

The Budget-Building Book for Nonprofits

A Step-by-Step Guide for Managers
and Boards

Second Edition

**Murray Dropkin
Jim Halpin
Bill La Touche**

JOSSEY-BASS



John Wiley & Sons, Ltd

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Praise for *The Budget-Building Book for Nonprofits*

First Edition

“This is a book every nonprofit needs.”

—Peter F. Drucker

“Provides clarity, strategy, and utility to the financial and asset management of social-sector organizations.”

—Frances Hesselbein

“This book is clear, insightful, and required reading for all who are responsible for the success of not-for-profits. If you work for or run a not-for-profit agency, you should read this book.”

—Peter Block, author of *Flawless Consulting* and *The Empowered Manager*

“*The Budget-Building Book for Nonprofits* is a definitive and practical guide to the art of budgeting. It is well-written and reliable, as well as easily understandable.”

—Ronald J. Werthman, vice president, finance/treasurer, and CFO, Johns Hopkins Health System, The Johns Hopkins Hospital

Second Edition

“This book is the gold standard for providing executives and managers with information essential to making the best decisions for their organization, and it will give them the confidence in their fiscal systems that they need in the competitive world of nonprofit management.”

—Don Sykes, former director, Office of Community Services for the Clinton Administration and President, Community Development Solutions

“This book is an indispensable step-by-step guide for managers of not-for-profits. Written in clear language easily understood by the layman, it contains guidance on both proper procedures and the real-world challenges of getting the organization to adopt them. The worksheets and sample forms alone are worth the price.”

—Elizabeth Rosen, retired chief financial and systems officer, The Morgan Library and Museum

“Everything you ever wanted to know about budgeting and didn’t know who to ask is contained in this second edition of *The Budget Building Book for Nonprofits*. It’s practical, sophisticated, and contains many useful forms and examples. Whether you are an experienced nonprofit executive, board member, or finance person or new to the field, you will want to add this budget book to your library. It’s a tremendous resource for everyone who works or volunteers to support the nonprofit sector.”

—Carol Wolff, executive director, Area Health Education Center, Camden, New Jersey

“The second edition of *The Budget-Building Book for Nonprofits* presents a primer for managers with limited financial expertise and resources in nonprofit settings. In my 20 years of consulting to behavioral health systems, these kinds of adjustments are often the critical difference in the financial health of an organization. This book should be mandatory reading for the non-financial administrator of any nonprofit organization.”

—Harvey E. Hoffman, president, Healthcare America, Inc.

“Too often the process of building a budget in nonprofit organizations fails to receive the attention and focus appropriate to its importance. When a properly constructed budget is used effectively it represents far more than a simple spending plan. Rather, it becomes a guiding statement of values and priorities and a road map for how the organization plans to achieve its goals for the budgeting period. That view—carefully honed by these highly skilled authors after many years of experience on the front lines—is well captured in this second edition of *The Budget-Building Book for Nonprofits* and forms the foundation for the

practical methods so clearly presented. Nonprofit executives and their boards of trustees alike will be well-served by this edition and well-advised to make it their own.”

—Alan G. Kaufman, former director, New Jersey Division of Mental Health Services, and president, Argus Solutions for Behavioral Health

“The budget-building book is a clear, well-written guide for nonprofit managers, whether experienced or new to the job, and demonstrates the importance of the budgeting process. Using plain language and real-life examples, the authors provide a comprehensive and systematic approach to developing and monitoring the budget. It should be required reading for all nonprofit managers and boards.”

—Irwin Nesoff, associate professor and director of the New Jersey Institute for Nonprofit and Social Work Management, Social Work Department, Kean University

Spotlight Review (of the First Edition) on Amazon

★★★★★ Budget Management, April 23, 2006

By Alex Nalicat “nalicat” (CA, USA)

When I purchased this book I thought it might be outdated for my organization. I was wrong; this is an excellent budget workbook. The authors did an excellent job in bringing to light the complex and problematic issues of budgeting for nonprofit organizations, and they take you step by step through the process. *The Budget-Building Book for Nonprofits* covers everything from starting a budget to the financial reporting of the budget. This book also provides numerous samples of budgets. If you're a budget manager

or director, this book should give a fresh new way to look at the budgeting process.

