



# AJFCA

Association of  
Jewish Family  
& Children's Agencies



## The Importance of Budgeting and Financial Literacy in a Nonprofit Setting

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# Focus Areas

## Budgeting

*Why is budgeting an important start to nonprofit financial reporting?*

## Nonprofit Financial Basics

*What is unique to nonprofit financial reporting?*

## Nonprofit Financial Statements

*What are the key elements of nonprofit financial statements?*

## Financial Statement Analysis Fundamentals

*How do I go about interpreting the financial statements?*

## Indicators of Financial Health

*What should I be looking for on the financial statements?*



# The Importance of Budgeting



# Why Create a Budget?

- Facts
- Control expenditures
- Creates a financial roadmap
- Plan for future growth



# Types of Budgets

- **Operational budget**
  - Forecasts and tries to closely predict yearly revenue and expenses for an organization
- **Cash flow budget**
  - A cash flow budget details the amount of cash you collect and pay out
- **Capital budget**
  - Helps determine how much money you need to put in place for your facility or to be able to launch new products or services



# Types of Budgets

- Line Item Budgets

- Focus on income and expense elements of the financial statements such as: salaries, fringe benefits, supplies and other types of organizational expenses

<b>Income</b>	
Foundations	\$ 25,000
Government Contracts	37,000
Parent Fees	159,000
Total Income	<u>\$ 221,000</u>
<b>Expenses</b>	
Salaries	\$ 150,000
Payroll taxes	12,000
Benefits	14,495
Professional fees	7,000
Supplies	1,820
Telephone	2,100
Postage	936
Occupancy	16,750
Insurance	5,000
Travel	1,000
Depreciation	6,000
Total Expenses	<u>\$ 217,101</u>
<b>Excess Surplus/(Deficit)</b>	<u><u>\$ 3,899</u></u>



# Types of Budgets

- Functional or Program Budgets

- Focus on programs and program elements which represent the activities for which funds are spent

	Total	After-School Program	Summer Program	Parent Education Program	Fundraising	Administrative
<b>Income</b>						
Foundations	\$ 25,000	\$ -	\$ 3,000	\$ 22,000	\$ -	\$ -
Government Contracts	37,000	31,250	5,750	-	-	-
Parent Fees	159,000	88,750	66,250	4,000	-	-
<b>Total Income</b>	<b>\$ 221,000</b>	<b>\$ 120,000</b>	<b>\$ 75,000</b>	<b>\$ 26,000</b>	<b>\$ -</b>	<b>\$ -</b>
<b>Expenses</b>						
Salaries	\$ 150,000	\$ 74,175	\$ 54,935	\$ 11,740	\$ 950	\$ 8,200
Payroll taxes	12,000	5,934	4,394	940	76	656
Benefits	14,495	7,168	5,308	1,135	91	793
Professional Fees	7,000	5,200	800	500	400	100
Supplies	1,820	900	500	260	-	160
Telephone	2,100	1,365	399	231	-	105
Postage	936	568	170	130	-	68
Occupancy	16,750	10,888	3,182	1,843	-	837
Insurance	5,000	3,250	950	550	-	250
Travel	1,000	700	-	300	-	-
Depreciation	6,000	3,900	1,140	660	-	300
<b>Total Expenses</b>	<b>\$ 217,101</b>	<b>\$ 114,048</b>	<b>\$ 71,778</b>	<b>\$ 18,289</b>	<b>\$ 1,517</b>	<b>\$ 11,469</b>
<b>Excess Surplus/(Deficit)</b>	<b>\$ 3,899</b>	<b>\$ 5,952</b>	<b>\$ 3,222</b>	<b>\$ 7,711</b>	<b>\$ (1,517)</b>	<b>\$ (11,469)</b>



# Types of Budgets

- Income based budget
  - Income based budgets start by estimating expected income in the upcoming period and determining expenses based on that level of income
- Expense based budget
  - Expense based budgets start by estimating expenses in the upcoming period and estimate the amount of income needed to cover those expenses





# Steps in Budgeting

1. Assess your current situation
2. Develop your baseline - estimated income or expenses
3. Calculate expenses based on income estimate or income necessary to cover expenses
4. Review and adjust
5. Communicate
6. Monitor



