

# Fiscal Management

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- 1. Introduce general principles of fiscal management**
- 2. Apply these general principles to the fiscal management of human service organizations**
- 3. Identify and discuss the following fiscal responsibilities carried by managers in human service organizations:**
  - **Budgets, budgeting and the budgeting process**
  - **The budgeting cycle**
  - **Asset management**
  - **Controlling costs**
  - **Investment planning**
  - **Tax issues**

## ■ Fiscal management

- “the administration of financial affairs through planning, budgeting, recording, reporting, and analyzing an entity’s flow of funds”

## ■ Fiscal management also refers to:

- *safeguarding resources* or properties owned by the organization
- using the funds for the *purposes* to which they were dedicated
- accumulating necessary *information* concerning work performed, and
- submitting whatever *reports* are required by funders and governmental authorities

- **Fiscal management is one of the principal components of the management process in human service organizations**
- **along with other management functions, fiscal management focuses on obtaining, allocating and controlling scarce resources**
- **Fiscal management focuses very much on the daily decisions and dilemmas faced by managers**

# The Functions of Fiscal Management

- 1. assessing changes in revenues, expenditures and service utilization**
- 2. monitoring patterns in services and expenditures**
- 3. analyzing program costs and unit service costs**
- 4. taking corrective management actions**

## ■ Accounting

- “a system of accumulating, summarizing, and reporting financial transactions and the results thereof in terms of the organization’s financial position (what it owns and what it owes) and the changes that occurred during the reporting period to increase or decrease those net assets” (Blazek, 1996:251)

- **Accurate accounting is at the heart of the fiscal management...*but accurate accounting is only one of the functions performed through fiscal management***

- **Fiscal Management is a means to an end...not an end in and of itself**
  - The focus of fiscal management is not strictly on the management of or control over an organization's resources
- **In a more fundamental sense, fiscal management is about the judicious use of organizational resources for the purpose of helping the organization achieve its mission**

# Identifying the Organization's Mission

- **Organization's Mission Statement**
- **If no formal statement of mission exists, then, look to:**
  - **IRS forms 1023 & 1024 for mission statement as supplied to the federal government at the time of establishing the organization**
  - **Funding proposals**
  - **Annual reports**
  - **Strategic plans**
  - **Minutes of the Board of Directors**
  - **IRS tax returns (Form 990)**

- **Financial management in the not-for-profit sector is about managing other people's resources (both cash and in-kind)**
- **Stewardship is the principle that guides that management of OPR**
  - The act or process of managing the property, finances, or household of another
- **Transparency is the key to success**
- **Active participation of key stakeholder is an essential feature of stewardship**
- **Must adhere to strict code of ethics**

- **The Association of Fundraising Professionals**

[http://www.afpnet.org/ethics/guidelines\\_code\\_standards](http://www.afpnet.org/ethics/guidelines_code_standards)

- **National Society of Fund Raising Executives Code of Ethical Principles and Standards of Professional Practice**

<http://www.nonprofits.org/npofaq/11/23.html>

- **National Society of Grant Writing Professionals, Inc.**

<http://www.nsgwp.org/coe.htm>



# Financially Healthy Organizations

- **The financially healthy organization has sufficient income to ensure stable programming**
- **The financially healthy nonprofit has an internal source of cash or ready access to cash in times of shortfall**
- **Financially healthy nonprofits engage in income-based, rather than budget-based spending**
  - **Income based budget begins with realistic income projections**
  - **Determines realistic costs of next year's service delivery through analysis of last year's costs**
  - **Considers current market conditions**
  - **Reflects functional cost allocation**

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\*The Stevens Group at Larson-Allen, St. Paul MN

# Seven Characteristics of Financially Healthy Nonprofits

- **At the end of each year, the financially healthy organization retains a positive cash fund balance (surplus)**
- **In years where a deficit does occur, the financially healthy organization has accumulated surpluses sufficient to cover the current year's deficit**
- **The financially healthy organization has established (or has plans to establish) an operating reserve to finance growth and cash shortfalls**
- **The board and management of financially healthy nonprofits hold themselves responsible for the financial stability of the organization**



# Budgets & Budgeting

## ■ Budget:

- “a financial plan of action for future periods” (Blazek, 1996:253)
- also, the financial goals for the next year(s) expressed in numbers

■ **Seeks to answer the question: “how much revenue will the organization collect from what source, how much will be spent on what program or administrative cost?”**

# Five Purposes of a Budget (Maddox, 1999)

- **Budgets put a business strategy into operation**
  - Budget's inevitably reflect the organization's *real* strategy
- **Budgets allocate resources**
  - Budgets presume resources are limited; therefore, not everything can be done...at least not equally
- **Budgets provide incentives to managers**
  - Budget rules encourage and reinforce certain behavior (both negative and positive)
- **Budgets control spending**
  - With luck, budget administrators will impose “self control” over fiscal decisions rather than requiring administrative control
- **Budgets communicate plans and expectations**
  - Both internal and external groups rely on budgets to understand the organization's plans and expectations

- Revenue
- Expenses
- Net Budget



# Revenue

- **Earned income**
  - Fees for service
  - Membership fees
  - Sales
- **Grants and contracts**
  - Grants
  - Contracts
- **Gifts**
  - Cash
  - In-kind
- **Investment income**
- **Royalties and rents**
- **Patent income**
- **Income from for-profit activities**

## ■ Fees for service

- Direct services
  - » Clinical
  - » Other services
- Indirect services
  - » Education and training
  - » consultation

## ■ Membership fees

- Individuals
- organizations

## ■ Sales

## ■ Grants

- A gift or donation received for either a restricted or unrestricted purpose

## ■ Contracts

- a formal or legally binding agreement, such as one for the sale of something or for the provision of a discrete service

