

American Society of Health-System Pharmacists

The Budget

ASHP's Financial Toolkit for Affiliates

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THE BUDGET

The budget is an outline of estimated income and expenses for the year.

In many cases a finance or budget committee usually has the responsibility of developing a budget for the organization. This committee may be elected or appointed according to the organization bylaws and is generally chaired by the treasurer.

A budget is not only a guide but also a working document. It shows a plan for spending those funds to meet the needs of the association's yearly activities, for obtaining funds and also should allow adjustments when those estimates are not exactly accurate. A budget does not show what an organization must do; it shows the general membership what the organization intends to do. Just because a program or fundraiser is listed on the budget does not mean that it must be done. But if it is not on the budget, it cannot be done.

Developing the Budget

Effective budgeting includes consideration of the organization's stated goals and planned activities, as well as the financial needs to achieve these.

The committee should study the previous year's budget and treasurer's reports to determine how well that budget met the association's needs. Next, members should determine the projected financial requirements, taking into consideration the funds needed for the approved programs, projects, and leadership development. They should determine the sources of funds to meet these requirements.

From this information, the committee then develops the annual budget. The budget should show the allocated expenditures for the year's activities, as well as the funds on hand and the anticipated receipts. Expenditures should equal receipts. Budgets cover a one-year period. How the year is defined should be determined in the organization bylaws.

The budget should be tied to the association's strategic plan and should be monitored regularly.

Approving the Budget

After the budget has been drafted, the budget committee chair should present it to the board/executive committee for consideration. This presentation is made during the association's general meeting where a quorum is determined to be present.

Funds should not be spent until the budget is approved and funds have been released by a quorum of members at an association meeting.

At each regular meeting of the board/executive committee throughout the year, present a statement showing how the amounts expended to date compare with corresponding items in the approved budget.

Amending the Budget

Since the budget is only an estimate of the planned expenditures for the year, it may be necessary, from time to time, to amend it. When there are major additional expenses or a change in an allocated expenditure, the budget may be amended by a vote of the board at any regular meeting or at a special meeting called for that purpose.

Approval of Expenditures

The adoption of the budget authorizes the treasurer to pay for routine expenses covered in the budget only if such authority is given to the treasurer in the bylaws or policies and procedures. If not, the treasurer shall pay bills only when the board/executive committee vote to expend the money, and then only upon presentation of properly signed vouchers, as required in the association bylaws.

All expenditures must be included in the treasurer's regular financial report to the board. Any additional expenditure not provided for in the budget must be approved by the board. The regular financial report should be attached to the minutes of the meeting at which it is presented. Changes in the budget, whether in income or expenditures, must be presented as amendments to the budget.

Budget Surpluses

There is no ruling from the IRS that limits the amount of money that an association may carry over to the next budget year. No association has the authority to write checks for unbudgeted items to "clean out" the accounts. Funds not spent in one budget year should be included in the new budget.

Reserves

Reserves for all nonprofit organizations are a result of accumulated earnings over a period of time. Reserves are excess earnings which are not used for annual operations, but are rather put aside for particular purposes.

Ideally, reserves should only be tapped in the following situations:

- Provide funds for maintaining operations during times of financial or other stress, given a solid plan of action
- Venture capital or seed money for new programs and services necessary for organization growth and for appropriate multiyear programs and services, to be repaid to the reserve fund if possible when the venture is operational and sustainable
- Fund necessary, multiyear research, such as needs assessments, market research, or other research with multiyear benefit that cannot be funded from one fiscal year;
- Fund infrastructure requirements that cross several years in service or use and therefore should not be charged to the yearly operating budget, such as IT systems with multiyear impact.

Creating a Reserve Policy

The first step in this process is to establish a formal policy. A formal policy will help ensure your organization remains disciplined enough to build and maintain reserves. A well thought-out and defined policy will do the following:

- Identify a particular target for your organization's reserves so the organization has a measurable goal for which you can strive
- Create parameters for the organization's use of reserves once they exceed the identified target
- Outline a plan for replenishing your organization's reserves should they fall below the reserve target

Without a formal policy in place, it is especially tempting to overspend excess reserves or to neglect a shortfall in reserves. When times are good and resources are aplenty, it's easy to make rash decisions and spend irresponsibly. Conversely, when resources are sparse, it's easy to avoid the tough decisions and sacrifices necessary to rebuild a weakened reserve pool. A formal reserve policy could help keep an organization from doing these things.

Nonprofit organizations have to strike a balance between establishing big enough reserves and providing a continuously high level of service to their constituents. An organization's members who feel they are not getting satisfactory return on their dues will be quick to criticize the association's management. Worse, dissatisfied members may not renew their memberships.

Reserve Levels

Many finance experts recommend that reserves should be targeted at a minimum of six months (50 percent) of annual unrestricted operating expense. However, be aware that the organization and its environment will change over time. The reserve level should be reviewed annually, balancing the needs of the organization against the desire to achieve the 50 percent target.

Organizations should avoid having account levels drop below 25 percent of unrestricted annual operating expense. If the budget process or financial projections show that this threshold will be crossed, the finance committee and the board should be informed and management should take corrective action as directed.

Contribution to Reserves

The organization should build in an annual contribution to reserves as part of the expense budget. In normal times, nonprofits should budget to contribute between two and five percent of total revenue to reserves, while in financially difficult times, they should budget for a five to 10 percent infusion of reserve funds into the operating budget if needed. (This assumes that downturn years will be substantially fewer than better years.)

Reserve Oversight

No volunteer leader or staff member should have authority to make investment decisions. The executive committee, treasurer, finance committee, and/or board will approve the investment strategy suggested by the organization's independent investment advisor, and the investment

advisor should present the board with a summary of the year's activities and future projections at least once per year, and more often as necessary.

Additional assumptions to keep in mind:

- Appropriate insurance coverage should be maintained to offset revenue losses for events that are at risk (such as event cancellation insurance)
- Revenue sources should remain fairly diverse and relatively balanced in their overall impacts
- Overall unrestricted operating income should be expected to grow approximately one to three percent per year in normal years and decline by less than 15 percent in challenging years.

Use these guidelines to have a conversation with your board to ensure you have thought through key elements that are important to include in any well-crafted association reserve policy.

Restricted Funds

While it is a common rule that one board cannot obligate the next year's board, there is one exception to that rule. The IRS has strict rules on restricted funds: when money is raised for a specific purpose, (technology, scholarships, etc.), the money must be spent for that purpose. It does not matter if it is one year, five years, or 25 years from now. If someone donates money for a specific purpose, it must be spent on that purpose. Otherwise, you will have to notify the donors that you intend to use the money for a different purpose and if they wish to have their money back, you must send it back. If you advertise that money raised is going towards something as well as other organization projects, then the funds are not restricted and your board and future boards are able to use that money for whatever budget purpose they wish.