



Nonprofit Budgeting and Finance

October 17, 2013



Wake Forest University

Institute for Public Engagement

&

Community Law & Business Clinic



Overview/Agenda

1. About the Institute for Public Engagement
2. Introductions and case studies
3. Past
4. Present
5. Future
6. Conclusion and Q&A

* we will follow a 50-10 schedule





The Institute for Public Engagement



- Established at Wake Forest University School of Law in 2010
- Prepares students for civic leadership, action and reflection, provides faculty with resources to enhance their work in the community and supports innovative relationships among faculty, students, administration, staff, alumni and the broader community
 - Building Community
 - Supporting Service
 - Commitment to Publicly Engaged Teaching
 - Facilitating Community-Based Research
 - Sustaining Clinics

Introductions



- Casey T. Crowley
 - Fellow at Wake Forest School of Law Community Law & Business Clinic
 - Work in nonprofit strategy and finance
 - Build capacity for small businesses and nonprofits
 - JD/MBA from Wake Forest University in 2012
 - B.S. University of North Carolina Asheville 2004 with distinction

- Steve Virgil
 - Founder and Director, Community Law & Business Clinic
 - Professor of Law, Wake Forest University School of Law
 - Director, Institute for Public Engagement

- You!
 - Name
 - Organization
 - Responsibilities

Survey

- Who has worked in the nonprofit sector for 3 months or more? 1 year? 5 years? 10 years? More than 10 years? How long? Longest tenure in nonprofit sector...?
- Charlotte metro? Other areas of the state?
- Who has seen their organization's 990? Who has read it?
- Who has compiled/assisted with nonprofit accounting/financial statements?
- Who has done budgeting for their nonprofit organization?
- Any CPAs? Nonprofit CFOs?





The Nonprofit Sector: An overview



- What is a nonprofit?
 - Legal definition
 - Financial definition
 - Social definition
- How big is the sector? What is its impact?
- What role do each of us play?

Nonprofit definitions

- Legal
 - State: Chapter 55A of the NC General Statutes
 - Federal: USC Title 26 - Internal Revenue Code, Chapter 1, Subchapter F, Part I, Section 501, Paragraph C, Subparagraph 3:
 - *organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes...no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is...attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in...any political campaign...*



Nonprofit definitions

- Social
 - Differs based on the organization and its workers, members and beneficiaries



Nonprofit definitions

- Financial

- Organizations that do not exist primarily to generate profits, either directly or indirectly, and that are not primarily guided by commercial goals and considerations. They may accumulate surplus in a given year, but any such surplus must be plowed back into the basic mission of the agency and not distributed to the organizations' owners, founders, or governing board.

United Nations, 2003



Largest Nonprofits

(Forbes 2012)



Rank ▲	Name	Private Support (\$mil)	Total Revenue (\$mil)	Fundraising Efficiency (%)	Charitable Commitment (%)	Donor Dependency (%)
1	 United Way	3,903	4,140	91	85	100
2	 Salvation Army	1,698	2,828	88	82	124
3	 Catholic Charities USA	1,607	4,600	96	89	87
4	 Feeding America	1,145	1,185	98	97	100
5	 American National Red Cross	946	3,646	87	92	76