## ■ Cash

- Immediate
- Pledged
- Planned giving

## ■ In-kind

- “donated services and goods furnished without charge” (Blazek, 1996:258)
- Includes, but not limited to:
  - » Securities
  - » Real estate
  - » Antiques and art
  - » Time, talent and leadership

# Elements of Budgeting: Investment Income

- **Investment income**
- **Includes, but not limited to:**
  - Interest from savings accounts
  - Interest from Certificates of deposit and other time-based instruments
  - Dividends from investments in stocks and other equities
  - Profit from rentals

- **A rapidly expanding arena of “revenue enhancement” for NPOs**
- **Includes, but not limited to:**
  - **Commercial activities related to the central mission of the NPO**
    - » **A university operating a bookstore**
    - » **A museum operating a gift shop**
  - **Commercial activities not related to the central mission of the NPO**
    - » **Renting surplus space or facilities**
    - » **Selling third-party products strictly for the profit**

- **Council on Social Work Education, 2002**
- **Fig. 5.1a Resource Flow for Business League**
- **Fig. 5.1b Resource Flow For Academic Institution**
- **Exhibit 4.6 State Association of Nonprofit Managers: Overall Budget**
- **DT1: Underworld Symphony**



# Costs/Expenses

## ■ Direct Costs

- an expense specifically associated with and identifiable by program, project or activity

## ■ Indirect Costs

- Costs not readily identifiable with a particular aspect of organizational operation
- Often referred to as *overhead* or *administration*

# Elements of Budgeting: Direct Costs

- **Personnel (full- vs. part-time; employees vs. non-employees)**
  - » Salaries
  - » Benefits
- **Consultants**
- **Rent and mortgage**
- **Equipment (include rental, leases, access fees)**
- **Supplies**
- **Travel (local, national, international)**
- **Patient/Client Care Costs (inpatient vs. outpatient)**
- **Alterations and Renovations**
- **Other expenses**

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**Compensation =**

**[f (Salaries & Wages + Employee Benefits)**

■ **Salaries:**

- a set sum of money paid at regular intervals to an employee, especially for professional or clerical work
- A salary is usually presented as an annual or monthly figure, as opposed to the wage paid to manual workers, which is usually based on an hourly rate and paid weekly

For salary ranges in the nonprofit sector for 2005 see:

[http://www.nptimes.com/Feb05/NPT\\_TopExec2005.pdf](http://www.nptimes.com/Feb05/NPT_TopExec2005.pdf)

■ **Wages:**

- a sum of money paid to a worker in exchange for services, especially for work performed on an hourly, daily, or weekly basis, or by the piece

- **Setting salary levels**
- **Benchmarking**
  - Major competitors
  - Salary guidelines established by trade associations and workers organizations
  - Newspaper adds
- **National surveys of salaries of NPO staff**
  - Exhibit 1. Nonprofit Times Salary Survey, 2005
  - Exhibit 2. Public and other Not-for Profit Salary Guidelines  
<http://jobstar.org/tools/salary/sal-prof.php#Social>
- **Personal negotiations (base + something extra)**

- **Federal income tax**
  - 100% employee paid
  - Progressive and depends on:
    - » Amount of earnings
    - » Marital status
    - » Numbers of exemptions and dependents (\$3,200 in 2006)
- **State income tax**
  - 100% employee paid
  - PA Tax rate: 2.8% of gross income earned in the state
  - Tax sharing for income earned in other states
- **City income tax**
  - 100% employee paid
  - In Philadelphia, different rates for residents and non-residents
    - » 4.54% for residents; 3.96% for non-residents

## ■ Social Security (FICA)

- Total Rate in 2006: 12.4% on \$94,200
  - » 50-50 match between employer (6.2%) and employee (6.2%)
- Reported on Form W-2

## ■ Medicare

- 2.9% on all wages
  - » 50-50 match between employer (1.45%) and employee (1.45%)

## ■ Federal Unemployment Insurance (FUTA)

- Wage base and rate = 6.2% through 2006 (less credit for contributions funds to maximum of 5.4%) on \$7,000
- Reported on Form 940

## ■ 401(k) limit in 2006 = \$15,0000

Type of Tax	Employer's Share	Employee's Share	Total
<b>Federal Income Tax</b>	<b>0</b>	<b>Progressive, based on earnings, marital status and number of dependents/exemptions</b>	<b>Variable. See tax tables and calculators</b>
<b>Social Security: FICA</b>	<b>6.2%</b>	<b>6.2%</b>	<b>12.4%</b>
<b>Social Security: Medicare</b>	<b>1.45%</b>	<b>1.45%</b>	<b>2.9%</b>
<b>Federal Unemployment</b>			<b>6.2% on first \$7,000 up to \$434 maximum</b>
<b>State Income</b>	<b>0</b>	<b>On 100% of gross earnings in the state</b>	<b>PA = 2.8%</b>
<b>Local Income</b>	<b>0</b>	<b>On 100% of gross earnings in the locality</b>	<b>PA = 4.54% R PA = 3.96% NR</b>

# Electronic Resource on Payroll Taxes

- **Electronic resource useful for computing estimating federal and state taxes on all salaries and wages:**

