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TECHNICAL LEAFLET #268
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Building Better Budgets

By Stacy L. Klingler and Laura B. Roberts

You probably entered this field of public history because you were excited to be in close contact with the stuff of history and to share your enthusiasms and amazing discoveries with the public. Perhaps you chose to pursue history or another area of the humanities because you hit algebra or geometry and decided that math was not for you. Managing the financial side of a nonprofit history organization is hardly ever the carrot that entices us into this work. You are a whiz at writing in Word, but Excel is still a mystery. But now, alas, just when you thought you'd escaped, you find you need to complete and stick to a budget and provide your board an accounting of just how accurate that budget is proving to be. And if this year's finances aren't enough of a headache, there's a board meeting ahead to discuss next year's budget. How to begin getting together complete, accurate, and helpful reports and data that will inform good planning and decision-making without either overwhelming them in minutiae or hiding significant issues and trends?

Yes, there is special terminology and software that can be difficult to master, but the truth is that most of the math you'll need, you learned in elementary school—addition, subtraction, multiplication, division, percentages. Take one example: a historic house museum is open three days a week. Paid guides cost $8,000 a year; admission fees are under $1,300. The phrase "negative net income" may be unfamiliar, but it isn't difficult to see that the house loses $6,700 a year.

The hard work is not in the numbers but in making sure you can use information about the past (the money you've earned and spent) to tell the story of the present (financial reports for board meetings) and to create a strong future (in a budget that shows how you'll make your plans a reality). A good budget will take time to build, but it's worth it!

Devote the Time

Hardly anyone likes budget time. How can you really know what next year will be like? Will it rain every weekend all spring? Will the school system continue to send every fourth grader to the site? Will the gutters last another year? Instead of being a chore, use budgeting as the time you not only look back but also imagine the future of your organization and solve real problems—not just in a lofty, visionary sense, but in the nuts and bolts of what really makes your organization function.

Put aside the fourteen other projects begging for your attention and embrace the challenge of crafting a better budget. You will appreciate it next year, when you are able to confidently spend the money you've carefully matched with your needs and projects or quickly adapt to unanticipated changes such as rising utility rates or the loss of an important donor.

Do You Have a Plan?

A budget is really just a plan in numbers, describing the financial resources you need to do the valuable work of meeting your mission. Your "plan" may be as simple as a calendar of activities for the coming year or as complex as a strategic plan that prioritizes several new initiatives and sets detailed goals regarding mission-building activities, attendance, and finance. Or it may be something in between. A well-built budget helps to ensure that you have allocated financial resources where you need them in order to realize your plan and helps you adapt when plans don't go as expected. Regardless of the level of complexity of your plan, the same principles for building better budgets apply:

- Use the most accurate data/estimates you can in building your budget.
- Document and understand where your budget numbers come from.
- Understand that the budget must be flexible enough to respond to changes.

Before You Begin

If you have a current budget, ask yourself, is this budget understandable? If you find that people ask the same questions about the budget each board meeting, then something is missing. If the board never asks questions, then the budget and financial reports are probably not giving them the right kind of information in a way that helps them focus on what is important.

The most common questions board members are likely to (or should) ask are:

- How did we come up with this number? What data did we use? What is our plan for getting to this number?
- Why is it different from last year? How has our plan changed? Has something else changed?
- Why is the actual number different from the budgeted number? How is reality different than what we planned for, and why?

As the person responsible for creating, managing, and/or reporting on the budget, you should be able to answer these questions. To do so, you need to do two things in preparing the budget: gather good data and be transparent about your calculations. But how do you accomplish these basic tasks?

Basing Your Budget on Good Data

When starting the budget process for the next year, a natural place to start is the current year's budget. However, although this is the easiest place to start, it's rarely the best. The budget doesn't tell you if your predictions about income and expenses were any good. So, in starting the budget process, the most important pieces of information to have are the actual income and expenses (called the "actuals") for the last year or several years. The actuals bring reality to the budgeting process. Unfortunately, the actuals do not always provide enough information to make better decisions. You really need to know why the actuals are what they are (that is, why they are more or less than the budget).

Perhaps the most valuable and informative calculation you can do is to figure out the net income or loss from each activity undertaken by the organization. Business people call this a profit/loss calculation. Just because you run a nonprofit, that doesn't mean you shouldn't do the same thing. Not everything you do is expected to make a profit. Some projects are planned to break even. Others—the most central to your mission—may cost more than they earn. But each should still have a projected bottom line: how much you expect to make or lose. Only by knowing how close you came to the projected bottom line can you appropriately manage your budget.

So for each project or event, you need to know:

- How much income did it bring in? (This is called the "gross income.")
- How much did it cost? (These are called the "direct expenses.")
- How much did the organization gain or lose? (This is known as the "net," which might be positive or negative.) And how does that compare to what you expected you would gain or lose on that program?