Largest Nonprofits



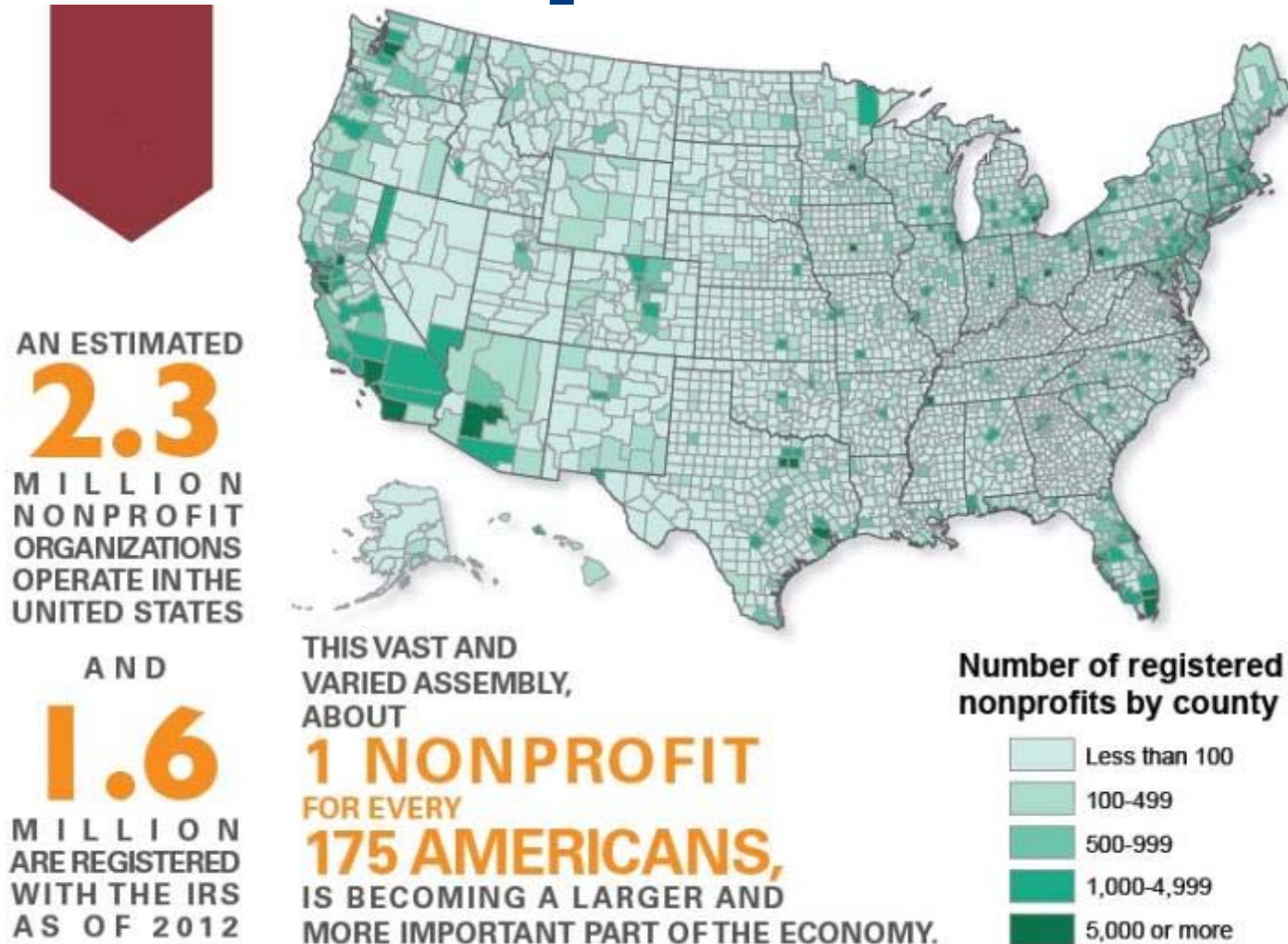
Rank ▲	Name	Private Support (\$mil)	Total Revenue (\$mil)	Fundraising Efficiency (%)	Charitable Commitment (%)	Donor Dependency (%)
6	 Food for the Poor	930	938	97	96	101
7	 American Cancer Society	896	1,014	77	72	93
8	 World Vision	846	1,055	88	86	103
9	 YMCA	823	5,986	86	85	68
10	 Goodwill Industries International	778	4,437	97	88	61

Nonprofits or not?

