Computer Tech Services - 16					0.00		0.00
5220 Utilities, Security, Maintenance	150.00	150.00	150.00	150.00	600.00	600.00	1,200.00
5221 Parking Reimb					0.00		0.00
5223 Board Meetings					0.00		0.00
5224 Meals - non-travel	200.00	50.00	50.00	50.00	350.00	750.00	1,100.00
5225 Travel	0.00	0.00	0.00	0.00	0.00	1,000.00	1,000.00
5226 Professional Development	0.00	0.00	0.00	0.00	0.00	4,330.00	4,330.00
5229 Internet/Communications	10.00	10.00	10.00	10.00	40.00	650.00	690.00
5230 Intuit Quickbooks Online					0.00	400.00	400.00
5232 Website Development					0.00	0.00	0.00
5235 Printing					0.00	500.00	500.00
5250 Accounting Fees	0.00	0.00	0.00	0.00	0.00	6,000.00	6,000.00
5252 Consulting	0.00	0.00	0.00	0.00	0.00		0.00
5255 Dues & subscriptions					0.00	120.00	120.00
5280 Marketing	52.20	25.00	25.00	25.00	127.20	250.00	377.20
5282 Childcare					0.00		0.00
5284 Family and Community Engagement	0.00	0.00	0.00	0.00	0.00		0.00
5286 Scholarships	1,250.00	1,725.00	5,500.00	500.00	8,975.00	10,000.00	18,975.00
5288 Special Projects and Incentives	400.00	300.00	925.00	325.00	1,950.00		1,950.00
5299 Contingency	0.00	0.00	0.00	0.00	0.00	1,500.00	1,500.00
5400 Volunteer Expenses	30.00	30.00	30.00	30.00	120.00	100.00	220.00
Total Expenses	$ 46,000.00	$ 17,000.00	$ 22,000.00	$ 3,500.00	$ 88,500.00	$ 158,500.00	$ 247,000.00
Net Operating Income	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00
Net Income	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00	$ 0.00

Income

Expenses

Net Income