Developing and Managing Budgets

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INTRODUCTION

The term ‘budget’ is quite often used generically in our everyday lives. We frequently hear people say, ‘I have to put myself on a budget’ or ‘this purchase is going to break my budget’. In this chapter, however, we are not going to talk about personal budgets or household budgets but about the sort of institutional budgeting typically undertaken by organizations. While the term ‘institution’ can cover all types of organizations – for-profit businesses of all sizes, government at all levels and the non-profit sector – we are focusing on the non-profit sector. Within that sector, we are looking at entities which raise funds from the general public and from the government, or are part of a larger organization which does the same. These larger institutions may well have substantial sources of earned income as well; e.g. tuition, fees, rent, royalties etc., but they would not exist without raising and/or receiving funds in the form of grants and contributions from outside sources. Within the US and other countries, there will be regulations and laws governing the structure and activities of such entities. We will not delve into the regimes of legal oversight that operate in specific countries but will confine our discussion to entities that could exist in any environment where funded non-profit institutions operate.

The intended audience for this chapter consists of research centre directors, programme managers, project managers, department heads and finance officers. It is intended to explain
and clarify the budget process and to emphasize the interrelationships between programme and administrative costs and funding requirements in the context of a total institutional or university budget. Another objective is to show how the institutional budget represents an aggregation of information from the various programmes and projects which encompass the institution’s work. I also want to make clear the importance, for budget purposes, of isolating and budgeting for only those activities which can be accomplished and funded within the fiscal year.

I have worked as an accountant in the non-profit sector for over four decades. After completing the work experience in an accredited accountancy firm required for professional certification, I received my license to practise as a Certified Public Accountant (CPA). Shortly thereafter I proceeded to head the finance unit of a community development organization which ran programmes in economic development, affordable housing, community organizing, and arts and culture. Later I became the treasurer and director of financial services of a multibillion dollar international foundation which made over $100 million annually in grants to hundreds of organizations in the US and the developing world. For the last twenty years I have run my own consulting practice where I have assisted more than 100 organizations on financial and management issues. These organizations have been involved in civil and human rights, policy and advocacy, arts and arts services, capacity building, and endowment planning. One thing that has continually concerned me is the lack of organizational capacity and knowledge in the financial area in many institutions, even those with sizeable budgets and the resources to keep their financial affairs in order. This chapter is intended to be a small contribution to making non-profit entities more financially aware of the issues involved in transparent, realistic and flexible budgeting. I have often said, in total seriousness, that ‘financial management is too important to be left to accountants’. We are all budget officers and managers.

**BUDGETING FOR FUNDED PROGRAMMES AND PROJECTS**
Programmes are generally funded either primarily or in whole through grants. The primary source of grants is the private foundation community; although programme grants from corporations or individuals are not unusual. Many organizations also receive grants from the various levels of government. In this chapter, we are not going to discuss government grants due to the complexity of the subject. Suffice it to say that government grants require much more administrative and accounting support, as well as management oversight. Programme/project managers should be aware of government compliance requirements and implications. The compliance requirements, explicit and implicit, in government funding, may even require additional staff to assure that grant funds are being properly accounted for, managed and monitored. Although government grants can provide substantial support, organizations need to clearly understand what is required before basing their programme funding structure on this method of support. Government grants also require additional audit costs. Outside the US, the picture is similar. European Union funding, for example, comes with particularly detailed reporting and audit requirements, although some national government agencies may behave more like private foundations. The principles set out here should, however, be sufficiently generic to adapt to the circumstances in which a research leader is working.

We are going to assume that the institution has a business development/fund raising unit and that there are ongoing relationships with foundation or other funders who are generally supportive of the institution’s mission. And to further the process, as an example, we will assume that initial conversations have taken place about possible support for a research programme examining initiatives that have attempted to improve the academic progress of ‘at risk’ teenagers.

Here are the working assumptions for this funding request:
1. The fiscal year begins on 1 October and ends on 30 September.

2. The funder has not previously supported programmes on this specific topic but has a record of interest and substantive work in the educational area.

3. The foundation submits proposals quarterly to its Board for approval, in March, June, September and December.

4. To be placed on the Board agenda, proposals have to be vetted in full a month in advance of its Board meeting.

5. To be sure that enough time is allowed for review, the foundation requests that funding proposals be submitted three months in advance of the next Board meeting.

6. Work on this proposal should begin around 1 February. The budgeting process should begin at the same time as the proposal outline.

