BUDGET CHECKUP:

Critical Components to the Nonprofit Budget Review Process

By communitybrands / The NonProfit Times

OVERVIEW

Your Budget Is a Management Tool

A sound annual budget is a must for any well-run nonprofit. Working together, the nonprofit's staff and board members will use the budgeting process to intelligently establish priorities and allot resources for the coming year. But that's only the beginning of the budget's lifecycle. A successful budget is carefully crafted and implemented by a thorough budget team, then cautiously monitored and continuously updated throughout the year to reflect inevitable changes affecting the nonprofit, whether that's new funding, higher expenses, unexpected opportunities, or other factors that influence the organization's ability to fulfill its mission. By enabling well-informed, responsive management, a good budget makes for an efficient, effective, and successful nonprofit.

Monitoring

It cannot be emphasized too strongly: You must monitor your budget continuously throughout the year. That way, any issues affecting funding or expenses can be detected in plenty of time for management to make informed decisions about them. To do this effectively, you need operational processes and technological tools (discussed in the next section) that make it easy to see where variances arise between the budget and actual results.

TIP! Keep in mind variances – even large ones – are not necessarily bad things. Small variances are to be expected. Larger ones may point to a problem or opportunity that needs attention from management; they can also help you understand how well your organization is operating in the face of current real-world conditions versus prior expectations.

TIP! It's important to remember some projects – for example, a building expansion – may require assessment over a period that stretches well beyond a single fiscal year. What's most important is that your monitoring and review processes match the underlying operational processes, and that major variances are addressed in a timely way by management (and, when necessary, the board).

However frequently reviews are carried out, they should tell you how efficiently your organization is performing, and help you to account for real-world events, such as:
- Is your revenue on target?
- Did you get a source of funding – or lose one – that you didn't plan for?
- Are economic challenges or regulatory changes having effects you couldn't foresee?
- Is there an unexpected need – or opportunity – to help the population you serve?

Monitoring · Assessing and Revising · Working with Budget Team · Half-Year Review · Budget Creation and Implementation · Annual Review

Chapter One:
CRITICAL COMPONENTS OF A NONPROFIT BUDGET

A strong budget is more than a collection of line items with dollar figures attached. Used correctly, a budget is a vital management tool, but its effectiveness is dependent on the level of engagement, the operational processes, and the technology know-how of the people using it.

Assessing and Revising

The cadence for assessing your budget and making revisions depends on how your nonprofit operates, and it may vary for different parts of the organization. Some departments that are more cash-oriented (for instance, if your organization runs a retail shop) might conduct weekly reviews, whereas service programs might perform reviews on a monthly or quarterly schedule.

Whatever the case, regular assessments will help you uncover why variances occur, and allow you to deal with the implications of them.

There can be quite a bit of budget revision at the staff level that does not impact the organization as a whole. Because of their outside funding sources and divergent timetables, for instance, grant-based programs often require management almost like separate financial entities. Program managers overseeing them need to be able to run a separate

P&L (profit and loss statement) for each grant, and check for variances, so they can detect issues or know when to change the pace of spending to ensure none of the grant money is wasted. Other revisions must be addressed at the board level, as noted below.

Working With the Budget Team and Bylaws

Good stewardship of your organization's funds requires close cooperation among the staff and board members who make up the larger budget team. As part of that stewardship, you should establish a regular cadence of budget reviews and reports, and be prepared to make formal changes to your budget when required to by your organization's bylaws. For example, you might receive a large capital grant that triggers your nonprofit's entry into a new service area, or increases your funding above a certain percentage or dollar threshold. Changes like these may imply large amendments to your budget that require formal board approval, according to your bylaws. Following this process scrupulously is a way of demonstrating your nonprofit is treating a major grant or gift properly in terms of organizational oversight and acknowledgment of any special restrictions or provisions about how the money is to be used.

Chapter Two: BUDGET REVIEW BEST PRACTICES

The National Council of Nonprofits puts it simply: "Budgets should not be 'written in stone' because the financial position of the nonprofit may change during the year." Continuously monitoring your budget and comparing it to actual results is a vital practice for strong, responsible management of your nonprofit; that process works best when it's tied to regular reviews and reports for executive leadership, board members, and key staff members.

Continuous Review and Monitoring

Your nonprofit needs tools to help you properly monitor your budgeted versus actual revenue and expenses, from a granular level of transactions up to the overall organizational budget. Many organizations, unfortunately, still rely too heavily on spreadsheets, meaning they lack built-in alerts and other automated processes that catch mistakes and make budget creation and review much easier.

TIP! BEST PRACTICE: When deploying budgeting software, look for setup wizards, alerts, and other automated processes that will eliminate errors and save your staff time and effort.

A cloud-based true fund accounting™ product, for example, can offer dashboard monitoring for keeping an eye on the most important figures, such as actual versus budgeted revenue and spending for the fiscal year to date, across the organization.