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First Edition

**Dedicated to Thomas H. Gregory, a great friend and
mentor**

Second Edition

**Dedicated to Bill La Touche, coauthor of the first
edition of this book and a great friend, mentor, and
writer**

Preface

DESPITE AN INCREASINGLY complex regulatory atmosphere and shrinking funding sources, the nonprofit sector continues to grow in size and importance. Recent Internal Revenue Service (IRS) statistics identify approximately 1.8 million tax-exempt organizations in the United States, not including organizations claiming tax exemptions as religious organizations. In recent years as many as ninety thousand applications have been received by the IRS requesting tax-exempt status. The number of Americans who are in some way involved with tax-exempt organizations continues to expand at an incredible pace. According to the IRS the tax-exempt sector had total assets of \$3.7 trillion and revenues of \$1.2 trillion as of the end of 2002. Tax-exempt organizations are a major employer and a vibrant part of the local and national economy.

The ways in which nonprofits are supported, regulated, and monitored by government makes them far more complex than comparable commercial organizations in almost every area of operation. Nonprofits are subject to a much wider range and a greater degree of government and private regulation and oversight than are most commercial entities. Thus nonprofits may have more complex accounting systems, budgeting processes, auditing procedures, taxation considerations, and financial and organizational management concerns than for-profit organizations do.

News of financial mismanagement in tax-exempt organizations always seems to get magnified in the press and in public discussions. Donors and government funding sources react very quickly to news of a nonprofit's financial

problems because such organizations are supported with public funds and routinely scrutinized by the public. Sometimes tax-exempt organizations take public positions that are not popular; this may also make them especially vulnerable to bad press.

Recent legislation aimed at “reforming” the oversight of nonprofit organizations, modeled after the Sarbanes-Oxley federal law, has been passed by some state legislatures and is being considered by a number of others. The new legislation has increased the scrutiny of the financial operations of nonprofit organizations. In the long run such legislation may strengthen the tax-exempt community, because stronger financial controls are important. However, in the short run such pressure finds nonprofits increasingly under the microscope of government and other regulatory agencies. This, coupled with greater competition for funds, has forced many nonprofits to reevaluate everything from how they conduct day-to-day operations to their overall strategic plans, in order to stay viable.

We found out very early in our work with tax-exempt organizations that underlying every aspect of nonprofit operations is the budget. The budgeting process is the foundation on which any nonprofit’s long-term and short-term health rests. Budgets are required before organizations can apply for funds from most funding sources. Yet our search for information yielded very few budgeting resources written specifically to offer step-by-step guidance to nonprofit managers, boards of directors, financial staff, and the consulting and accounting professionals that serve them. The purpose of this workbook is to offer practical assistance to the people involved in preparing budgets for nonprofit organizations.

Since 1965, we have been assisting small (\$100,000), medium (\$10 million), and large (\$2 billion) nonprofit

organizations to plan, develop, process, and implement program, capital, operating, zero-based, department, cash flow, and various other budget programs, analyses, and reports. We have trained thousands of board members, financial staff, managers, and program staff in proper budget preparation. We have also trained funding-source staff at government and private organizations. What we have found, across the board, is that the tools available for budgeting are difficult for anyone other than highly specialized financial professionals to understand, are difficult to apply to the unique circumstances in which many nonprofits operate, or are wonderful in their explanation of the theoretical principles but do not detail the nuts and bolts of budgeting.

We wrote this workbook to offer nonprofits and their stakeholders a comprehensive and systematic approach to developing and monitoring a budget. One of our most important objectives was to create a resource that is understandable and useful to those with no financial background as well as those with formal financial training. To accomplish this objective we have incorporated detailed explanations, checklists, worksheets, examples, and simple-to-use forms to address every phase of the budgeting process.

The first edition of this book has been very well accepted, and many organizations are using it to help guide staff through the budget process. A number of colleges and universities are using the first edition for courses on budgeting and finance. Reader feedback and our own desire to make the book more useful have led us to add three new chapters in this second edition. These new chapters are devoted to capital budgeting, zero-based budgeting, and cash flow forecasting. In addition, we have included a CD with tools to help you implement the concepts in this book.

We believe *The Budget-Building Book for Nonprofits* is a practical resource for anyone involved in the budgeting process of a small, medium, or large nonprofit—whether a thorough review of overall budget methodology is needed or just a minor reworking of the budget preparation process.

The Budget-Building Book for Nonprofits is divided into three parts that may be used independently or as a complete, sequential package. Part One introduces and provides an orientation to budgeting basics. The chapters in this part present an overview of the common types of nonprofit budgets, the key roles of the various players in developing a budget, overall budgeting strategies, and the effects of different sources of nonprofit revenue on a budget.