To get a really complete picture of what a program costs or earns, you want to keep track of some other data as well:

- How many people participated in or benefited from the activity? Did they represent audiences that are a priority for the organization to reach?
- Were any services or materials donated? If you had to pay for those services, what would that cost?
- How much volunteer time was needed? Is it getting easier or harder to recruit volunteers for this project? Do they have fun? Are you worried that they won't be available or enthusiastic in the future?
- How much staff time did it take? You may not be in a position to track every hour of your time, but an estimate is useful. Did this take you away from activities that you consider more important (that is, more central to the organization's mission or long-term goals)?
- Were there any external factors (publicity, weather, competition) that impacted your numbers?

You will likely end up with an initial calculation and notes that explain in more detail why your income and expenses were what they were and the impact of the activity on your plan. With this information, you have the tools to make good decisions for the future.

The more information you can compile about *why* the actuals came out the way they did, the better you'll be able to plan for the next year. So when looking at actuals, consider the story behind what they are. By way of an example, let's look at the membership numbers for last year.

Example: Membership Numbers

Your budget said you'd bring in $10,000 in memberships, but in reality, revenue was only $9,000. You budgeted $1,200 in expenses and spent slightly less: $1,000. So instead of net income of $8,800, your membership drive brought in $8,000. If you simply use the budgeted numbers from last year, you'll likely be off by $800. Perhaps that's not a big number, but maybe there's even more going on.

First, you recall that you used extra envelopes left over from another mailing, saving you $400. Next year, you'll have to print envelopes. Also, previously, you always relied on three friends who enjoyed getting together to gossip and stuff the mailing. Alas, one has moved out of state, and a second is nursing a sick husband. So you had to hire some high school students to get the work done, which cost $200. If you don't find replacement volunteers, you'll have that expense next year as well.

But the real question is why you only took in $9,000. Did a single $1,000-member pass away? Or did you lose twenty members at the $50 level? Those are two very different challenges. Perhaps all of the major donors are still with you and loyal, but you realize that when a major employer in the area closed, several of those $50 members moved out of state. So if you are going to get back to $10,000 in income, you might consider a broad membership campaign to reach newcomers. Alternatively, if a single major donor was lost, you might review your dependence on those large annual memberships and work to move some lower level donors into those higher categories.

A step better than analyzing the actual income and expenses from last year is to look at income and expenses for the last *few* years. By looking at income and expenses over time, you can see if those numbers are increasing or decreasing, depending on the organization's action or inaction over time, plus any outside circumstances.

In our example, you might find that membership income has been steadily dropping for years. You can't point the finger at the one departing employer; overall membership support has been declining, and a membership campaign is overdue.

When There Are No Actuals

But what about your new plans? How do you budget for something you haven't done before? As best you can, you'll need to find estimates for your new activities. You can get estimates from suppliers for each element of the program (such as printers, caterers, or other vendors). Most suppliers will be more than happy to provide you with estimates. But don't forget to call more than one place; you may find a wide range of costs.

Another strategy is to contact colleagues who have done a similar project. Most people who work in this field will be quite open with you about the cost of creating a new exhibit or starting a new program.

Example: Membership Campaign

Going back to our example, let's say you realize you need to do a membership campaign. How much will it cost, and how much will it bring in? Start by looking at what supplies you will need: letterhead, membership brochures, envelopes, reply cards, return envelopes, postage, mailing list, and time to pull it all together. Call a couple of local printers and the office-supply store to get an idea of how much the mailing will cost per person. Make sure you document the details of the estimate; you have the option of adjusting them later. You might plan to spend $1 per mailing: $.50 for postage and $.10 each for the other five items. When postage goes up or you find a supply of membership brochures under a table, you can easily adjust your per-person mailing cost.

The more difficult-to-answer question is how much income will the campaign generate? The return you will experience depends highly on the quality of your mailing list. Are you mailing to every registered voter in town or just people who live in historic houses? Are you trading lists with another nonprofit with similar goals or using the youth soccer mailing list? Talk to other nonprofits that have recently done membership campaigns and ask them how it worked out. Consider contacting a museum or cultural nonprofit of your size in a similar community in your region or your state, or ask your regional field service office to help you estimate how much income you might expect to generate. Ask them how many appeals they sent, what was the pitch and/or incentives, and how many new members signed up. And while you are at it, ask what they would do differently the next time around.

After all your research into last year's and previous years' actual income and expenses, and after getting good estimates, make sure you document how you arrived at the numbers you use in your budget. A note or a formula that explains how you arrived at the numbers in the budget will not only help you explain it to others, but it will also help you adapt to changes throughout the year.