# Understanding Costs

- **Fixed cost**
  - Operating costs that don't change from year to year or vary with an increase or decrease in activity
- **Variable cost**
  - Operating costs that change in direct proportion to the amount of activity taking place
- **Direct costs**
  - Can be applied specifically to a certain program or activity
- **Indirect costs**
  - Benefits multiple programs or activities and can't be directly assigned specifically to one or another



# Budgeting Best Practices

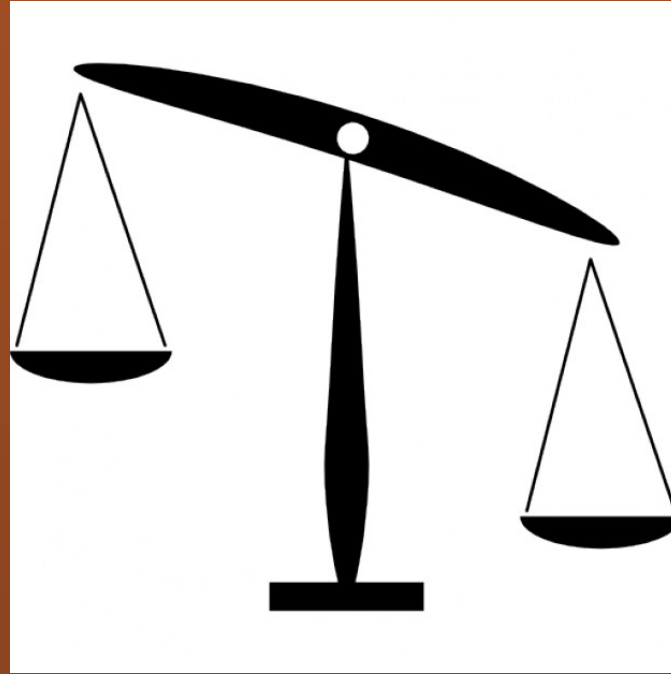
- Confirm the budget's relationship to your mission and long range/strategic goals
- Understand business drivers
- Establish reasonable, realistic budgets
- Budget for capital in addition to operations
- Provide narrative notes to explain budget assumptions
- Promote accountability



# Common Budgeting Problems

- Not consistent with organization mission or values
- Inaccuracy
- Assuming that the existence of revenue is indicative of being cash-flow positive
- Too rigid and prevents fast responses
- Can stifle innovation and improvement
- Can protect rather than reduce costs
- Focus on income and expense targets rather than customer satisfaction or program success





# NONPROFIT FINANCIAL BASICS

## Five Nonprofit Myths

1. Mission is more important than market.

2. Nonprofits cannot make a profit.

3. Nonprofits must have balanced budgets.

4. Deficits are better than surpluses.

5. Income is more important than assets.



# Nonprofit Financial Basics #1

**There are two types of nonprofit income.**

## Support

charitable contributions  
and grants

## Revenue

self-generated fees for  
service and product sales



# Nonprofit Financial Basics #2

**Financial information is based on periods of time.**





# Nonprofit Financial Basics #3

**Numbers are meant to be compared.**

Actual vs. Budget

Current year to date vs. Prior year to date

Current month vs. Prior month

Budget vs. Historic averages

# Nonprofit Financial Basics #4

**Anticipation is the key to financial stability.**



# Nonprofit Financial Basics #5



**Financial health is essential for the effective delivery of nonprofit services.**





# NONPROFIT FINANCIAL STATEMENTS

## What are you looking at?

- ✓ Internal financial statements
- ✓ Audited financial statements
- ✓ Form 990
- ✓ Budget

*Organizations produce various types of financial reports which provide different types of information to readers and are used for varying purposes.*



# Cash vs. Accrual Based Accounting

## Cash Basis

- Income is recorded when cash is **received**.
- Expenses are recorded when cash is **paid**.

## Accrual Basis

- Income is recorded when **earned**.
- Expenses are recorded when **incurred**.