**<http://www.payroll-taxes.com/>**

# Direct Costs: Personnel—Benefits

- **Paid time off**
  - Holidays
  - Vacations
  - Personal
  - Funeral
  - jury duty
  - military leave
  - family leave
- **Unpaid family leave**
- **Disability benefits**
  - Paid sick leave
  - Short-term disability
  - Long-term disability
- **Survivor benefits:**
  - Life insurance
  - Accidental death and dismemberment
  - Survivor income benefits
  - Dependent life insurance
- **Health care benefits:**
  - Medical care
  - Dental care
  - Vision care
  - Outpatient prescription drug coverage
- **Pre-Tax accounts**
  - Dependent care
  - Health care
- **Discount purchasing plans**
- **For a detailed discussion of the range of employee benefit programs in the public sector see:**  
<http://www.bls.gov/ncs/ebs/sp/ebbl0018.pdf>


# Examples of Employee Benefit Costs

Benefit	Sub-Benefit	Cost to Employer	Cost to Employee
<b>Paid Days Off</b>	Vacation	Varies based on tenure in position	0
	Holiday	Usually fixed number of days	0
	Sick Leave	Varies based on tenure in position	0
	Personal Leave	Varies based on tenure in position	0
<b>Insurances</b>	Health	Co-pay; most employers cover employee only	Employee picks up cost of dependents
	Dental	Co-pay; most employers cover employee only	Employee picks up cost of dependents
	Vision	Usually, service only	Employee often picks up total cost
	Prescription	Co-pay; most employers cover employee only	Employee picks up cost of dependents
<b>Survivors Benefits</b>	Life Insurance	Co-pay; most employers cover employee only	variable
	Disability Insurance: Short Term	Co-pay via FICA and Medicare	Co-pay
	Disability Insurance: Long Term	Service only	Employee pays


- **Most large employers permit employees to choose between a “basket” of benefit programs/packages**
- **Allows for a “better fit” given the different needs of different individuals and families**
- **Examples of flexibility in EB provision:**
  - **Public Sector**
    - » **Table 1. National survey of EB programs, state and local government**
  - **Private Sector**
    - » *Penn Choice* brochure
- **University of Pennsylvania historical and current employee benefit, indirect cost, and other negotiated rates:**

<http://www.upenn.edu/researchservices/history.htm>

# Examples of Budgeted Employee Costs

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- **State Association of Nonprofit Managers**
    - Exhibit 4.10 Personnel Budget
  - **Underworld Symphony**
    - DT3: Distribution of Fees/Salaries by Program

# Other Reductions to Personnel Income

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- **Union dues**
  - **Retirement plan contributions**
  - **Health insurance**
  - **Court ordered garnishment (e.g., child support)**

- **Quite complex...but real and must be paid for**
- **Often cannot bill for such expenses directly and, therefore, must include in some other “cost recovery” rate (almost always a percentage of direct costs)**
- **To fullest extent possible, seek to allocate appropriate share of indirect costs to direct cost centers**

**Include but are not limited to:**

- **The cost of administration**
- **Non-project/department-specific facilities**
- **Insurance**
- **Legal and other professional fees**
- **Building and grounds maintenance**
- **Staff training and development**
- **Fundraising**
- **Library development**
- **Inter-agency planning and similar types of activities with partners, collaterals, etc.**

# Electronic Resources For Determining Costs

- **Indications of allowable indirect costs for federally supported grants to educational institutions can be found in OMB Circular A-21**

**For a listing of all OMB Circulars**

**<http://www.whitehouse.gov/omb/circulars/index.html>**

- **See Society of Research Administrators (SRA International) for more resources related to public-sector funding:**

**<http://www.srainternational.org/newweb/default.cfm>**

- **Net Budget = [ f (revenues – expenses) ]**
- **Examples of Net Budget:**
  - Council on Social Work Education, 2002
  - Underworld Symphony: DT1
  - State Association of Nonprofit Managers: Exhibit 4.6

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- **University of Pennsylvania Finance Office  
(including V-P Finance, Comptroller, Treasurer,  
<http://www.upenn.edu/services/finance.php>)**



# Types of Budgets

## ■ The Operating Budget

- Also referred to as the “income statement” or “balance sheet” budget

## ■ The Capital Budget

- Reflect expenses in tangible and other “real” assets that extend beyond the current operating year

## ■ The Cash Budget

- Also referred to as “the cash flow” budget

- **The *operating budget* refers to the organization’s plan for *revenues* and *expenses* related to current period operating activity**
- ***Current period operating activity* consists of revenues for services delivered and expenses for services consumed in the time period covered by the budget**
- **Operating expenses may include both *cash* and *non-cash* items**
  - **Once an organization issues a bill for services to be rendered in the current period, it counts as current period revenue whether payment is received in the period or not**
  - **The difference between what is billed and what is expected to be collected is recorded as “write offs” of “bad debts”**

- Most budgets included both *projected* and *actual* performance in terms of revenues and expenses
- Operating budgets can be structured in different ways:
  - *Type of expense* or activity (e.g., rent, advertising, telephone)
  - *Degree of specificity* (e.g., many object codes with a comprehensive Chart of Accounts to track both revenues and expenses in relation to these object codes)
- Operating budgets can be subdivided in other ways as well:
  - *Program* (division, department or activity focused)
  - *Organization* (responsibility-centered)
  - *Fund type* (from a given source or for a given purpose)
- Smaller organizations prefer more simple coding approaches to tracking revenues and expenditures

## ■ **Underworld Symphony**

- DT1: Summary of operating results
- DT2: Operating results by program

## ■ **State Association of Nonprofit Managers:**

- Exhibit 4.6 Overall Budget
- Exhibit 4.7 Functional Revenues and Expense Budget
- Exhibit 4.11 Program Cost Analysis

- Among other *real assets*, capital budgets include:
  - Land
  - Buildings
  - Improvements to buildings
  - Furniture and Fixtures
  - Computers
  - Major computer software
  - Equipment
  - Works of art
  - Musical instruments
  - Stage sets and costumes
  - Books
  - Vehicles