- Which of the following are nonprofit entities?
 - Ikea
 - New York Stock Exchange
 - Until 2006
 - Blue Cross Blue Shield NC
 - “Taxed nonprofit”
 - NFL
 - PGA
 - NHL



Sector Size/Scope



- NC – 10,300+ NPs with over \$50,000 in revenues



Sector Economic Impact

- 5.5% of US GDP
- Approx. \$820 billion annually
- \$300 billion in charitable contributions
- Additional \$300 billion estimated value of volunteer hours
- NC – total impact of NPs estimated at \$38 billion (up from \$17 billion in 2002...more than double)
- Public charities (501(c)(3) orgs.) reported \$1.51 trillion in revenue and \$2.71 trillion in assets in 2012



Two Important Questions

- What is your role in managing this large and influential sector?
- What can you do to improve your organization?





■ *“It is not enough to do good; it must be done well.”*

-St. Vincent de Paul (1581-1660)



Case Studies

- Read case studies (8 minutes)
- Team up in groups and discuss the case studies, noting issues you see with each of them (8 minutes)
- Report back regarding issues you see with each organization (8 minutes)



COURTESY: WINSON-SALEM, CVE

Billings House - Quick Note



Form 990 **Return of Organization Exempt From Income Tax** OMB No 1545-0047
 Under section 501(c), 527, or 4947(a)(1) of the Internal Revenue Code (except black lung benefit trust or private foundation) **2009**
 Department of the Treasury Internal Revenue Service **Open to Public Inspection**

A For the 2009 calendar year, or tax year beginning **JUL 1, 2009** and ending **JUN 30, 2010**

B Check if applicable: Address change, Name change, Initial return, Terminated, Amended return, Application pending

C Name of organization: **HULL HOUSE ASSOCIATION**
 Doing Business As: **36-2170135**
 Numt: **5,351,524.**
 City: **CHIC**
 F Name and address: **1030 WE**

D Employer identification number: **36-2170135**

E Total revenue: **26,197,876.**
F Total expenses: **17,062,470.**
G Net assets or fund balances: **-3,625,723.**

I Tax-exempt status: **J** Website: **WWW.HU**
K Form of organization:

Part I Summary statements, and to the best of my knowledge and belief, it is true, correct.

1 Briefly describe the organization's mission or most significant activities: **ASSOCIATION IMPROVES SOCIAL CONDITIONS FOR UNDERSERVED PEOPLE AND**

2 Check this box if the organization discontinued its operations or disposed of more than 25% of its net assets

3 Number of voting members of the governing body (Part VI, line 1a) **32**

4 Number of independent voting members of the governing body (Part VI, line 1b) **32**

5 Total number of employees (Part V, line 2a) **476**

6 Total number of volunteers (estimate if necessary) **825**

7a Total gross unrelated business revenue from Part VIII, column (C), line 12 **0.**

7b Net unrelated business taxable income from Form 990-T, line 34 **0.**

	Prior Year	Current Year
8 Contributions and grants (Part VIII, line 1h)	25,622,329.	22,759,433.
9 Program service revenue (Part VIII, line 2g)	526,115.	400,783.
10 Investment income (Part VIII, column (A), lines 3, 4, and 5)	0.	0.
11 Other revenue (Part VIII, column (A), lines 5, 6, 8c, 9c, 10c, and 11e)	49,432.	126,363.
12 Total revenue - add lines 8 through 11 (must equal Part VIII, column (A), line 12)	26,197,876.	23,286,579.
13 Grants and similar amounts paid (Part IX, column (A), lines 1-3)	1,672,362.	1,575,357.
14 Benefits paid to or for members (Part IX, column (A), line 4)	0.	0.
15 Salaries, other compensation, employee benefits (Part IX, column (A), lines 5-10)	17,062,470.	14,344,826.
16a Professional fundraising fees (Part IX, column (A), line 11e)	0.	0.
16b Total fundraising expenses (Part IX, column (D), line 25)	416,513.	416,513.
17 Other expenses (Part IX, column (A), lines 11a-11d, 11f-24f)	8,469,862.	8,412,068.
18 Total expenses. Add lines 13-17 (must equal Part IX, column (A), line 25)	27,204,694.	24,332,251.
19 Revenue less expenses. Subtract line 18 from line 12	-1,006,818.	-1,045,672.
20 Total assets (Part X, line 16)	5,351,524.	4,386,032.
21 Total liabilities (Part X, line 26)	8,977,247.	9,886,325.
22 Net assets or fund balances. Subtract line 21 from line 20	-3,625,723.	-5,500,293.