7. Preliminary discussions with this foundation have been positive and a programme vice president at the foundation has requested that a proposal be submitted.

The programme/department unit will have primary responsibility for preparing the budget, however, it will work closely with the finance unit in this effort. I will discuss later how programme and project budgets fit into the overall institutional budget.

All non-administrative activities of any non-profit entity are generally described as programmes. An institute or department should not have a myriad of major programme areas. It can have as few as one programme: while there is no maximum number, somewhere around five or six programmes would seem to be the upper limit. More than that number might be an indication that the entity is not properly structured to manage its activities or is trying to do too much or is too fragmented to carry out its mission. A programme defines a major line of activity while a project represents one of the strategic efforts undertaken to carry out the objectives of the programme. As noted above, programmes are generally funded through grants, although these may be supplemented by funds from an organization’s endowments or basic operating
budget. In the UK, for example, most universities receive a degree of block funding from
government that can be used at the institution’s discretion to complement external grants. A
programme would likely have more than one project. Projects fall within programme budgets.
They are generally shorter in duration than the life span of the programme.

In this section, I will discuss how to develop a project budget for a grant proposal – the
factors to be considered, how to have sufficient funds to accomplish the project’s objectives
(short-changing the project can lead to failure), providing for contingencies, and recovering
sufficient overhead to support the parent organization’s administrative cost recovery target.

**BUDGET COMPONENTS**

A budget is usually broken down into the following components:

1. Direct costs (all programme related expenses)
   a. Personnel
      a) Salaries
      b) Payroll taxes and benefits
   b. Other than personnel costs (OTPS)
   c. Contingency

2. Indirect costs

3. Other funding sources

4. Funding requested

I will discuss these sections individually.

**Personnel**
This section should include all staff positions that will be involved in the project. Some personnel will spend 100 per cent of their time on the project and some will have part-time involvement. For part-time involvement, a reasonable estimate of their anticipated time commitment is acceptable. Caution should be taken so as not to overstate or understate the time allocation, since time recording systems may be cross referenced to budget reports by auditors. Material discrepancies in time allocations could result in disallowed project costs. The time involvement of senior management should also be included if they are to be directly involved in the project. This would be especially true if, for example, a senior manager had professional expertise in the type of research to be undertaken.

In calculating personnel costs, the following expense categories are included – salaries, payroll taxes (usually government mandated health and welfare assessments), benefits (health insurance, life insurance, long term disability insurance, pension) are all included. Details on these costs should be obtained from the Finance unit and/or Human Resources unit of the parent institution.

Personnel costs would also include consultants/independent contractors who will work on the project. Consultants frequently provide key technical expertise, evaluative skills and specific knowledge in a particular field that is beyond that of programme staff. If the consultants have been identified at this stage of the process, an estimate of their time involvement and fees can easily be obtained. On the other hand, if the consultants have yet to be selected, the programme unit should survey others with the requisite credentials as to rates and the time commitment. The consultant category should also include all reimbursable expenses which may be incurred by the consultant.

Sometimes, a programme utilizes other entities outside the home institution – universities or research organizations in the home country or overseas – to carry out major portions of the
programme work. In that case, a more complex negotiation with the university may be required. Please note that universities normally have relatively high indirect cost (overhead) reimbursement rates. These rates are seldom negotiable and should be clearly understood before entering into a subcontract relationship.

Other than personnel costs (OTPS)

This category is also referred to as Other Direct Costs. It aggregates every cost category that is not related to personnel. Although it would seem to encompass anything imaginable, it can generally be broken down into a manageable number of generic categories – far fewer than would be found in an accounting system’s chart of accounts. The following list may not be all-inclusive but it should cover virtually all of the types of costs which are associated with a typical research project:

1. Travel – includes local and out of town travel, meals and lodging en route and incidental expenses, such as tips, while conducting fieldwork or representing the programme at conferences;
2. Supplies – office supplies, postage, printing, reproduction;
3. Communications – allocated cost of central telephone system, cell phone, fax, internet;
4. Meetings and conferences – events organized by the programme team to promote their work may need to cover facilities rental, honoraria, materials, equipment costs, facilitators, transportation, visas;
5. Website and IT enhancements – dedicated web applications, IT support;
6. Publications – editing, writing, printing, graphics, fulfilment;
7. Business meals or other hospitality – directly related to project;
8. Evaluation costs – also may be included with consulting costs if not contracted to an entity.
Travel, publication and evaluation costs should be developed by the programme unit based on the specific design of the programme. The other direct cost categories (#2, #5 & #7) should be developed with the participation of the finance unit which can look at similar proposals for similar activities to come up with a reasonable estimate or allocation amount. Given that these categories are more generic than those used for accounting purposes, it is important for the finance and programme units to understand how these generic categories will be mapped to the chart of accounts for internal reporting purposes.