Part Two contains information and tools for the hands-on development of budgets and supporting documentation. Some of the elements are step-by-step descriptions and instructions for developing organization-wide and program budgets; developing a budgeting calendar; establishing budgeting goals, priorities, guidelines, policies, and procedures; creating budgeting forms; and estimating and projecting income and expenses. The chapters in this part then detail the final steps in the budgeting process, from revising draft budgets to final budget approval. Among the topics are developing and presenting budget proposals to the board of directors, establishing systems for board review and revision of budgets, and monitoring and modifying approved budgets. This part contains checklists, worksheets, and tips for preparing for, navigating through, and streamlining the budgeting process. Our goal is to demystify and systematize budget development.

Part Three contains a broad collection of sample forms and illustrative materials, including a master worksheet for creating a program or unit workplan, an example and a

worksheet for a detailed organization-wide expense budget, and worksheet samples of budgeting forms for several different types of programs.

Due to the comprehensive nature of this workbook, many of the topics are discussed in several places. Depending on your experience and requirements, you may find that you prefer to jump to particular topics rather than to read the book in a linear fashion. Important topics are covered in multiple chapters to provide you with the information you need regardless of how you use this book.

In our years of experience in dealing with every aspect of nonprofit finances, we have found that nonprofit organizations with effective budgeting practices have a substantial edge in competing for funding over those that lack such practices. Successful organizations also use some of the tools found in this book to monitor and adjust their budgets as situations unfold. We believe that the potential exists within every nonprofit to budget effectively and efficiently. This book can give your organization and your budget team a *budget edge* that will lead to future success.

June 2007

Murray Dropkin
Brooklyn, New York
Jim Halpin
Edison, New Jersey

Acknowledgments to the First Edition

A NUMBER OF PEOPLE gave us their time, effort, and encouragement as we researched, wrote, reviewed, and revised this workbook. We truly appreciate the contributions of Allyson Hayden; David H. Freed, president, Overlook Hospital; Philip M. Henry, publishing consultant and freelance writer and editor; Sylvan Leabman; Kate Miller; Scott Phillips; Edward Kitrosser; Pendar Digges La Touche; Ronald J. Werthman, vice president of finance, treasurer, and chief financial officer, Johns Hopkins Health System Corporation; and Carol Wolff, executive director, Camden Area Health Education Center.

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The Authors

MURRAY DROPKIN is the president of CMS Systems, Inc., and the managing partner of Dropkin & Company, Certified Public Accountants. Both firms specialize in working with nonprofit organizations. Dropkin's experience with nonprofit budgeting spans four decades, during which time he has participated in the budgeting processes of virtually every type of nonprofit organization, from child welfare and protection agencies to mental health organizations to theater development organizations to university-based academic medical centers. He has trained staff and board members in effective budgeting techniques and has assisted an extensive number of organizations with budget development. Dropkin has published extensively in the field of nonprofit accounting and is coeditor of *Nonprofit Report*, a monthly newsletter. He is also the coauthor (with Allyson Hayden) of *The Cash Flow Management Book for Nonprofits* and (with Jim Halpin) of *Bookkeeping for Nonprofits*, both published by Jossey-Bass. He is a coauthor of the *Guide to Audits of Nonprofit Organizations*, published annually since 1989. Dropkin earned his BS degree at Brooklyn College and his MBA degree at New York University. He is a certified public accountant in the states of New York, New Jersey, and Wisconsin and a member of the American Institute of Certified Public Accountants and of the New York and New Jersey state CPA societies. He can be reached at murray@dropkin.com.

JIM HALPIN is a software developer, systems consultant, and accountant specializing in cost accounting concepts applied to the long-term health care, legal, transportation,

manufacturing, and retail industries. He is a certified public accountant in New Jersey. He has thirty years of experience in accounting, auditing, taxation, management consulting, software development, and computer consulting. He developed a job cost accounting software package that was widely used in the construction industry. He is the coeditor of the monthly newsletter *Nonprofit Report*, the coauthor (with Murray Dropkin) of *Bookkeeping for Nonprofits*, and the author of articles published in professional business and computer magazines. Halpin is a member of the New Jersey Society of Certified Public Accountants. He holds an MS degree in management systems analysis and a BS degree in management science from Kean University. He can be reached at jph@dropkin.com.