Part II Signature Block

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than officer) is based on all information of which preparer has any knowledge.

0 2012



Past: Accounting



- Definitions
- Types of statements as defined by FASB
 - What they measure
- Types of accounting
 - Cash vs. accrual
- Costing (managerial accounting)
- The Form 990
- Financial statement analysis
 - Ratios
 - Sample statements exercise
- The overhead/efficiency metric
 - Letter from Guidestar and BBB
 - Palotta video

Accounting Definitions



- Managerial accounting - Management accounting provides information to people within an organization while financial accounting is mainly for those outside it, such as shareholders (budgeting, forecasting, etc.)
- Financial Accounting - Financial accounting is required by law while management accounting is not. Specific standards and formats may be required for statutory accounts such as in the I.A.S International Accounting Standard within Europe.
- FASB 117 standards – standards established by the Financial Accounting Standards Board dictating how nonprofit financial statements should be handled
- Direct vs. indirect costs
 - Direct – those clearly associated with a specific project
 - Indirect – costs not considered direct
- Full cost – direct + indirect costs for a cost objective

Accounting Definitions, cont.



- Fixed vs. variable costs
 - Fixed – costs that remain the same regardless of volume
 - Variable – those that increase with service increases

- Revenue - increases in unrestricted net assets that arise from exchange transactions in which the other party receives direct tangible benefits commensurate with the resources provided
 - Membership dues
 - Program service fees
 - Sales of supplies and services
 - Investment income
 - Some grants

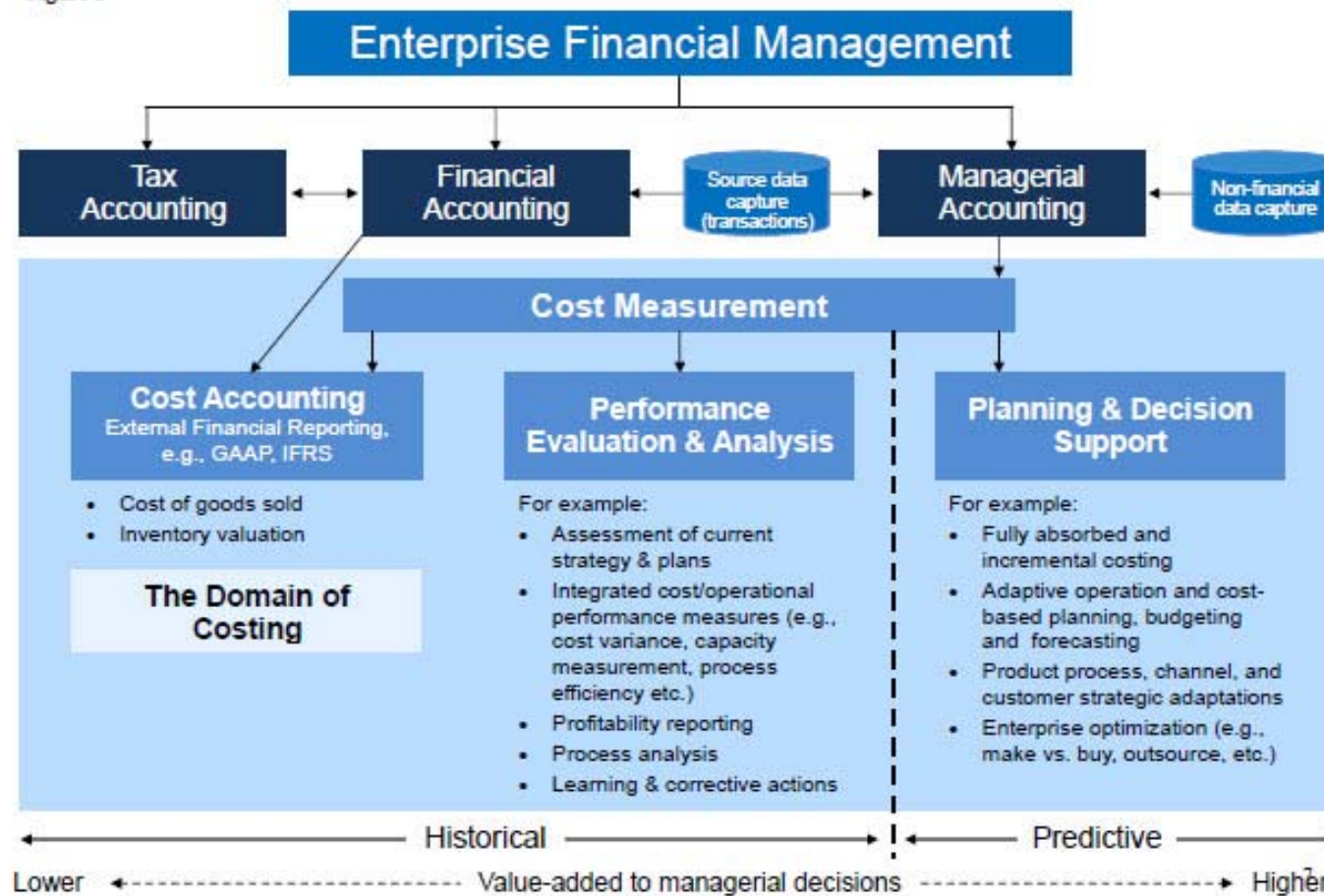
- Not for profit (NFP) – accountants' term for nonprofit organizations