If the project has been in existence for some time, use recent project data as a starting point or reference point for developing the budget. If the project is likely to extend into future periods, certain cost categories may become benchmarks for future budget proposals. Therefore, one must be particularly careful in reviewing the eligibility of the various cost categories for inclusion under the funder’s rules or policies – and at what amounts and under what assumptions – so as not to prejudice future submissions. This is particularly true with regard to allocated personnel and support costs and indirect overhead.

**Contingency**

All projects have unexpected cost items or costs in excess of the budgeted amounts. To provide for those situations, an amount (5%–10%) of the total direct costs should be set aside as an unspecified contingency, if the funder’s rules allow this. The contingency category can then be used to supplement other project line items when required. Some funders do not permit a formal contingency line in the budget but will normally allow some virement, which means that underspends in one line of direct costs can be used to make up for overspends in another line. If this is the case, you should be particularly careful to ensure that each line starts out with the maximum sum that can reasonably be requested so that there is effective contingency provision within the overall budget for direct costs. It may be possible to persuade your institution to
allow you to transfer some money from indirect costs if you are desperate but this will probably
damage your credibility with your finance unit. (It is very rare that funders will allow money
to be transferred from direct to indirect costs so there is always a challenge to ensure that the
direct costs budget is fully spent by the end of the programme.)

Indirect costs

As discussed previously, one of the ways in which the institution funds its own operating costs
is through the indirect cost recovery (IDC) mechanism. These operating costs include the
salaries of administrative staff and the provision of libraries, buildings, utilities, IT
infrastructure and other facilities. Foundation funders generally allow grantees to use a certain
percentage of the grant proceeds to fund indirect costs/overhead. This percentage is calculated
from the base of the total requested for direct costs. For example, if direct costs in the grant
proposal budget total $800K, the funder might allow 15 per cent or $120K to be added on as
an IDC recovery, bringing the total proposal budget to $920K. This approach seems
straightforward, but unfortunately it is not the way the process works in reality. There are two
reasons why this is not so. First, foundation funders are not at all consistent in the allowable
indirect cost percentage. This may be as low as 5 per cent and as high as 25 per cent in the US
context. Within any given foundation, each grant making unit may have differing practices as
to IDC rates. There is usually a little room for negotiation with funders about the rate, and
programme units should be aware that they should not acquiesce to an inadequate IDC without
making a case for one that meets your true indirect cost rate. In other contexts, funders’ IDC
rates may be relatively fixed and non-negotiable: most UK government agencies, for example,
pay 80 per cent of the full economic costs (fEC) to the institution, which is similar to an IDC.

Secondly, and of equal importance, the IDC recovery is frequently a significant ‘revenue’
source for funding the institution’s overall operating budget. So there is a major institutional
stake in maximizing IDC recovery from programme/project grants. Organizations should set a ‘target’ IDC recovery rate and programme staff should adhere to the rate in constructing proposal budgets. This rate will often be set higher for research funded by industrial or commercial partners. It is incumbent on programme managers to understand that they have a dual responsibility in negotiating grant funding: to secure funding both to further the programmatic mission of the institution and to contribute sufficient IDC to sustain a major portion of the operating budget.

Having said that, a policy of maximizing the IDC rate will not in any way assure that foundations will be accepting of it. Therefore, proposal budget preparers often will try a second approach to increase the size of the grant. This approach makes the case for including certain admin costs as direct costs of the grant by placing those costs ‘above the line’. Examples of ‘above the line’ funding are website and IT enhancements, dedicated accounting staff positions, grant administration and allocations of space costs and office support. However there needs to be an inherent logic in including these items as direct project costs. It is apparent that arguments can be made that some operating costs could be considered to be either indirect costs or ‘above the line’ direct programme costs. It is the job of the proposal budget preparer to make the best case (aided by the finance unit), using either the IDC rate or the ‘above the line’ approach, for including specific operating costs in the proposal budget. Although making the case for a fair IDC is technical in nature, the most successful projects exhibit a fair degree of creativity in the process. Knowing the funder’s rules and policies can be crucial to this: it is not uncommon for funders that resist higher but unspecific IDC rates to be more generous towards ‘above the line’ claims.