# Statement of Financial Position (Balance Sheet)

*Indicates the organization's financial position at a particular point in time.*

**ASSETS:** Economic resources the organization owns or has been promised.

**LIABILITIES:** Financial obligations; what the organization owes to others.

**NET ASSETS:** The difference between total assets and total liabilities.



# Statement of Financial Position, continued

## (Balance Sheet)



**NET ASSETS** represent the accumulation of surpluses or deficits the organization has achieved over time.

- *If, through the years, surpluses have exceeded deficits, net assets will be a positive amount.*
- *If the opposite has occurred, the organization will show negative net assets and could be in financial trouble.*





# Three Categories of Income and Net Assets

## Unrestricted

- Assets free from donor-imposed restrictions
- Includes board designations

## Temporarily Restricted

- Contributed assets with donor-imposed restrictions
- Restrictions may be removed by actions of the organization or by the passage of time

## Permanently Restricted

- Contributed assets with donor-imposed restrictions
- Restrictions may never be removed by time or the actions of the organization



# Statement of Activities (Income Statement)

*Presents all of the organization's financial activities from one point in time to another (e.g. beginning to end of the fiscal year).*

- Sources and amounts of **INCOME**
- **EXPENSES** by category or activity
- How much income was left (**SURPLUS**) at the end of the year, or by how much income was overspent (**DEFICIT**) at the end of the year





# FINANCIAL STATEMENT ANALYSIS FUNDAMENTALS

## What story is being told?

- Financial analysis produces insights that allow the reader to form judgements and questions.
- Financial analysis should always be done in **context**:
  - *Nature of the programs/activities*
  - *Age or lifecycle stage*
  - *Size*
- Financial analysis uses **quantitative tools**:
  - *Changes and trends*
  - *Comparisons with similar organizations*
  - *Ratios*





# INDICATORS OF FINANCIAL HEALTH



# Financially healthy nonprofits...

- 1. Have sufficient financial resources to ensure stable programming.
- 2. Have cash, or access to cash, available in times of shortfalls.
- 3. Are committed to income-based spending.
- 4. Retain, at the end of each year, positive cash and net assets.

# Financially healthy nonprofits...

- 1. Have accumulated surpluses which are greater than the current year's deficit.
- 2. Have established an operating reserve to finance cash shortfalls and program growth.
- 3. Have boards and management that hold themselves responsible for the financial stability of the organization.
- 4. Understand when and where to take appropriate risks.

# Financial Indicators

*Financially healthy nonprofits...* **have sufficient financial resources to ensure stable programming.**

INDICATOR	DEFINITION	WHAT IT TELLS ME	WHERE I FIND IT
<b>Net Asset Position</b>	Total assets minus total liabilities	A positive number represents accumulated surpluses/ solid financial performance over time.	Statement of financial position (balance sheet)
<b>Permanent Capital</b>	Funds that have been restricted by a donor. The restriction usually prohibits the use of "corpus."	Organization has a supporter who believes in the mission enough to make a permanent investment.	Statement of financial position (balance sheet)
<b>Semi-Permanent Capital</b>	Funds that have been designated by the board	Leadership recognizes the need for working capital.	Statement of financial position (balance sheet)





# Financial Indicators

*Financially healthy nonprofits... have cash, or access to cash, available in times of shortfalls.*

INDICATOR	DEFINITION	WHAT IT TELLS ME	WHERE I FIND IT
<b>Working Capital</b>	Current assets minus current liabilities	How much of the assets are liquid and available for day to day needs.	Statement of financial position (balance sheet)
<b>Current Ratio</b>	Current assets divided by current liabilities	Proportion of liquid assets to the claims on those assets (should be >1)	Statement of financial position (balance sheet)
<b>Days Cash on Hand</b>	Unrestricted cash / [(Total Expenses – Depreciation Expense)/365]	Indicates how many days the organization could be sustained on current cash reserves at current expense rates	Statement of financial position (balance sheet) & statement of activities



# Financial Indicators

*Financially healthy nonprofits...* **are committed to income-based spending.**

INDICATOR	DEFINITION	WHAT IT TELLS ME	WHERE I FIND IT
<b>Unrestricted surplus/deficit</b>	Income less expenses = surplus (deficit if negative)	Positive number means the organization lived within its means for the time period shown.	Statement of activities



# Financial Indicators

*Financially healthy nonprofits...* **retain, at the end of each year, positive cash and net assets.**

INDICATOR	DEFINITION	WHAT IT TELLS ME	WHERE I FIND IT
<b>Positive Cash Net Assets</b>	Cash + Receivables – Temporarily Restricted Net Assets > Zero	Positive number means the organization has enough liquid assets to cover what has already been received in temporarily restricted funds, with some left for operational needs.	Statement of financial position (balance sheet)