Managerial vs. Financial Accounting



IFAC PAIB COMMITTEE INTERNATIONAL GOOD PRACTICE GUIDANCE

Figure 1



4 NFP Financial Statements

- Statement of financial position (balance sheet)
 - Provides relevant information about an organization's assets, liabilities, and net assets and about their relationships to each other at a moment in time
- Statement of activities (operating/income statement)
 - Provides relevant information about (a) the effects of transactions and other events and circumstances that change the amount and nature of net assets, (b) the relationships of those transactions and other events and circumstances to each other, and (c) how the organization's resources are used in providing various programs or services



4 NFP Financial Statements

- Statement of cash flows (same)
 - Provides relevant information about the cash receipts and cash payments of an organization during a period
- Notes to financial statements
 - Describes organization and accounting policies, and gives information about leases, investments and debt obligations



Cash vs. Accrual Accounting

- Cash-basis – focuses on cash in and out; expenses are paid or revenues deposited
 - Simpler to implement/use
 - Excellent way to track cash on hand
 - Small organizations
- Accrual-basis – focuses on when revenue was earned and expenses incurred
 - More complex, but better for planning and budgeting
 - Poor representation of cash flows
 - Should generally be used if organization has paid staff
 - Gives better picture of financial position of organization
 - How dependable are your donors/revenues?



Cash vs. Accrual Accounting

- Quick fact: 50-50 mix amongst nonprofits using cash vs. accrual
- Cash vs. accrual accounting exercise
 - Conclusions:
 - Accrual basis accounting shows the business as making steady profits of \$1,000 per month
 - The business is **not going to be able to complete the contract** - probably having to close the first week of the second month because it has run out of cash and cannot meet its payroll
 - Possible solution: extend payments of some non-personnel costs



Costing

- Allocating costs is important when determining where money is flowing
- Allocate indirect costs based on a proportionate share of a single item of cost all programs use (ie, full time equivalent employees)

	Fixed Cost	Variable Cost
Direct	Supervisor's salary in foster home program	Payments to foster parents for room and board
Indirect	Portion of the executive director's salary	Electric bills allocated to foster home program



IRS Form 990

- Who files what?