Finally, in wrapping up this discussion of IDC recovery, one has to look at the subject from the funder’s viewpoint. When a foundation invites a potential grantee to submit a proposal, it
will have a ‘ballpark’ amount that it is willing to fund. This is based on the foundation’s
programme priorities and its own budget constraints. It should be noted that foundation budgets
are a derivative of investment performance, economic conditions and its own allocation of
resources between grant making and admin costs.

So, in our example of a $920K grant, consisting of $800K of direct programme costs and
$120,000 of IDC (at 15 per cent), it may well be that the foundation has internally set a
budgeted amount of $900K for this proposal. This would reduce the IDC recovery to $100K
and 12.5 per cent. If this were the case, then we will be faced with the choice of reducing direct
costs in support of programme activities by $20K or accepting the lower IDC recovery. If the
choice is to accept the lower IDC rate, then senior management, either you as research director
or someone in the larger institution, will be forced to come up with the additional $20K from
other revenue sources.

Senior institutional management must explicitly state and enforce the organization’s policy
in this area. IDC funds are not under the control of programme or finance. I have seen
organizations where the Chief Financial Officer totally controls the use of IDC funds. And I
have seen instances where programme managers agree to disturbingly low IDC rates so as to
maximize programme funds available in grants. The IDC policy requires ‘buy in’ at all levels
of the organization. Conversely, some institutions may claim a percentage of the grant for IDC
recovery, even beyond the percentage allowed by the funding source.

Other funding sources

On occasion programmes have independent revenue sources, not related to grants. Some
possibilities are publication sales, royalties, consultancies, memberships and service fees.
These sources would be includable in project budgets if relevant to the project.
Funding requested

Not all grant proposals require 100 per cent funding. Two possibilities come to mind.

The organization may choose to ‘match’ some of the foundation funding itself. For example, it may decide to match 10 per cent of the proposal budget by underwriting the required website enhancements. This situation should be clearly noted in the budget if applicable. On the other hand, some funders, particularly government funders, may require that the grantee absorb some of the project cost itself. This process is known as ‘cost sharing’. It is increasingly asked for by funders: possibly to signify institutional commitment to the project and/or to spread the funder’s grant budget further. Be creative in thinking about this. For example, if the funder is not going to provide the full IDC rate you require, you may be able to claim what is not being provided as ‘cost sharing’ from your side. Or, if senior management oversee the work of the proposal but are not directly charged to the grant, a portion of their salary may be considered ‘cost sharing’.

PROPOSAL PREPARATION TIPS

These are some tips to be considered when reviewing proposal drafts

1. Make sure all costs are covered in the proposed budget. For example: If you are planning a meeting, have you budgeted for airfares, taxis, hotels, meals, catered meals, considering the most current rates available for the meeting location?

2. Have you included ‘other administrative costs’ such as telephone, mailings, printing, postage, etc. that are associated with the project?

3. Have you included all levels and types of staff time associated with the project? If this is a multi-year grant, it should include an estimate for a cost of living increase – your finance unit is likely to have a standard figure for this.
4. Have you included payroll taxes and benefits on the salaries? There should be a budgeted percentage for benefits such as contributions to insurance or pension schemes.

5. Are all overhead costs budgeted above and below the direct costs line?

6. Have all research and research related costs been included?

Common mistakes:

1. Not including benefits as mentioned above.

2. Not understanding how to calculate the indirect cost amount. To figure out 20 per cent on a $200,000 grant, you need to divide the $200,000/1.20. This can be very confusing to less experienced project managers.

3. Not including anything for administrative costs and contingency, where contingency is allowed.

4. Not budgeting enough staff time on the project.

5. Basic arithmetic errors.

6. Inconsistencies between the proposal narrative and the proposal budget.

7. Budget categories not translatable to the chart of accounts.

A credible, well-prepared and realistically justified budget is often as important as the scientific quality of a proposal in determining its fate with a funder. The idea may get you over a threshold of review but the funder will be looking at the budget proposal to see if you can be trusted with their money. One of the commonest mistakes made by less experienced research leaders is not to ask for enough to do the job that they are proposing: if you say you can fly to the moon for a nickel, your credibility is immediately shot to pieces. If the funder likes your idea, they will pay a realistic price for the work. If they will not pay a realistic price, the project is probably not worth doing because you will not be able to deliver a quality product – and
poor-quality research is both an abuse of the goodwill of everyone who has taken part in it and likely to damage your reputation and that of your team.