BILL LA TOUCHE, a former university teacher and community organizer, was coeditor of *Nonprofit Report* and coauthor of the first edition of this book. Over a thirty-year span, he used his writing, planning, training, and organizing skills to help a wide range of individuals, groups, and organizations. He created numerous training, personnel, self-study, and orientation manuals; employee handbooks; funding and development materials; policy and procedure guides; and public information literature. He was a fellow of the Institute for Individual and Organizational Development.

Introduction

How to Use This Book

THE BUDGET-BUILDING Book for Nonprofits covers the subject of nonprofit budgeting from a practical, hands-on perspective and presents the material so that someone who has never participated in the budgeting process may be able to do so with confidence. We believe as well that even those with extensive budgeting experience or other financial background will find a great deal of helpful information in this book.

Our top priority as we developed *The Budget-Building Book for Nonprofits* was to make it useful and relevant to readers at all levels of financial and budgeting experience. Nevertheless your own budgeting experience, professional background, and role in the budgeting process will determine how you can best use the book. To help you determine how your organization might use this workbook, we have included descriptions and tips on how readers in different situations might approach and benefit from *The Budget-Building Book for Nonprofits*.

The CD that accompanies this book contains material you will find useful regardless of your background and budgeting experience. Many of the exhibits and worksheets in the book are available as spreadsheet files on this CD. In addition, the CMS Nonprofit Budget Builder, a Windows software application, is included for you to use as you implement the ideas in this book within your organization.

If you are budgeting for a smaller nonprofit, especially one with just one or two programs, this book will be most

valuable to senior staff, especially the executive director (or equivalent), the senior financial manager (whether salaried or volunteer), and the board members. Your organization can use *The Budget-Building Book for Nonprofits* to establish its entire budgeting process from beginning to end or to revitalize one it already has. This book may also be used to educate board members, especially new ones, on the board's role in the budgeting process and how an effective budget is developed. Additionally, this book may be an excellent tool for educating newly hired financial personnel with primarily for-profit backgrounds and limited nonprofit experience. The CMS Nonprofit Budget Builder software (on the CD) is a good way to get started.

If you are budgeting for a medium-sized nonprofit or one with multiple programs and sources of income, *The Budget-Building Book for Nonprofits* will be useful to senior executives and financial staff for modifying and improving the existing budgeting system. It may also be used to orient program and support department managers to budgeting techniques and can be especially helpful for managers new to the organization. As in the case of smaller nonprofits, *The Budget-Building Book for Nonprofits* is a practical tool for orienting both new board members and financial staff who are new to the nonprofit environment.

If you are budgeting for a larger nonprofit, *The Budget-Building Book for Nonprofits* will enrich the budgeting process when it is used to educate program and support department managers about budgeting. This book will also be very useful for large nonprofits' affiliates and chapters that are required to do their own budgeting but must conform to organization-wide budgeting standards. Furthermore, new financial staff and board members of larger nonprofits will benefit from using *The Budget-Building Book for Nonprofits* to orient themselves to the nonprofit budgeting process.

If you are inexperienced in developing budgets or are unfamiliar with nonprofit budgeting, we recommend that you read *The Budget-Building Book for Nonprofits* in its entirety and in sequential order, starting with Part One, which contains important background information. After reading this part, use the diagnostic budgeting checklist in Chapter Seven to alert you to the places where you will find the specific information you require to develop your budget. We recommend that you then continue to read the book sequentially, paying particular attention to the sections you have highlighted in the checklist. As you read, make notes and jot down the book sections that you find especially helpful. Be sure to review the checklists, worksheets, and budget examples found throughout the book, especially in Part Three. When you are finished reading the book, use the diagnostic budgeting checklist, the annotated Contents, the tools on the accompanying CD, and your notes to direct you back to the materials you need for developing your budget.

If you are experienced in developing nonprofit budgets, we recommend that you at least skim all the material in *The Budget-Building Book for Nonprofits*. You never know when you might find something that sparks a great new idea to use in your budgeting process. Otherwise, start at the diagnostic budgeting checklist in Chapter Seven to navigate to the information that will be most helpful to you. The checklist and the many cross-references throughout will refer you to the chapters and sections that have the material you need. You may also use the annotated Contents to find the specific information and tools you need for budget development. *The Budget-Building Book for Nonprofits* is also a good reference to turn to when a particular issue has stalled your budgeting process. Additionally, reviewing the exhibits and worksheets (especially those in Part Three) and the software on the CD might yield an especially useful budgeting or planning tool,