THE FALSE COMFORT OF A "BALANCED BUDGET"

By Mike Batts, CPA

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*Your annual budget was voted on and approved for the new year. But what does it look like to implement your new budget? Is it going to help you both effectively advance your organization's mission and strengthen its financial health? The following excerpt from my newest book, **Nonprofit Finance: The Field Guide for Financial Operations of Ministries, Schools, and Other Public Charities**, explores the misleading term "balanced budget" and describes how nonprofit organizations can better pursue a healthy financial position.*

In order to ensure that a nonprofit has adequate financial capacity to carry out its programs, activities, and initiatives, its leaders must ensure that the organization's financial plan is sound. Sound financial management includes development and approval of a responsible operating budget. Many nonprofits operate under the belief that there is something improper about generating a positive bottom line—that is, a surplus of revenues over expenses. In fact, in many nonprofits, a desirable budget is a "balanced budget." While operating a balanced budget may seem like an admirable goal, it simply means that the nonprofit expects to incur expenses equal to its revenues. The term "balanced budget" sounds attractive because the term has a positive connotation (what's the alternative—an "*unbalanced* budget"? That doesn't sound like a good thing!). But, if the nonprofit's budget is prepared on a cash basis and the nonprofit has a "balanced budget," the nonprofit is essentially saying that it plans to spend every nickel of revenue that it brings in, with little or no room for error. An unexpected dip in revenues in an organization that follows such a practice can cause immediate financial stress for the nonprofit and its leaders. That is no way to improve a nonprofit's financial position.

A better approach to budgeting involves determining the nonprofit's desired or targeted financial position (liquidity, reserves, debt levels, and so on) and the desired timetable for achieving it. With a long-term plan for improving financial position, the nonprofit can develop operating budgets that not only provide for carrying out its mission and purpose, but also can contemplate using reasonable surpluses to contribute toward the targeted financial position.

Improving a nonprofit's liquidity and financial position requires intentional effort as an essential part of the planning and budgeting process. That effort must include planning to spend less than what the nonprofit receives in cash revenues. For a nonprofit that has been following the habit of spending all of its cash receipts annually, the transition can be challenging. If the nonprofit's revenues are growing, the nonprofit may be able to make progress in this area by slowing or stopping spending increases as revenues rise. For nonprofits whose revenues are not growing significantly, the transition will require the nonprofit to pursue additional revenue (through additional contributions from donors or from alternative revenue sources…), apply expense reductions, or apply a combination of the two.

No matter how good it *may* sound, a "balanced budget" is probably not an ideal financial operating plan. As demonstrated through this article, a nonprofit's budgeting process should be much more strategic than simply estimating revenues and expenses. As your nonprofit charts its financial future, use the budgeting process as a unique opportunity to implement and follow a strategic plan to support your mission and develop a healthy financial position.

*While the book **Nonprofit Finance: The Field Guide for Financial Operations of Ministries, Schools, and Other Public Charities** covers concepts applicable to nonprofits generally, I encourage church leaders charged with managing financial operations to refer to its "sister" book **Church Finance: The Church Leader's Guide to Financial Operations.***