**PROPOSAL TRACKING**

If we assume that all the parties would like a decision to be made at the foundation’s June Board meeting, the proposal will need to be ready for submission by mid-March. The programme team and the institution should work back from that in timing the preparation of the proposal budget and the proposal narrative, which can be done simultaneously. The funder is also likely to require other documentation, such as CVs in a prescribed form for key personnel or evidence of the institution’s compliance with wider policies. European Union funding, for example, often requires a statement about the institution’s practices for promoting the participation of women in scientific careers. These extra documents should be taken seriously because they are treated as evidence of the overall administrative competence of a research team and the institution where they work and may well serve as ‘tie-breakers’ when the funder is considering what to do with proposals of equal scientific merit.

During the three month period in which the proposal will be under review, it is important for your organization to continue to track the proposal’s progress through the foundation vetting process. This is not overkill. Any internal delay at the foundation, whether due to absence of key staff in the approval process or unplanned-for occurrences requiring a shifting of day-to-day priorities or real issues raised during the vetting process, it is incumbent on your programme staff to continuously check in on the progress of the proposal. A good rule of thumb would be to check in every two to three weeks. Programme managers should know the status of their proposals at all times.

This monitoring is important for several reasons. Obviously, the importance of winning approval of funding for an important initiative is paramount to the organization. But budgetary
reasons are extremely important as well. If the grant is not approved, or is approved for a significantly lower amount, or is delayed for more than a few months, there will be an impact on the next fiscal year’s budget. The overall scope of work, in effect the size of the institution’s programme, will be diminished. Secondly, the amount of IDC recovery will be less than needed to fund operating costs, thereby placing pressure on senior management to make cuts in that area. Finally, the proposal budget will have included the personnel costs of several programme staff members for the new fiscal year. These positions will now be unfunded and will force serious discussion about whether and how to fund these positions until foundation support is assured. In other words, programme and institutional momentum will have been slowed and the next fiscal year’s budget will now have ‘holes’ in it.

**BUDGET MONITORING**

Although the finance unit is charged with the task of monitoring all programme/project budgets as well as the institution’s budget, it is a primary responsibility of programme/project managers to closely monitor activity in their grants on a regular basis – quarterly (or monthly if required). The finance unit must have accounting software that tracks expenses by programme, funding source, grant and account category. Anything less will most likely be inadequate for the task. Although accounting software can be fairly expensive, in organizations that have a less complex programme environment, relatively inexpensive software such as *QuickBooks*, can do the job, assuming that the chart of accounts is well designed and structured to meet budget reporting as well as accounting needs. Programme/Project managers should avoid trying to track budget charges by using spreadsheets independent of the official accounting reports. Dual ‘systems’ lead to time-consuming reconciliations and loss of credibility in both approaches. I have experienced the credibility issue at billion dollar universities and at the smallest community organizations. It is the responsibility of the finance unit to work closely with programme staff at all levels to provide timely, accurate and user-friendly information.
Unfortunately, many institutional accounting systems are designed primarily to supply information to the finance unit rather than to support local managers, which creates a temptation to develop a ‘shadow’ set of accounts. It can be helpful as well to institute a way of tracking commitments, the intent to reserve funds to be spent in a certain way, so that programme staff do not inadvertently spend the same funds twice.

Assuming adequate accounting software, programme/project managers should receive a budget status report by mid-month of the following month. This report should show actual grant related expenses for the current month, and cumulatively for the current fiscal year and for the total grant. These expense totals should ‘roll up’ into the categories of the proposal budget and should be compared to the budget. Variances between actual expenses and the budget should also be shown. Ideally, the reports will be available online as well as in hard copy form for programme managers. If online access is available, there should be a ‘drill down’ function available so that programme managers can access the actual transactions supporting the current month’s activity. In addition to providing a more in-depth understanding of charges against the grant, drill down scrutiny can help to identify miscodings or misunderstandings between the finance and programme units. It should be noted that not all charges against a grant will emanate from the programme unit. Most personnel related costs and allocated expenses will be initiated by the finance unit based on the original approved grant budget and organization-wide methodology. Salaries, taxes, benefits, office and communications allocations and the indirect overhead charge will be initiated by finance while all other direct charges will be initiated by the programme unit.

Although it is best that programme/project managers review budget vs actual data monthly, keeping in mind that the most recent expenses will not yet have ‘hit’ the accounts, we strongly recommend that there be a quarterly budget vs actual review jointly by programme and finance.
The finance unit has the primary responsibility of alerting programme management at any time of a potential, or actual, over-budget condition with a grant. Depending on the materiality of the overspend, senior management may also be brought into the discussion.