2010 Tax Year and later (filed in 2011 and later):

Gross receipts normally \leq \$50,000	990-N ("e-postcard")
Gross receipts $<$ \$200,000, and Total assets $<$ \$500,000	990-EZ or 990
Gross receipts \geq \$200,000, or Total assets \geq \$500,000	990
Private foundation	990-PF

Parts of a 990

- <http://www.irs.gov/pub/irs-pdf/f990.pdf>
- Instructions: <http://www.irs.gov/pub/irs-pdf/i990.pdf>
- Part I – summary of activities, revenues and expenses
- Part II – signatures
- Part III – program service accomplishments
- Part IV – checklist of required schedules
- Part V – other IRS filings and tax compliance
- Part VI – governance, management and disclosure
- Part VII – compensation disclosures



Parts of a 990, cont.

- Part VIII – statement of revenue
- Part IX – statement of functional expenses
- Part X – balance sheet
- Part XI – reconciliation of net assets
- Part XII – financial statements and reporting
- Schedule A – Public Charity Status and Public Support



Financial Statement Analysis

- Helpful in determining the financial position of an organization
- Rules of thumb:
 - Look at comps, both year-to-year and within the sector
 - Take a holistic approach...the mission of the organization dictates the financial position more than in for-profit entities



Nonprofit Ratios

- The following are ratios not on your handout:
 - Earned income ratio = total earned income/total income
 - Demonstrates ability to be self-sufficient
 - Contributions and grants = revenue from C&G/total revenue
 - Extent of the organization's dependence on voluntary support
 - Cost per unit of service = total program expenses/units of service
 - Difficult to calculate even for program-based nonprofits
 - Identifies program efficiency and changes in costs over time



Statement Analysis Exercise

- Statement analysis exercise



The Efficiency Metric

- Popular ratio for nonprofit analysis
 - $\text{Program service expense} / \text{total expense}$
- Read letter from Guidestar on the use of efficiency ratios



Accounting Rules of Thumb

- Hire the right staff/accountant
 - UNDERSTAND what they do
- Follow accounting procedures
- Keep up to date
- Control payments strictly (restrict access and track)
- Control deposits strictly
- Make sure financial reports are accurate and produced on time



Dan Palotta: The Way We Think About Charity is Dead Wrong



Link to video:

http://www.ted.com/talks/dan_pallotta_the_way_we_think_about_charity_is_dead_wrong.html



Present: Budgeting



- Budget vs. financial statements
- The budgeting process
- Business models and how nonprofits are similar and different from for-profits
- Business model canvas and overlap (example)
- Types of budgets
- Deficits, surpluses and breakevens
- Bankruptcy in for-profits vs. nonprofits
 - The insidious cycle of scaling back

Budget vs. Financial Statement

- Budget – forward-looking
 - Control revenues and expenses by estimates and projections
 - Useful in implementing a set strategy; provide a map for the organization
- Financial statements – present actual information on revenues, expenses, etc.
 - Based on *actual* data, not *aspirational* data



The Budgeting Process

- Prepare
 - Establish the budget period and review program achievements and financial performance for the current year.
 - Set goals for programs and activities
- Estimate
 - Assign and estimate expenses
 - Estimate anticipated income.
- Plan
 - Bring income and expenses into desired relationship
 - Map cash flow
- Approve and implement the budget
- Monitor and adjust
 - Compare actual numbers with budget
 - Update cash flows, revise plan and budget if needed



Difference Between for-profit and NFP

- Businesses: mission and scope of operations determine income
- Nonprofits: income determines mission and scope of operations



Sample Program Budget



- Direct costs of Program A
- (less) Program service revenue of A
- (less) Contributions restricted to A
- (less) Net assets released from restrictions for A
- (equals) Gross margin (deficit) of Program A
- (less) Program A's share of indirect cost at administrative and organization levels
- (equals) Net margin (deficit) of Program A

Business Models



- Business model definition:
 - The plan implemented by a company to generate revenue and make a profit from operations. The model includes the components and functions of the business, as well as the revenues it generates and the expenses it incurs.