In this membership example, you are transparent when you document how many members your currently have at each level (and can expect to renew) to get you to $9,000. To get to $10,000 in income, document a plan to complete a mailing campaign with the goal of getting four $100-members and twelve $50-members. Your plan is clear.

The more time you spend during the budgeting process doing this research, the more realistic your budget will be. Our tendency is to be conservative, when what we need to aspire to are realistic projections. When you estimate expenses that are too high or revenue that is very modest you end up limiting what the organization thinks it can accomplish. On the other hand, you need to be responsible. When your revenue estimates are too high ($20,000 in admissions!) or your expenses are too low (volunteers will do all the work!), you may take on projects that are too risky. When you don't meet budget and have to tap cash reserves, you are limiting what your organization can do in the future. Reserves should be used strategically and in case of disasters, not as a Band-Aid for poor planning.

Budget

Revenue	*Prior Year Actual*	*Current Budget*	*Notes*
Memberships	$9,000	$10,000	*Membership campaign for 4 @$100 & 12 @$50*
Annual fund	$15,645	$15,000	
Admissions	$7,965	$8,000	*Open 8 months*
Group tours	$4,568	$4,000	*No change; no new advertising*
Student tours	$1,890	$2,000	
Shop sales (net)	$4,367	$6,200	*Allows for $1,000 in new merchandise*
Town grant	$5,000	$5,000	*No change expected*
Wine tasting (net)	$1,980	$2,300	
Auction (net)	$4,756	$4,200	*Includes $500 for advertising previously donated*
Investment income	$3,678	$3,600	*4.5% draw*
Total Revenue	**$58,849**	**$60,300**	

Expenses	*Prior Year Actual*	*Current Budget*	*Notes*
Director salary+benefits	$36,000	$36,000	*No increase this year*
Guides' hourly wages	$6,120	$6,000	*No hourly increase this year*
Insurance	$3,600	$4,000	*Rate increase 10% from previous year*
Maintenance	$2,655	$3,000	
Utilities	$3,689	$3,300	*Expected reduction of $400 with new furnace*
Temp exhibit	$0	$4,500	*Based on average of three quotes and XYZ's new exhibit*
School program supplies	$824	$800	
Printing, postage, office	$856	$1,500	*Includes membership campaign @$500*
Website contract	$2,850	$1,200	*New provider; includes 2 updates per month*
Total Expense	**$56,594**	**$60,300**	

Transparency—Where Did Your Numbers Come From?

To make sure this information is useful in the next year and beyond, be consistent about how you categorize income and expenses. Make sure that each person or group of people contributing to the process (either in planning or reporting) uses the same categories in the same way. If each program has a printed brochure, will you categorize that as a marketing expense or part of printing? As long as the categories are useful to the decision-makers and used in the same way across the organization and over time, you'll be able to depend on your actual income and expenses over years as a useful budget resource.

Create a document that describes what kind of expenses go in each category, that can be shared with all committees (or people contributing to the budget), and that can be passed from director to director and treasurer to treasurer, so that they budget and

Thoughts about Accounting Software

There is nothing wrong with using a paper-and-pencil ledger if your income and expenses are simple and no one in your organization is computer-savvy. But the ability to generate a variety of reports and to easily create digital backups are two good reasons that you might consider shifting to computer-based financial tracking.

There is no one right accounting software. Or rather, the right accounting software is the one that lets you track your finances at the appropriate level of complexity for your organization. If your budget is less than $25,000, you have no payroll, and rarely need to track grants, basic home accounting software might be adequate. However, as your needs increase, you will likely want software designed for small business or nonprofits.

Here are some key issues to consider in picking and setting up your accounting software:

- Do multiple people (staff and/or board members) need to know how to use the software?
- Is inexpensive and easy-to-access training available?
- Is there an expert available (either from the software producer or a knowledgeable local person) to answer your questions? Will this expertise be available for several years?
- Will you be working with an accountant (to prepare tax documents or to review the accuracy of your financial information)? What software is she familiar with?
- Do you need to group income and expenses together for reporting or analysis (as in the case of grants or fundraising activities)?

The more familiar those using the software are with it, the better. And if, as either a staff member or a new treasurer, you find yourself needing to use software that you don't really understand, seek out help now. Check with other local nonprofits, accountants, or your state field services or museum association office for recommendations. And recruit more than one software expert to your finance committee or as an as-needed volunteer, so that you always have someone who can answer your questions.

QuickBooks is the most popular software, largely because almost any accountant can use the files. The nonprofit version links income and expense categories to Internal Revenue Service reporting requirements, and for a fee you can subscribe to automatic payroll updates if you pay staff directly and file quarterly employer tax returns (Form 941). It also lets you group income and expenses together as a "class," so you can organize reports for grants or other activities. The version for businesses may be more familiar to both accountants and small business owners on your board, so it would be prudent to consider both options.

allocate expenses in the same way each year. When they are consistent, they can compare across years and across programs.