- The capital budget is an organization's planned funding and expenses related to the acquisition and disposal of assets from which it expects to receive benefits for a period greater than one year

- *Capital projects* are the projects the organization undertakes to acquire these items, through purchase, construction or other means
- Capital projects differ from operating expenses in that they involve both expenditures and *a source of funds*
  - Borrowing or bond financing
  - Gifts
  - Grants
- The focus in capital budgeting is on reviewing and approving major projects

# Example of Capital Budgeting

Project	Completion Target	FY2000 Budget	Proposed FY2001 Budget	Previous Spending	Remaining Cost	Total Budget
<b>CONTINUING PROJECTS</b>						
Fiber optics installation	2003	\$500,000	\$500,000	\$445,000	\$1,055,000	\$2,500,000
Library Addition	2002	\$850,000	\$1,000,000	\$225,000	\$225,000	\$2,300,000
Admin Building Renovation	2001	\$600,000	\$25,000	\$275,000	0	\$900,000
<b>NEW PROJECTS</b>						
New Dorm	2003	0	\$120,000	0	\$2,880,000	\$3,000,000
Resurface Football field	2001	0	\$600,000	0	0	\$600,000
Biology Lab Renovation	2001	0	\$800,000	0	0	\$800,000
<b>TOTAL PROPOSED 2001 CAP BUD</b>			<b>\$3,045,000</b>			

# Depreciation & The Capital Budget (cont'd)

- Capital assets *over time* are consumed and, therefore, represent real expenses to organizations
- The cost of these expenses are reflected in *depreciation*
  - expenses charged against operating results that presents the value of that portion of an asset's useful life estimated to be expended during the accounting period
- Depreciation entries are based on a schedule developed at the time an asset is acquired that estimates the asset's annual decrease in value
  - Standardized depreciation schedules for most items have been developed by the IRS and are contained in the instructions for completing Form 990
- Examples:
  - Exhibit 4.6 of the State Association of Nonprofit Managers
  - Filed tax return of a local NPO

<http://nccs.urban.org/990/>

# Example of Depreciation: Good Neighbors, 2001

Item	Original Cost	Date Acquired	Useful Life (years)	Annual Depreciation	Cumulative Depreciation	Net Value
Central Office Building	\$2,500,000	1987	50	\$50,000	\$750,000	\$ 1,750,000
Vehicle	\$ 18,000	1994	5	0	\$ 18,000	0
Personal computers	\$ 15,000	2000	3	\$ 5,000	\$ 10,000	\$ 5,000
Desks	\$ 3,000	1995	10	\$ 300	\$ 2,100	\$ 900
Printer	\$ 980	2000	5	\$ 196	\$ 392	\$ 588
Fax machine	\$ 500	1999	5	\$ 100	\$ 300	\$ 200
<b>TOTAL</b>	<b>\$ 2,537,480</b>			<b>\$ 55,596</b>	<b>\$ 780,792</b>	<b>\$ 1,756,688</b>

- The cash budget is an organization's *planned cash receipts and disbursements* for a particular period of time, i.e., *cash flow*

- **The cash budget is constructed by starting with the change in net assets for the operating year**
- **This figure is adjusted in three ways:**
  - **Non-cash operating activity is backed out**
    - » **Backed out activities include reserve expenses, depreciation, non-cash contributions and payments in kind, and changes in receivables**
  - **Cash flows from investing activities are documented**
    - » **These activities include adjustments for purchases and proceeds from sales any asset, such as investments, property or equipment**
  - **Cash flows from financing activities are recorded**
    - » **These items include restricted funds for investment, proceeds from loans and bonds, and payments of principal on debt**

## ■ State Association of Nonprofit Managers

- Exhibit 5.3a Cash Flow, Version 1
- Exhibit 5.3b Cash Flow, Version 2
- Exhibit 5.3c Charted Cash Flow, Ver 1 & 2

## ■ Underworld Symphony

- DT4: Monthly cash flow
- DT5: 4-year summary of financial data
- DT6: 4-year summary of ticket sales by program
- DT10: analysis of 4-year trends

- **To their detriment, the cash flow budget is the budget most likely to be ignored by smaller organizations**
- **In a small organization, the development of a cash flow budget can be fairly easy; more difficult in larger organizations with many funding streams**
- **For both types of organizations, cash budgeting allows for more strategic interventions to adjust budget to reflect changing fiscal circumstances**

## Budget types vary by:

- **Degree of Centralization:**
  - *Centralized vs. Participatory Budgets*
- **Emphasis on Redistribution of Resources:**
  - *Incremental vs. Redistributive Budgets*
- **Institutional Focus:**
  - *Institutional vs. Center-Based Budgets*
- **Time period covered:**
  - *Single vs. Multi-Year Budgets*

# The Budget Cycle

- 1. Budget Development**
- 2. Budget Monitoring, Tracking, and Adjustments**
- 3. Analysis of Final Results**

# The Four Steps of Budget Development

- **Step 1: Committee Budget Planning**
- **Step 2: Staff Budget Planning**
- **Step 3: Reviewing & Approving Departmental Budgets**
- **Step 4: Loading Budgets Into The Accounting System**

## Committee Budget Planning

- **Analyze most recent fiscal year**
  - Where did the organization make or lose money?
  - What were the sources of the variances?
- **Analyze multiple years**
  - Identify factors contributing to long-term trends
  - Identify especially volatile factors (e.g., 9/11, unemployment)
- **Review past fiscal strategy**
- **Review general parameters**
  - Inflationary trends
  - Loss of major funder(s)

## ■ Underworld Symphony

- DT5: 4-year summary of financial data
- DT6: 4-year summary of ticket sales by program
- DT10: analysis of 4-year trends