Virtually all funders will require a budget vs actual report during the life of the grant.

This report may be quarterly (rare), annually (common) or only at the end of the grant as part of the final report. Reports to funders are a joint effort between finance and programme. Official accounting data is used, after any adjustments have been reflected. Programme/project managers must explain any significant variances in cost categories in comparison to the approved budget.

If, during the life cycle of the grant, there is a shift in the context or objective of the project, the budget may need to be revised by reallocating expenses within the various cost categories. Significant modifications usually must be approved by the funder. Such modification requests are accompanied by a narrative outlining the reason for a change in budgeted cost categories. Again, modifications are a joint effort between programme and finance. The circumstances under which modification approval is needed, and the process for applying for a modification, should be described in the grant award letter or contract. For example, many funders allow a modest amount, perhaps 10 per cent, to be shifted among categories without requesting a modification, while others do not.

Budget monitoring is a continuous responsibility of programme/project managers. There should be a continuous consciousness as to budget vs actual status. Managers should set up internal benchmarks or limits as to when to do a top to bottom review of the project. For example, if a project is running 5–10 per cent over budget, the manager may decide that is beyond his/her risk tolerance level and conduct an in-depth review of actual and projected costs. This would occur whenever that limit was present.
MULTI-FUNDED PROGRAMMES AND PROJECTS

Not all programmes/projects are totally funded from one source. Some have more than one foundation funder and some programmes are not fully funded by external funds. In those instances, internal resources must be tapped to complete funding of the programme. Those internal resources must be identified and be available in the organizational budget. The following is an example of a multi-funded programme:

<table>
<thead>
<tr>
<th>Project budget</th>
<th>$900K</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foundation A</td>
<td>300K</td>
</tr>
<tr>
<td>Foundation B</td>
<td>400K</td>
</tr>
<tr>
<td>Foundation C</td>
<td>100K</td>
</tr>
</tbody>
</table>

Total external funds $800K

Shortfall 100K

Internal funding $100K

A project with three external funding sources will require somewhat more complex accounting but, assuming that the three external funders are funding all budget categories proportionally, the task is easily manageable. Reports to the funders will show all funds expended as well as each funder’s contribution to the budget. The proposal budget should break out each funder’s proposed contribution to the overall budget as well as the organization’s internal match of the shortfall. It is worth noting that for programmes with multiple funders, intensive coordination at all levels is required.
If the funders are not supporting the project cost categories proportionally, the accounting reports will have to be manipulated to address that requirement. We recommend that detailed discussions take place before the inception of the programme so that finance and programme completely understand the particular requirements of each funding source.

AUDITS

Virtually all grant approval letters from funders assert the funder’s right to conduct an audit of the utilization of grant funds. However, such audits are uncommon. They arise in one of two circumstances. Some funders, as a matter of policy, audit a representative sample of their grants on a cyclical basis. The other circumstance in which an audit might be undertaken would be a serious funder concern about the use or misuse of the grant funds. Funders may use an independent CPA firm to carry out the audit or, in larger foundations, there may be internal audit staff available to conduct external grantee audits. A funder’s audit will look in great detail at transaction documentation and approvals as well as compliance with all grant conditions. The audit process will allow the grantee organization to review a draft of the audit findings and respond to inaccuracies or unsubstantiated conclusions before the audit is finalized.

The annual organizational audit, normally performed by an external firm, will examine grants accounting, compliance and reporting on a test basis and will also review grant administration files and specific documentation for the grants selected for review. Deficiencies in the internal administration of grants may be noted by the auditors in the Auditor’s Letter of Management Recommendations prepared for the Board of Directors or its equivalent. Universities may also have an internal audit function that provides a further check on the compliance of both finance and programme units with internal and external policies and rules.

ORGANIZATIONAL BUDGETING
Context

Budget preparation is an organizational responsibility. A major fallacy that I have encountered is that the organizational budget is solely or primarily a responsibility for the finance unit. It is most definitely not. Although budgeting is a finance related function, it is not a task solely performed by the Controller or Chief Financial Officer. It is a direct responsibility of senior management, led by the President/CEO/Executive Director who directs a team, which includes the Chief Financial Officer, in drafting a budget to be presented to the Board for review and approval. The finance unit should be the group responsible, under the direction of the Chief Financial Officer, for coordinating and assembling the budget materials. This would include setting a budget timetable, providing sufficient information to units to prepare their budget submissions and reviewing the budget for mathematical accuracy and reasonableness. Finance would also prepare charts and tables and, possibly, draft the narrative or talking points to accompany the budget.