# Financial Indicators

*Financially healthy nonprofits...* **have accumulated surpluses which are greater than the current year's deficit.**

INDICATOR	DEFINITION	WHAT IT TELLS ME	WHERE I FIND IT
<b>Net Asset Position</b>	Total net assets at end of year	Positive number means there are enough net assets at the beginning of the year to “fund” the current year deficit, if there has been one.	Statement of financial position (balance sheet)



# Financial Indicators

*Financially healthy nonprofits...* **have established an operating reserve to finance cash shortfalls and program growth.**

INDICATOR	DEFINITION	WHAT IT TELLS ME	WHERE I FIND IT
<b>Presence/ Absence of a Reserve</b>	Assets include a cash reserve or similar fund, and net assets shows the same fund	The organization's leaders have acted upon a perceived need to dedicate resources to financial stability.	Statement of financial position (balance sheet)



# Financial Indicators

## Other helpful indicators:

INDICATOR	DEFINITION	WHAT IT TELLS ME	WHERE I FIND IT
<b>Debt / Net Assets Ratio</b>	Loans + notes payable / net assets	Indicates how much debt the organization carries in proportion to its net worth. The higher the %, the more the organization relies on borrowed money for its ongoing operations.	Statement of financial position (balance sheet)
<b>Contributions to Total Revenue Ratio</b>	Contributed income / total revenue	Measures the proportion of the revenue that comes from grants, donations, and other charitable contributions. A diverse mix is ideal.	Statement of activities



# Financial Indicators

## Other helpful indicators:

INDICATOR	DEFINITION	WHAT IT TELLS ME	WHERE I FIND IT
<b>Program to Total Expenses Ratio</b>	Program expenses / total operating expenses	Measures the proportion of expenses used to support programming vs. how much is spent for general management and fundraising.	Statement of activities
<b>Contribution Revenue to Fundraising Expenses Ratio</b>	Contributed income / fundraising expenses	Measures the return on investment for fundraising activities, or how much contributed revenue is generated by each dollar expended for fundraising efforts.	Statement of activities





## NEXT STEPS (on your own)



# Financial Health Components

## Financial Performance & Position

- Availability of financial resources
- Existence of a working capital reserve
- Monitoring of key performance metrics
- Positive fund balances over time

## Board Engagement & Oversight

- Understanding by the board of governance, legal, and fiduciary responsibilities
- Alignment of mission/strategic plan with use of resources, goals, and budget
- Diverse skill set on the board

## Financial Reporting & Planning

- Commitment to realistic, income-based budgeting and spending
- Existence of a system/process for monitoring financial health
- Timely and accurate reporting function
- Clear communication of short and long term financial goals

## Capacity

- Thorough understanding of sources of income and key drivers
- Financial systems are properly staffed, with proper internal controls
- Maintenance of healthy external financial relationships (e.g. banks and auditors)



# Financial Health Assessment

- Thoughtfully consider the components of financial health noted in the four preceding areas.
- In each of the four component areas, brainstorm:
  - *What are your greatest strengths?*
  - *What are your greatest weaknesses?*
  - *What goals do you want to set for your organization?*
  - *What is your map for getting there?*



# 5 Key Questions to Consider as a Nonprofit Constituent

Are available financial resources sufficient support for our organization's mission?

How are our resources being used, and are they being used efficiently and effectively?

How is our organization performing relative to other organizations?

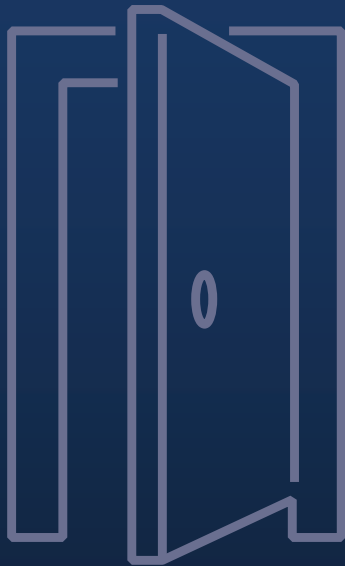
What are problem areas we can try to solve?

What areas of superior performance or accountability can we discover?





# QUESTIONS & ANSWERS



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