## Staff Budget Planning

- Identify the budget base, i.e., the starting point for the department budget
- Identify budget instructions and guidelines, i.e., salary increases limited to a total of 3%
- Focus on the Personnel Budget
  - always requires special handling
  - May account for as much as 80% of total budget
- Prepare the final department budget proposals
- Reviewing and approving departmental budgets

## ■ **DHHS-Public Health Service**

- Detailed budget for initial budget period
- Budget for entire proposed project period
- Budget justification

## ■ **American Cancer Society**


- Proposed budget
- Budget justification

## Reviewing and Approving Departmental Budgets

- Basically, an action taken by organization's Board of Directors or its relevant public oversight body

## Loading budgets into the Accounting System

- Today, almost always electronic
- Must communicate clearly with existing system
- Must allow for comparison between past, present and future budget performance



# The 12-Step Budget Development Process

- **List all the accounts used in the organization**
  - See Chart of Accounts
- **Classify these accounts as either “restricted” or unrestricted”**
  - *Restricted*: resources (including gifts) received *with* explicit stipulation by the donor on their use
  - *Unrestricted*: resources (including gifts) received *without* explicit stipulation by the donor or “circumstances surrounding the receipt of the contribution that make clear the donor’s implicit restriction on use

- **Distinguish between the types of information needed to be kept or archived, and the types of information needed for updates**
- **For information that needs to be archived, distinguish and label the location and methods of storage of such information:**
  - Identify who is responsible for the updating
  - How frequently the updating should occur
  - How a user knows whether he/she is using update or outdated information
  - If the updating is in monetary terms, whether there is a need for factor in considerations such as inflation

- **Must make a distinction among the types of assets (e.g., interest, dividends, and rental monies) inasmuch as the use of some of these assets may be restricted and others may not**
- **Determine whether transfer of funds is permissible from a capital budget to an operating budget**

- **Determine who must/should be involved in the budget development process—a critical step to ensure ownership of the often difficult decisions/choices necessitated by resource scarcity**
  - Resource allocation affects work, positions, status and distribution of tangible and intangible resources
  - It also affects staff relations, staff-client matching, staff development, unit growth, job security and growth
  - It makes a real difference in whether an agency can retain its most productive members
  - It is always a mistake to totally exclude staff from fiscal matters that impact so directly on their work and morale

- **Distinguish the type of costs (fixed/variable; common/joint)**
  - Important to separate out the various costs and, then,
  - To assign differential costs to each service unit, including those associated with central administration
- **Determine the method of assigning costs to the programs, especially if these programs have similar overhead costs**
- **Compute joint costs to be absorbed by the program. Together with fixed and variable costs, the total costs can be computed**

- **Determine the unit of services**
  - Not an easy task inasmuch as most agencies have at least 3 categories of beneficiaries of agency activity
    - » Number of services provided
    - » Headcount of clients served
    - » beneficiaries
- **Compute unit costs**
- **Determine who should receive such information and how the information should be used**

# Asset Management

- **Optimizing existing or current resources**
- **Generating new resources**
- **Monitoring cash flow**
- **Controlling costs**
- **Managing cash flow imbalances**
- **Adjusting expenditures (including budget cuts)**

- **The first task of every manager is to optimize existing resources**
- **The guiding criteria are:**
  - Effectiveness
  - Efficiency
- **Don't have to be “mean and lean” but you do need to be efficient**

<b>COST</b>	<b>OUTCOME/BENEFIT</b>		
	<b>High</b>	<b>Moderate</b>	<b>Low</b>
<b>High</b>	Depends on resource base of consumers—PENN vs. Penn State	?	<b>AVOID</b>
<b>Moderate</b>	<b>INVEST</b>	<b>INVEST</b>	<b>AVOID</b>
<b>Low</b>	<b>INVEST</b>	<b>INVEST</b>	<b>AVOID</b>

- **Mangers of NPOs are true “Robin Hood’s,” i.e., people who seek to redistribute resources from the more-well-off to the less-well-off**
- **From 20%-30% of the time of NPO managers is spent in resource development**
  - Seeking charitable gifts and other contributions
  - Grants
  - Contracts
- **Commercial ventures increasingly are part of the resource development mix engaged in by NPOs**
  - Running for-profit enterprises
  - Sharing in profits made by independent for-profit entities associated with the NPO

# Examples of “Revenue Enhancement” Budgets

## ■ Underworld Symphony

- DT7: 4-year summary of individual contributions by category
- DT8: 4-year summary of membership revenue by category
- DT9: 4-year membership costs

## ■ Fundraising Guides

<http://caster.ssw.upenn.edu/~restes/praxis/funds.html>

## ■ Public Support Sources

<http://caster.ssw.upenn.edu/~restes/praxis/publsupp.html>

## ■ Private Support Sources

<http://caster.ssw.upenn.edu/~restes/praxis/privsupp.html>

- **A complex activity that require careful attention to lots of details *simultaneously***
  - Almost no organization has a fixed, totally predictable, revenue base, i.e., one in which the money keeps flowing in predetermined increments
  - Cash flow can be highly variable
- **Need on-going, timely review of fiscal performance**
  - Timing / frequency of reviews will be determined by:
    - » Requirements set by external bodies
    - » Sufficient new information to warrant need for a review (surpluses/deficits)
    - » Major events and transactions occur (windfall, market failures)
- **Requires willingness to act on what is learned from the reviews as well**

## ■ State Association of Nonprofit Managers

- Exhibit 5.3a Cash Flow, Version 1
- Exhibit 5.3b Cash Flow, Version 2
- Exhibit 5.3c Charted Cash Flow, Versions 1 & 2