Going deeper, your budget tool should also allow you to do real-time budget checking at the point a transaction is being posted, so you have an immediate view of how any item, even at the requisition or approval stage, will affect everything else. Even better, you can experiment with different possibilities to see what the impacts will be before you finalize any item. A true fund accounting™ system also allows you to set restrictions to keep you from inadvertently making a transaction that puts you over budget, and to set budget tolerance alerts to warn you when remaining funds have gone below a threshold you've set.

Your budget tool should also be able to create customized reports to find variances and make accurate forecasts for any segment of the organization (for example, a specific grant or department) over any time period. This allows your program managers to monitor their own parts of the budget and stay within the proper range of expenses and revenues. Having that programmatic perspective ensures managers can make effective decisions and the organization's money is spent correctly.

Chapter Three: ROUTINE BUDGET SCREENINGS

Monthly Reviews

As mentioned earlier, the cadence for budget reviews depends on the organization and its processes. For instance, the board treasurer might go over monthly variance reports with executive staff and program directors, then convey a summary (and perhaps recommendations) to the finance committee or the full board. Or a similar process might be carried out by a broader budget committee, with semi-annual and year-end reviews by the full board.

In any case, the relevant board members should regularly conduct financial reviews at a high level, noting budgeted versus actual results based on current performance and projections for the remainder of the year. Additional discussions can be triggered by significant variances. During these reviews, board members ideally will work hand-in-hand with the executive leadership, program directors, and other key staff members of the nonprofit.

Quarterly Reviews

Quarterly variance reports work the same way as the monthly variance reports described above, summarizing budgeted versus actual finances, based on current performance and on the projected plan for the rest of the year.

For many organizations, quarterly finance reviews go hand-in-hand with a formal presentation and distribution of a budget report to the board, executives, and other personnel who need the information. Without requiring a lot of financial expertise from their audience, these reports should provide insights on any shifts in the nonprofit's operational or financial performance, any adjustments made in response to them, the working assumptions driving decision making, and recommendations for moving forward.

Chapter Four: BUDGET MILESTONES: SIX MONTH CHECKUP

The Half-Year/Semi-Annual Review

The middle of the fiscal year is a typical milestone at which nonprofits address cumulative changes or large items that have made a significant impact on the organization's finances and mission. For a lot of organizations, this is a good time to reflect on what has happened so far in the year, determine how the assumptions that went into writing the budget have stacked up against actual results, and then adjust annual targets.

Budget Assessment

The half-year review should closely scrutinize budgeted versus actual financial performance to determine whether the current budget is still a good guide for the remainder of the fiscal year. It's common for some revisions and new assumptions to have already been made during the first quarterly review of the year; these should be reviewed and incorporated into the half-year budget assessment, as well.

Budget Amendments and Half-Year Revisions

An engaged board will ask for reporting that tracks actual financial results to the organization's strategic goals. This will allow board members to identify strategic risks and opportunities – the dominoes that might fall for good or ill – given different courses of action the nonprofit might take.

Having the right tools makes it straightforward for even non-financial managers and board members to identify areas for further investigation. On the one hand, it should be easy to tell when variances are minor enough that a budget area is still tracking to the right target; on the other, it should also be easy to spot larger variances – say, 10 percent above or below the budget for a line item – that are worth more discussion.

Highly useful in this vein is the ability to compare multiple budget versions during reviews, for instance to assess the potential impacts of reallocating funds from one program to another. Your budgeting tool should allow you to see the original budget alongside potential revised budgets with and without the reallocation to aid decision making.

Re-Budgeting

If there are substantial changes to the nonprofit's mission, strategy, or specific programs, the staff and board should re-budget for the remainder of the year. This process entails plenty of discussion, and it may have extensive

implications on operations, so you don't want it to be onerous from a technical perspective. Make sure your budgeting tool enables you to create a comprehensive, accurate new budget quickly and with minimum effort.

Chapter Four: BUDGET MILESTONES: YEARLY PHYSICAL

The Annual Review

By the end of the year, the budget – with its revisions – serves as a record of the year completed and a starting point for the one to follow. The annual review process, which we have covered extensively in other publications (see below), gives your staff and board members the opportunity to comprehensively review

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all aspects of expense management and revenue management, and to consider how things like fundraising expenses and dependence on different sources of revenue (including government bodies, foundations, individual donors, corporations, and sales of goods and services) affect the strategic direction of the nonprofit.

Year-over-Year Budget Comparison

For ease and clarity in creating next year's budget, your software must support the ability to easily compare data from prior years with the current year. You should be able to choose to see changes in either dollar amounts or percentages, and to make projections based off of the year-over-year comparisons.

The automated features mentioned in the "Best Practice" tip on Page 5 are especially useful when creating next year's budget. Setup wizards and options to quickly import historical numbers will allow

you, for example, to use last year's actual figures, perhaps with a fixed percentage added, as a starting point for a new draft budget in a matter of mere minutes.

To find out more about best practices for annual budget creation, check out our publications Building a Better Budget: The Nonprofit Budget Roadmap, Budget Quarterly Calendar, and Year-End Survival Guide for the Nonprofit Accountant, Third Edition. You can find out more about how MIP Fund Accounting™ and MIP Advance™ can help you with your budgets at here.