- For-profit model examples
 - Razor and razor-blade
 - Low-cost provider
 - Luxury segment-focused

- 10 nonprofit funding models article
 - http://www.ssireview.org/articles/entry/ten_nonprofit_funding_models
 - Policy Innovator – organizations that have innovative and novel approaches to pressing public policy issues, and convinces the government to fund them
 - Resource Recycler – efficiently collecting and distributing in-kind donations to the most appropriate recipients

Business Models, cont.

- How would we translate this to nonprofits?
- Steve Blank's Business Model Canvas exercise (handout)
 - In groups of 5-7, pick one of your organizations and apply the business model canvas.
 - Note the overlap between for-profit and nonprofit business model requirements.

<http://www.youtube.com/watch?v=QoAOzMTLP5s>



Budget Rules of Thumb

- Only operating expenses and revenues belong on a budget
- Involve people in the budgeting process
- Look at internal and external forces
- Make budget projections as accurate as possible
- Be sure the entire organization is on the same page
- Build in flexibility
- Revisit numbers to make adjustments as necessary



Case Study #2

- Bark Patrol is in a budget mess
- Suggestions for this year's budget
- Suggestions for how to improve the budget process at Bark Patrol for next year...?





Future: Planning/Strategy



- Sources of revenue
- PRI
- Sustainability in the nonprofit context
- Top-line health (capacity)
- Reacting to changes in funding sources and business model
- Planning for future events

Sources of Revenue

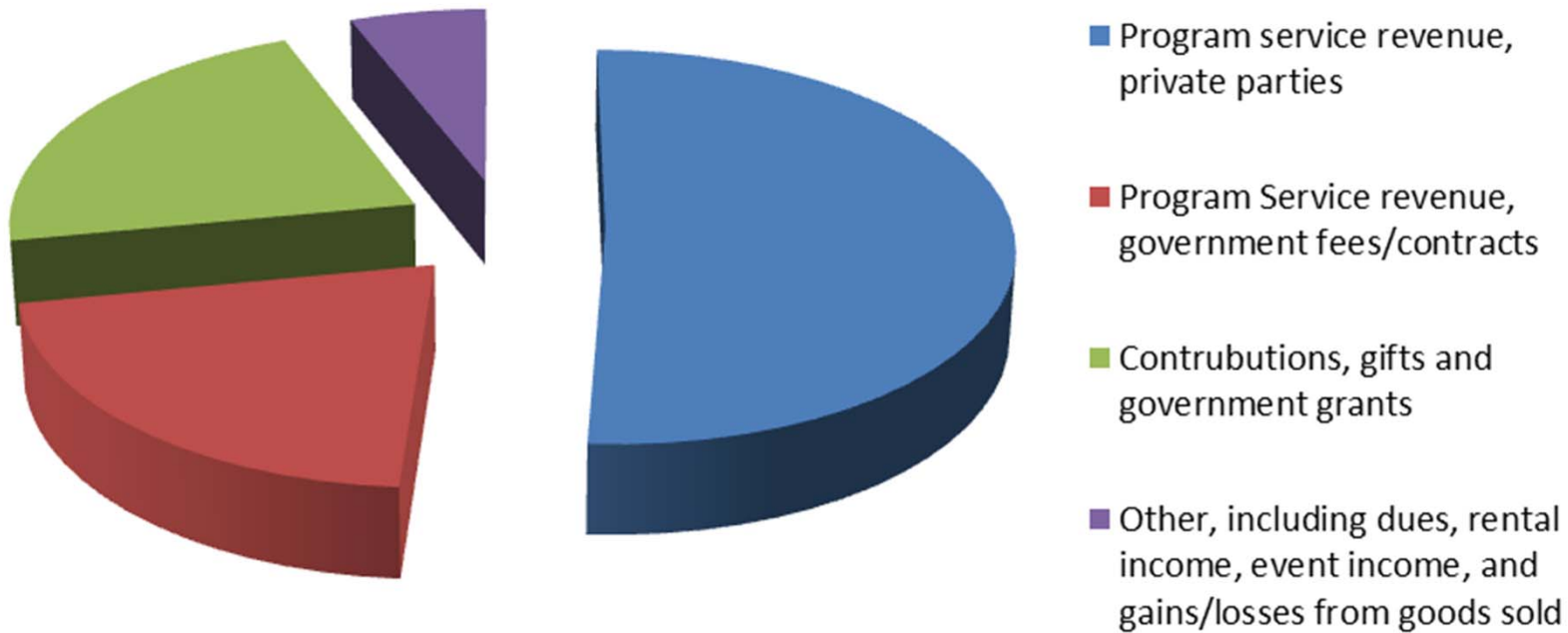


- In a for-profit model:
 - Equity financing
 - Debt issuance
 - Profits from operating activities
 - Income from investments