The list of expense and revenue categories is called the "chart of accounts." If your chart is murky or inconsistent, financial reports can be unclear or confusing. For example, the library wants to share a great new find with a notice on the website. A week later, the development committee needs to sell tickets to the wine tasting. And then the gift shop gets in some new merchandise to promote. Fortunately, you have a great webmaster who is not upset when three requests come in separately, five days apart. But are her services charged to each department or function, or grouped under marketing or website? The library updates probably don't have revenue implications, but those ticket and store sales do. If you don't keep track of the expense of those promotions, you have an incomplete picture. On the other hand, if you "charge" the library for those updates, will that

Any software for buisness or nonprofits will be more powerful and provide more reporting options than software designed for individuals, but it may not be as user-friendly, so count on a steep learning curve, enlist assistance, and be patient, whatever program you use. There is even some free or inexpensive accounting software for businesses that can be adapted for nonprofit use (such as Gnucash or Xero), but you must have the ability to use any software effectively. Alternatively you can check TechSoup.com to purchase accounting software at a reduced rate for nonprofits.

Regardless of the software you choose, here are a few tips that will make your work easier and more useful:

- Be consistent—decide how to categorize income and expenses and create a cheat sheet to help you (and future staff/treasurers) remember those decisions.
- Guard against data-entry errors—use the same name for vendors each time to avoid confusion.
- When naming categories or accounts, use a numbering system (either generated by the system or created by you) so that you can sort items in your reports in useful ways (e.g., grouping all membership types together). If you don't use numbering, your reports will be sorted alphabetically, which may not allow you to group information in a helpful way. Also, you can change the number to reorder reports without changing the name, which may be helpful when considering many years' worth of information.
- Use "class" to group income and expenses that are related to each other together. For example, if you receive a grant, create a "class" for that grant so that every expenditure and all income is grouped together for easy progress reporting and an accurate final report.
- Always export your reports to Excel so that you can add notes or annotations that explain why your numbers might be different than what was expected.
- Project as best you can your revenue and expenses from your budget month-by-month. This will save you from having to explain why you are under or over budget for items that come in on a basis that isn't the same each month. (And these projections are also useful for cash flow analysis and projections!)

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discourage the staff from actively promoting the great work of the organization? The answer is to be consistent. If the webmaster's bill is modest, you can probably just fold it into marketing, knowing that you will be asking her for ten to fifteen updates a year. But if it's a significant expense, allocate it to each program and tell the librarian she has $750 a year to spend on web updates.

Final Word: Flexibility—Budgets Are Never Set in Stone

When your budget emerges from your plans for the future, is based in reality, and is transparent, it becomes much easier to correct your course and adjust. Depending on how accurate your estimates are and your ownership of a crystal ball, you will likely find a time when your income is more or less than expected, or when an unexpected savings or expense surprises you.

In the example, let's say your membership campaign raised $250 from ten $25-members. In the short term, you know that you will need to either cut $750 from expenses or find another source for that income. But in the long term, you'll know that your mailing worked only to get low-level donors. If you repeat the effort, your projections will be more modest. Or you'll find a better list of prospects. Or change the messaging.

When you are going through the budget process, consider various scenarios. If income is less than expected, where can expenses be trimmed? Are there other sources of funding that could be tapped? And if income is more than expected, where are the biggest unmet needs (e.g., maintenance, collections-care supplies, or professional development)? Do you need to replenish your cash reserves or long-term maintenance funds? This kind of thinking is sometimes called contingency budgeting. Rarely does an organization produce multiple, complete budgets. Instead, the budget group considers better- and worse-case scenarios (not best- and worst-case, because major disasters and windfalls are unlikely), so that some priorities for adding to or taking away from planned spending can happen quickly.

Budgeting is the tip of the financial management iceberg; it is the right place to start. Once your organization has a budget in place, the ongoing challenge is monitoring financial performance on a regular basis and developing mechanisms for making sound financial decisions.

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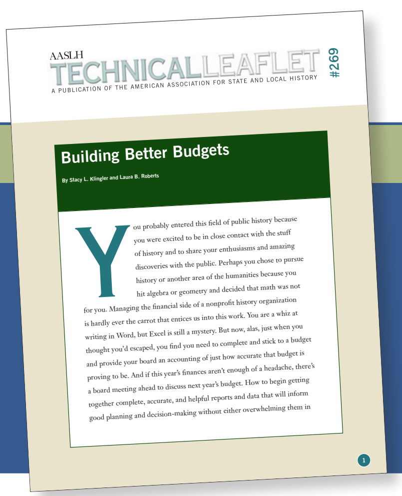
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COMING NEXT ISSUE!

Technical Leaflet #269 (Winter 2015) will continue the discussion of sound financial management by discussing other ways to improve your organization's financial health.