## ■ Underworld Symphony

- DT4: Monthly cash flow
- DT5: 4-year summary of financial data
- DT6: 4-year summary of ticket sales by program
- DT10: analysis of 4-year trends

- **“control” is the process through which the management of an organization makes reasonable assurance that:**
  - resources are used effectively and efficiently to further the organization’s missions and plans
  - Financial reporting is reliable
  - Organizational policies and relevant laws and regulations are followed
- **Control over financial resources is one of the most critical tasks facing management**

# Controlling Costs: Traditional Approaches

- **Traditional cost control approaches are generally highly prescriptive, i.e., telling people in the beginning of the year how much they can spend and on what types of expenses**
- **Traditional approaches tend to be detailed and strict**
- **Traditional approaches also can promote unnecessary rigidity, especially in high turbulent environments**

- **Build budget responsibility into *human resource development cycle*, i.e., greater participation and involvement on the part of those that have to translate resources into action**
- **Can slow down the process and certainly the center will feel some measure of loss of control**
- **But those closest to the field may well have a better sense of what resource priorities are the most appropriate in a rapidly shift service and resource base**
- **Obviously, need partnership between fiscal, administrative and other specialists to make budgets and, control over expenditures (and resource generation), real**
- **Can develop incentive systems based on budget performance**

- **Cash flow imbalances are of two types:**
  - *Deficit*: the amount by which expenditures exceed income or budget
  - *Surplus*: an amount of money remaining after all liabilities have been met
- **Also must distinguish between *absolute* surpluses/deficits and surpluses/deficits *against plan***

- 1.** Make cuts or increase revenues within the current year, i.e., *revenue enhancement*
- 2.** Return surplus funds to cover balances in other areas, i.e., *redistribution*
- 3.** Cover deficits through transfers between funds, i.e., *borrowing or actual consumption from past savings*
- 4.** Rollover deficits and surpluses into fund balances to be addressed in future periods, i.e., *postponement*

## ■ **Across-the-board cuts**

- **Easy to administer**
- **Often the most ineffectual—everyone suffers more or less equally**

## ■ **Targeted cuts**

- **Difficult to implement and often painful**
- **Need to be careful not to cut prematurely (investments take time to mature)**

## ■ **Process or technology driven cuts**

- **Introduce innovations in process or technology**
- **Working smarter, not harder (computerized vs. paper records)**
- **Requires a longer-term perspective to begin to see results**




# **Prudent Investment Planning**

- **An essential activity once an organization acquires resources beyond its operating expenses for a given year**

**The goals with investing are three-fold:**

- **Protect the principal**
- **Grow the principal**
- **In general, spend only a share of the earnings...while continuing to grow the principal**

- 
- In the end it's all about risk
  - That is, balancing the promise (expectation) of solid returns against the risks involved
  - Losses always are possible

## ■ Fixed money value

- Interest bearing checking accounts
- Money market account
- Certificates of deposit
- Treasury bills
- Series EE Bonds
- Fixed annuities

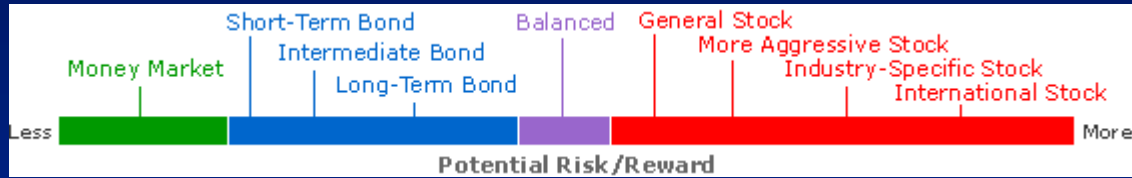
## ■ Variable money value

- Treasury notes and bonds
- Mortgage backed bonds
- Corporate bonds
- Municipal bonds
- Annuities or universal life insurance policies

# Investment Strategy: General Approaches (cont'd)

- **Equity investments**
  - Common stock
  - Preferred stock
  - Convertible bonds
- **Real estate**
  - Commercial real estate (office, store, hotel, or factory building)
  - Residential real estate (single person or multi-person apartment)
  - Raw land
  - Agricultural land
- **Tangibles**
  - Gold or silver
  - Antiques
  - Art
  - Minerals
  - commodities

# The Investment Continuum



- **The Vanguard Group**

<http://flagship.vanguard.com/VGApp/hnw/PersonalHome>

- **The Fidelity Group**

<http://www.fidelity.com/>

# Tax Issues in NPO Management

- **Obtaining tax-exempt status**
- **Maintaining tax-exempt status**



# Obtaining Tax Exempt Status

- **Engaged in charitable activity**
- **Promoting public benefit**
- **Directors and other policy makers do not benefit financially from the activities of the organization**
- **Willingness to make all financial and programmatic transactions transparent**
- **Willingness to file necessary paper work at prescribed intervals**

- All charities operate under Section 501[c] of the Federal Tax code
- Multiple types of organizations are eligible for such status
- For current statistics on number and types of NPOs see:

[http://nccs.urban.org/n\\_taxexempt.pdf](http://nccs.urban.org/n_taxexempt.pdf)



# **Maintaining Tax Exempt Status**

**Requires periodic renewal  
and  
continued vigilance**

- **Receives and reviews tax forms**
  - IRS filing required of all 501[c] organizations with incomes of at least \$25,000 per year
  - File on Form 990 (or 990-EZ)
  - Form 990-T for Exempt Organization Business Income Return
  - IRS Tax Guide Publication 15-A contains all the details
- **Requires proof that you are continuing meet tax exempt status:**
  - Engaged in charitable work
  - Make financial and programmatic reports to the public
  - Do not engage in political activities of any type
  - The Board and other “volunteers” do not benefit financially from the activities of the organization