- In a not-for-profit model:
 - ~~Equity financing~~
 - ~~Debt issuance~~ Bond issuance (hospitals and universities)
 - ~~Profits from operating activities~~ Fee for services/goods
 - ~~Income from investments~~ Program-related investment (PRI)
 - Charitable contributions
 - State/local/private grants and loans

Sources of Revenue, cont.

Revenue Sources, reporting charities (2012)



A Note on Revenue Diversity



- Tension between revenue diversity and focus:
- Revenue diversity – getting revenue from a variety of sources
 - Pro – Stability of revenue
 - Cons – Can be difficult for leaders to implement, may not always be implemented well
- Focused revenue – getting revenue from one or two sources
 - Pros – ability to cultivate relationships/gain expertise in a narrow area
 - Cons – very dependent on few sources, difficult to respond to sudden drop in revenues
- Diversifying product lines vs. markets
 - Product lines – affordable housing procurement for single mothers, diversifying to operation and construction
 - Markets – affordable housing procurement for single mothers diversifying to homeless vets and reentering juvenile offenders

Program-Related Investment

- PRI is a source of revenue from foundations
- Benefits for nonprofit grantees
 - Access to capital
 - Capacity building
 - New relationships
 - Sustainability
- Nonprofits hoping to attract PRI's should consider:
 - Relationship with the foundation
 - Need for a track record
 - Need for clear plan, reasonable projections and key leadership
 - Vision and value proposition



Investments

- Nonprofits can invest in securities and other similar instruments
- Makes management of the organization's finances significantly more complex
- Steps to implement investment strategy:
 - Due diligence on investment vehicles
 - Understand risk and the organization's risk tolerance
 - Outline capital and liquidity needs
 - **GET THE PROPER EXPERTISE**



Sustainability

- Capacity - the resources necessary to seize opportunities and respond to threats, balancing the cost of maintaining the assets with the benefits of having those assets
- Sustainability - rate of net change in financial capacity. In nonprofits, surpluses are often “cashed in” to expand mission or services



Planning Rules of Thumb



- Anticipate issues before they arise
- Maximize use of resources
- Ensure tax and legal compliance
- Evaluate services and financial/business model periodically
- Consider historical and new sources of funding to accomplish mission objectives
- Be efficient
- Let mission inform your strategy

Case Study #3

- Billings House is actually Hull House in Chicago
- By law, they had to dispose of their assets to other nonprofits, and did so before dissolution
- On January 27, 2012, it shut its doors and let its 300 employees go after giving them their final paychecks
- One board member said that they were used to always operating “on the brink of destruction”...and that the financial trouble seemed no different than it ever had
- <http://philanthropy.com/blogs/against-the-grain/hull-house-collapse-is-a-wake-up-call-for-boards-and-executives/28045>



Legal Red Flags

- Ethical Concerns
- Private Benefit/Private Inurement
 - Intermediate Sanctions
- IRS 990 Reporting
 - Failure to comply with annual funding
- Unrelated Business Income
 - Failure to correctly report these items
- Political activity
 - Campaigning for candidates



Resources

- Wake Forest Community Law & Business Clinic
 - community-clinic.law.wfu.edu
- Wake Forest Schools of Business
- Books:
 - Bowman – Finance Fundamentals for Nonprofits
 - Coe – Nonprofit Financial Management
- Your friendly neighborhood accountant





Conclusion

- Finance and budgeting in the nonprofit sector should have a triple focus: past, present and future