Institutional budgets

The institutional budget encompasses the total amount of revenues (from all sources) and expenses to be aggregated over a defined period of time (usually a year). The year can be the calendar year or a fiscal year, which can begin and end on any month during the calendar year. Fiscal years must be of twelve months’ duration. In preparing organizational budgets, care must be taken to include all activities, funded and unfunded, revenue generating or cost incurring, and all associated costs, both direct and indirect.

Particular care must be taken with regard to those revenues from grants which are restricted for specific projects and for time period(s) that may not coincide with the organization’s fiscal year. For those grants, only the activities anticipated to be undertaken during the fiscal year and the revenues available to fund those activities during the fiscal year can be included in the
Organizational budget. The balance of grant funds which will be spent in future fiscal periods are ‘carried forward’ to the next fiscal year and become components of the succeeding year’s organizational budget. Conversely, funds from grants awarded in a prior fiscal period but available for project activities in the current fiscal year, are included in the current fiscal year’s budget and are categorized as funds ‘carried forward’ from the prior fiscal year.

Organizations that mix restricted and unrestricted grant funds at the summary level may, unintentionally or not, leave the impression that the budget is in better shape than it is. For example, a deficit in unrestricted funds of $500K cannot be covered or offset by a surplus in restricted funds of the same amount. In this case, the budget is out of balance by $500K and the $500K ‘surplus’ in restricted funds is not really a surplus, but funding which must be carried forward to fund restricted programme activities in a subsequent period. This casualness with funds can seriously undermine relationships with key funders, the public, individual donors and can even threaten the overall survivability of the organization.

For the organizational budget, the revenue equation can be expressed as follows:

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\text{Fiscal year revenues} = (\text{Funds anticipated to be raised and/or earned in the current fiscal year} + \text{Funds carried forward from the prior fiscal year}) - \text{Funds carried forward to future fiscal periods}
\]

The institution needs to add together the income that it expects to receive in the current financial year and income that has been received but not spent in the previous financial year. It then subtracts money that will need to be spent in the future. The result of this calculation describes the institution’s current financial position.

**Administrative Budgets**
The second type of budget is known by several names: *administrative, operational or operating budget, overhead budget,* and *indirect cost budget.* These terms are used somewhat interchangeably. There is no particular preference – thus far we have mostly described it as the operating budget, but in this discussion we will use the term *admin budget.* It is critical for Department and Institute heads, Presidents, and Board members to understand the admin budget. Simply put, the admin budget includes all costs which are not directly attributable to programme activities. These costs include the following functional areas of the organization: the Board, Finance, Office Operations, Legal, Informational Technology, Human Resources, Investment Management, Fund Raising and the Executive Office. It can also include Programme Management costs to the extent that these costs are not expected to be funded by programme or project grants. For example, the compensation of a programme vice-president who manages a cluster of programme activities and whose compensation or a percentage of that compensation is not covered by grants should be included in the admin budget. The total admin budget should be viewed separately from the organization budget (of which it is a component) since it requires a variety of funding mechanisms to fund it in full for the year.

The admin budget should answer the following question: ‘what does it cost to run this organization for a year and at what levels of staffing, before considering any revenue streams which may or may not partially fund these costs?’ The admin budget is the specific responsibility on an annual basis of the Board and senior management. In my experience, I have found that this concept is not well understood by many organizations. The various methods of funding overhead are frequently interjected in the discussion without approving or questioning the gross amount of admin costs that are required to be funded.
In the budget process, once the total admin costs have been validated, the next step is to determine how that amount can be funded. The following are the primary sources of funding admin costs:

1. Indirect cost recovery from programme grants;
2. General support grants;
3. Direct charges of certain admin costs to programme grants;
4. Tuition;
5. Service or programme fees and rental income;
6. Merchandise sales, memberships, publications etc.;
7. Investment income (interest and dividends);
8. Endowment support;
9. Bequests and planned giving;
10. Individual donors;
11. Internet fund raising;
12. Year-end appeals;
13. Fund raising events;
14. Corporate sponsorships.

It should be noted that not all of these sources are available to all institutions, but all should be considered in any discussion of funding overhead both in the short term – the current year’s budget – or in the longer term – 3 to 5 years.