- **Must perform their policy development and oversight roles**
  - Determining organizational mission
  - Setting appropriate objectives and goals
  - Ensuring development of a sound financial plan
  - Assist in resource generation
  - Monitor all aspects of agencies activities
- **May delegate these roles to the Executive Director or CEO but, ultimately, they are responsible**

- **Must be filed annually by 501[c]3 organizations that generate \$25,000 or more in annual reviews**
- **For large organizations, can be very time consuming to complete; often requires input from accountants and others**
- **Completed returns are filed with national clearinghouses and are available to the public on-line**
- **For all versions of the form visit:**

**<http://nccs.urban.org/irsforms.htm>**

# Examples of Completed 990 Tax Returns



■ *National Center for Charitable Statistics*

<http://nccs.urban.org/990/>

- **Governmental forms are many and varied**

- Visit IRS form center for Charities & NPOs

<http://www.irs.gov/charities/index.html>

- **Internal forms**

- See McMillan (1999) *Model Accounting and Financial Policies and Procedures Handbook For Not-For-Profit Organizations*

# Some Cautions in Financial Management

- Checks and balances
- Ensure transparency
- Promote participation
- Be vigilant concerning potential abuses

# Checks & Balances: Check Signers

- **People who prepare checks should never be check signers**
- **People who reconcile bank statements should never be check signers**
- **People who approve invoices for payment should never sign the checks for payment of invoices they approve if they are check signers**

# Discussion

## Selected Books on Fiscal Management

- Blazek, Jody. 1996. *Financial Planning For Nonprofit Organizations* (New York: Wiley)
- Feit, Marvin D. & Peter Kwok Chei Li. 1998. *Financial Management in Human Services* (New York: Haworth)
- Maddox, David. 1999. *Budgeting For Not-For-Profit Organizations* (New York: Wiley).
- McMillan, Edward J. 1999. *Model Accounting and Financial Policies & Procedures Handbook For Not-For-Profit Organizations* (Washington: American Society of Association Executives)



# Supplemental Slides

# The Need for FM in the Human Services

- Since the early 1960s there has been increasing pressure for greater accountability in the administration and delivery of human services:
- Human services represent a *growing share of government expenditures*—even today 50% + of all federal expenditures and an even higher share of state and local expenditures (including housing, health services, etc.)
- *Lack of public consensus* on the “welfare function” of government (vs. private needs and/or the role of the private sector in dealing with needs)

# The Need for FM in the Human Services (cont'd)


- Impression that *human services are growing* at an escalating rate—even faster than would be expected under normal inflationary trends—e.g., health care, transportation, etc.
- The “*unsavory*” nature of many of the clients served by human service agencies, i.e., drunks, prostitutes, the voluntarily unemployed, drug abusers, etc. Society’s attitude toward these marginal population groups influences their attitudes (and assessment) of the “value” of publicly financed human service programs

# The Need for FM in the Human Services (cont'd)

- **Impression that many human service and *NPOs* are poorly administered with comparatively little attention given to solving recurrent social problems**
  - that agencies are more focused on “process” issues and rather less on “outcomes”, i.e., on the issues that members of the public require of all agencies (e.g., not just to feed the hungry, but to solve the problem of hunger; not just to distribute income and personal services to the poor, but to solve the problems of poverty)
- **A widespread belief that human service agencies would benefit from the adoption of budgeting, accountability and evaluation *methods characteristic of for-profit organizations***


# The Need for FM in the Human Services (cont'd)

- Increasing public concern over *opportunities for fraud and corruption* that exist in the management of funds by NPOs:
  - United Way of America and CEO's use of discretionary dollars to support his mistress
  - Ponzi scheme of New Era Philanthropy
  - American Red Cross and its “mis-handling” of the \$500 million+ raised in support of victims of “9-11”
- Thus, *pressure for increased accountability* not only for the resources under the control of NPOs but also for the outcomes they achieve.



**The**  
**Financial Management**  
**System (FMS)**

# Elements of Financial Management System (FMS)

- 
- 1. The Fiscal Subsystem**
  - 2. The Service Coordination Subsystem**
  - 3. The Program Planning Subsystem**
  - 4. The Program Evaluation Subsystem**

- *the fiscal subsystem essentially is about budgeting and accountability*
- **Activities of concern to this subsystem include activities that record, process, document and report:**
  - monies received
  - monies committed
  - expenditures and expenditures committed
  - services provide
  - number of clients served

- **The principles that apply to the fiscal subsystem are appropriate for all types of NPOs:**
  - simple and complex
  - centralized and decentralized
  - human service, arts & cultural, educational, and so on
  - professionalized and grass roots
- **They also reflect the fiscal activities of a broad range of actors/stakeholders in the NPOs financial environment:**
  - members of boards of directors and/or other bodies that oversee the activities of NPOs
  - executive directors and other members of senior leadership staff
  - line workers
  - contractual workers, including accountants, auditors and others hired to perform specific sub-tasks
  - Funders and other financial supporters

# The Service Coordination Subsystem

- **Focuses primary on *service coordination and management control***
- **Key activities of concern to this subsystem include:**
  - case management issues:
  - transfer of case management activities
  - staff supervision, orientation, and training
- **Also includes case- and program-related activities involving more than one unit of an agency or agencies:**
  - intra-agency
  - inter-unit
  - inter-agency

# The Service Coordination Subsystem (cont'd)

- **Service coordination activities are more difficult in multi-service than single-service agencies**
- **Also is more difficult in decentralized rather than centralized system, albeit effectiveness of decentralized units may be higher than centralized ones**

