

---

# NONPROFIT PERSPECTIVES



---

## Does Your Board Understand Budget Speak?

Although budget approval is one of the more important roles played by a nonprofit's board of directors, not every board member is a savvy businessperson used to budget work. At least some board members might be unfamiliar with key budget terms. And there's even a greater chance that they're reluctant to admit clarification is needed.

To help your board responsibly discharge their budget-related duties, make sure that, at a minimum, they understand the following terminology and concepts.

### Budget types and approaches

Part of a board member's confusion about budget terms may stem from the reality that different organizations use different approaches to budgeting, as well as different types of budgets. A single nonprofit, for example, may employ more than one kind of budget. The following definitions should help board members better grasp what they're considering when handed a "budget."

**Accrual basis.** In contrast to cash basis (defined below), accrual basis matches income and its related expenses in the same accounting period. That means income is recorded when earned, contributions are recorded when pledged, and expenses are recorded when incurred, regardless of when the products or services are actually received or paid. Accrual basis accounting is required by Generally Accepted Accounting Principles (GAAP).

**Capital budget.** A capital budget is a decision-making tool used by an organization when it's considering the cost and timing of significant and potentially long-term projects, such as a building purchase. Many not-for-profits prepare a capital budget each fiscal year, prioritizing purchases of capital expenditures for the coming year.

**Cash basis.** A nonprofit using cash basis doesn't record income until the cash is received or expenses until they're paid. Most nonprofits need to draft a cash budget whether or not their accounting is on the accrual basis. The cash budget also may include use of restricted funds when the funds are spent for the intended purpose. Some smaller organizations budget and keep their books only on the cash basis.

---



## Does Your Board Understand Budget Speak? Cont.

**Income-based budget.** This budget is built from realistic projections of reliable income for the budgetary period. Expenses must come in under the income projection.

**Incremental budget.** An incremental budget begins with the prior budget's detail and builds the budget by computing percentage increases or reductions to each line item. Existing programs and departments are treated as preapproved.

**Zero-based budget.** In contrast to an incremental budget, a zero-based budget assumes that no existing program will necessarily be continued and no money will necessarily be spent. It facilitates comprehensive evaluation of every revenue and expense component.

### Budgetary terms

Your board members also must understand common terminology in not-for-profit budgets, including the following:

**Capital expenditures.** Organizations make capital expenditures to acquire or improve long-term assets such as property, vehicles or equipment. They're expensed over time through depreciation, rather than immediately.

**Depreciation.** The cost of a capital expenditure is spread (or "amortized") across the asset's useful life through depreciation expense, matching the use of the asset to each accounting period and increasing the odds of having the necessary cash on hand to replace the capital asset at the end of its life.

**Direct costs.** Direct costs are incurred for a specific program or project. Examples include supplies for a community outreach program or food costs for a senior meals program.

**Fixed costs.** Those costs that don't change based on the number of projects, clients or other variables a nonprofit experiences are referred to as "fixed costs." They're incurred regardless of the level of activity or services. Fixed costs include permanent administrative staff, rent, and licensing or reaccreditation.

**Indirect costs.** Also known as "overhead" or the "common cost pool," these costs don't relate solely and specifically to an identifiable program or project, but are necessary to its completion. They may include rent, postage, utilities, Internet, and accounting and legal fees. Indirect costs have gained attention since the Office of Management and Budget changed its Uniform Guidance to provide for reimbursement of reasonable indirect costs incurred under a government grant.

**Variable costs.** As the name suggests, variable costs change as the level of activity or services changes. For example, the more seniors your organization feeds, the higher the food costs will be.



## Does Your Board Understand Budget Speak? Cont.

### Knowledge is power

A realistic budget lays the foundation for a not-for-profit's ongoing financial viability. To ensure that your board members are qualified to understand and approve such budgets, get them up to speed on critical budget terms.

### Sidebar: Don't forget in-kind contributions

When defining budget terms to your board of directors, pay special attention to what are known as in-kind contributions, a phrase that's not part of everyday language for most people. In-kind contributions are noncash donations of goods and services such as office space, parking, professional services, supplies or clothing.

Although these contributions ultimately have no effect on an organization's bottom line - because they're recorded as revenue when received and as an expense when used - it's wise to document them in the budget. By doing so, you'll provide stakeholders with a better picture of what's required to perform your mission.

© 2015