Earlier, we talked about the first revenue source, indirect cost recovery, in the context of programme/project grants. We also discussed how to fund overhead by directly charging some
admin expenses to projects. This type of funding is sometimes referred to as ‘soft money’. Needless to say, the challenge of funding admin costs/overhead is extraordinarily important to the financial well-being of any institution and requires many approaches and strategies to be successful.

**PROGRAMME BUDGETS**

As stated earlier, the programme budget is the aggregate of all programme activities (funded externally or internally) that the organization expects to undertake in the upcoming budget year. For the moment, let us focus on externally funded direct programme activities, as these are the activities which are funded from approved grant budgets. This is not as easy as it may seem. For one-year grants contemporaneous with the organization’s fiscal year, programme activities will equal the total direct costs in the approved proposal. However, where grants cover more than one year, or have a grant year that differs from the organization’s fiscal year, programme directors, in consultation with the finance unit, will have to calculate how much of the grant’s funds will be expended during the upcoming fiscal year.

After the total programme activities amount has been calculated, it is then looked at in the context of the total organization budget. Let us look at an example with the following hypotheticals:

[TS: Insert table 7.1 here - please note that it doesn’t need a caption or number - just set as very simple 2 x 4 table to single column width]

In assessing the situation at this point in the budget process, we see a gap in admin funding of $500K: $2 million – ($10 million × 15) = $500K.

Additionally, there is a shortfall in programme revenues of $500K. So at this point in the process, there is a budget ‘problem’ of $1 million. Before looking at other possible sources of
funding admin costs, let us look at the total programme volume. This poses the following question: what level of programme activities would be required to fully cover admin costs, assuming an IDC rate of 15 per cent? Doing the calculation ($2 million/15 per cent = $13.333 million) would mean increasing the programme budget by one third. This would appear to be difficult, at least in the short run, because new and/or expanded programmes could not be designed and funded in the few months before the next fiscal year, and would be questionable in the long run. It is questionable because it is not a given that admin infrastructure could sustain a one third increase in programme volume without an increase in costs. In simple terms, would additional non-programme staff have to be hired? Would additional burden be placed on space costs, IT support, etc.? However, it may be possible to increase some ongoing programme funding for the second half of the year. Let’s assume $500K of additional funding, thereby reducing the deficit by $75K ($500K × 15 per cent) to $925K.

The next step would be to scale back the unfunded programme costs through discussions with the programme units. Possibly, this amount could be cut to $250K. This may mean the elimination of some components of existing programmes, reducing pilot initiatives and even reducing the size of programme staff and consultants. So we now have a reduced budget problem of $675K. What to do????

At this stage we would need to look carefully at all of the potential non-programme sources of revenue. These twelve sources can be categorized as earned, e.g. rental income, programme service fees, interest and dividends etc. and unearned, e.g. general support grants, fund raising events, annual appeals etc. to see if it is reasonable to go forward on the assumption that $675K or 6.75 per cent of the proposed budget can be generated to close the gap. At this stage, senior management must also determine whether or not to present a budget to the Board for approval with a gap of $675K. If it does, this amount should be clearly captioned as ‘other revenue to
be identified’. The budgets presented to the Board should be accompanied by a brief narrative identifying the major budget assumptions, comparisons with the current year’s budget and actual expenses to date, specifics on how to raise the $675K needed to fully fund the budget and finally, a fall back or contingency plan to further cut the expense side of the budget if, during the year, it becomes apparent that the gap is not going to be fully closed. It is of critical importance for there to be total transparency between management and the Board regarding the state of the budget. This is no time for hedging or evasion or overly optimistic revenue projections. Board members must clearly understand what they are approving and with what risks.

According to our timeline, with the new fiscal year beginning on 1 October, the budget should be approved by the Board in September. This will allow time for Finance staff to enter the budget details into the accounting software.

**CONCLUSION**

In this chapter, we have attempted to discuss the key budget factors of a hypothetical funded non-profit institution at the macro and micro levels. We have tried to demonstrate how an organization constructs its budget in the time frame of its annual financial cycle and the key factors in assessing the feasibility of achieving the budget objectives. We have also examined programme budgets and outlined the process of constructing a proposal budget and tracking it through the approval process and, after approval, through the life of the grant.

And we have tried to show how the macro, programme and individual project/proposal budget efforts come together in a dynamic process to produce a meaningful, realistic budget. We have also tried to demonstrate the interaction of programme, finance and senior management in the ongoing process of budgeting. The budget process, if properly administered and led, is one of the most critical tools in managing the organization, one which should unite
the organization, including the Board, in furthering the mission in a prudent way and with full knowledge of the financial strengths and weaknesses of the organization.