- **Focus ins on *recurrent and emerging needs* that confront the agency**
- **Activities include:**
  - those that set and define goals and directions of an organization
  - those that established standards for organizational performance
  - those that seek to manage people based on results
  - and those that coordinate services and programs with other organizations
- **Goal specificity is an essential component/element of an effective PP subsystem**
  - many NPOs lack such specificity and, thus, one of the major activities of FM-focused managers must be to help organizations attain clarity concerning their mission, goals and objectives

- **the PP subsystem also is concerned with:**
  - changing client characteristics and service utilization patterns
  - the types of service demands projected for the future
  - identification of the types of services that are less time and effort consuming
  - the types and levels of monetary resources the organization expects to receive in the future (i.e., forecasting)
- **Information of this type enable program managers in *identifying program areas in which resources should be allocated and the types of services that will help the organization further its mission and achieve its goals***

- the focus on this subsystem on determining *the extent to which programs (and hence agencies) are achieving their mission, goals and objectives and doing so in an efficient manner*
- to be effective, the PE system requires clear (and measurable) goals and objectives
- data that reflects changes over time in relation to NPO goals and objectives
  - service
  - programmatic
  - fiscal

- **In NPO-focused PE, always we must be mindful of the unique functions and processes used by NPOs in advancing their mission.**
- **Their processes may differ significantly from those used by for-profit groups, e.g.,**
  - the definition of “benefit,” “beneficiaries” of services provided may differ as does the notion of “head counts of program participants
  - the “tangible” vs. “intangible” nature of the benefits derived from many services
  - benefits/outcomes measured in monetary vs. broad “social benefit” terms must be clearly delineated if a true picture of the nature of NPO activities are to be fully captured by any accounting/auditing system

- the PE subsystem is centrally concerned with issues related to decisions that impact on:
  - increasing, decreasing, retaining or eliminating existing service delivery patterns
  - measuring worker, unit, department and organizational *effectiveness*
  - measuring worker, unit, department, and organizational *efficiency*

# Centralized vs. Participatory Budgets

- **In a heavily *centralized budgeting system*, a central office:**
  - Controls the budget process
  - Makes decisions about how resources will be allocated
  - Controls expenditures once the budget is in place
- **Small organizations may have either centralized or decentralized budget systems.**
- **A *participatory system* may reduce or eliminate the need for budget staff, lower costs and reduce administrative burdens**
  - Involves units or program managers in developing budgets and controlling spending
- **Which approach is adopted depends on:**
  - Size of organization
  - Magnitude of fiscal resources to be managed
  - Fiscal skills of executive director, and others in the leadership team (and Board of Directors)

# Incremental or Redistributive Budgets

- ***Incremental budgeting*** refers to systems that base future allocations on current allocations and the new budget is created by increasing or decreasing the current budget by certain amounts or percentages
  - easy to administer, but has no mechanism for making significant adjustments to allocations between units
- ***Redistributive budgeting*** refers to systems that revisit the allocation at least in part, and may go so far as to reassess all allocations from scratch each year
  - More difficult to manage and requires that the organization go through a consensus building process that reflects new budget priorities

- **An institutional budget assumes that all resources are pooled so as to be able to focus on the resources of the organization-as-a-whole**
  - Works very well with smaller organizations
- ***Center-based budgets* divide the organization's total resources into parts that more or less stand on their own**
  - Departments
  - Divisions
  - Other units
- **Center-based budgets assume that the parts of the organization are financially independent in a fiscal, if not legal, sense**

# Single vs. Multi-Year Budgets

- **Most organizations have annual budgets, but a growing number are developing multi-year budgets as well (especially in the public sector)**
- **In single year budget systems, surplus resources are returned to central management for redistribution to cover deficits**
- **In multi-year budgets, the surpluses (deficits) of one year are transferred to future years**
- **In truth, most organizations function on a year to year (even quarter to quarter) basis despite having multi-year budgets**



# Accounting

- **Accounting focuses on two types of resources--*fixed* vs. *variable revenues* and *expenditures*:**
  - *fixed revenues*, i.e., that portion of the budget which remains fairly constant from one year to the next with slight modifications for changes in cost of living (i.e., grants, subsidies)
  - *variable revenues*, i.e., that portion of the budget which changes in response to certain activities the organization undertakes (e.g., fund raising, ticket/raffle sales, wind fall profits, gifts, etc.)
  - *fixed expenditures*, i.e., salaries for a more or less stable program, rents, etc.
  - *variable expenditures*, i.e., special programming (new initiatives, outreach efforts, bus trips, etc.)

- **Defined as the table of contents of a ledger, i.e., a listing of the account pages and account titles in the ledger**
- **Charts of accounts traditionally are set up in the order of the accounting equation, that is:**
  - *Assets*: anything that is owned and has money value
  - *Liabilities*: amounts due creditors and other interested parties; also, the ownership of the assets of an organization by its creditors
    - » The ownership extends to the creditor's right to collect what is due them before any distribution to the owners of the business
  - *Permanent capital*: the owner's equity in a business organization that is not expected to change other than as a result of an increase or a decrease in the owner's investment in the business
  - *Temporary capital accounts*: capital accounts that will be eliminated at the end of the accounting period, e.g., revenue, expenses and proprietor's drawing accounts

# The Standard Chart of Accounts for Not-For-Profits

- **Charts of Accounts differ between For- and Not-For Profit organizations**
- **Reasons:**
  - Charity, not profit focused
  - May not make a profit over the long-term
  - Directors do not participate financially in organization
- **See standardized Chart of Accounts prepared by the Alliance for Nonprofit Management:**

*What Should Our Chart of Accounts Include?*
- **See Blazek (1996:152-155) for a more detailed version**