CHAPTER I: FINANCIAL MANAGEMENT

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Introduction

Budgeting is the allocation of the church's resources, in accordance with a plan, for the achievement of its objectives and goals. The church budget is one of the most effective tools available for the proper stewardship of the church's assets.

The bookkeeping and accounting system, along with the related internal controls and procedures, the budgeting process, the financial audit, and the management oversight provided by the Vestry should be viewed as a single system. No part stands alone; each supports the other. This entire system enables the Vestry to fulfill its obligation of fiduciary responsibility and proper stewardship.

Section A. Budget Methods

The most frequently used budgeting methods are Incremental; Program; and Zero-based.

<u>Incremental Budgeting</u>

Most congregations adopt incremental budgeting (sometimes called line item or traditional budgeting). Incremental budgeting uses this year's budget as the basis for next year's budget and adjusts each line item. It is an easy method to use and to understand, but problems can arise if the budgeted amounts become routine. Prior programs and costs may not be re-evaluated. The budget and programs become reliant on the past and may not incorporate new ideas.

<u>Program Budgeting</u>

Costs are identified with the specific programs (activities/ministries) being carried out by the congregation. This budget method requires the congregation to do its planning before preparing the budget. This method begins by requiring the appropriate committees and groups to identify each program it conducts along with needs and objectives of each program. Each program chair and/or staff member examines his/her own program in terms of how well it is achieving its goals. If improvements are indicated, the chair assesses the benefits to the congregation as well as the cost implications. Finally, an estimate of the resources needed to operate the program for the next year is developed. Each program chair then compiles the data into a program budget format that includes a statement on the purpose of the program, a description of the services provided, program goals and objectives, the amount of money needed, and the benefits and costs of any requested program change.

Zero-Base Budgeting

Zero-based budgeting is very time- and paperwork-intensive; it is not recommended annually but periodically (e.g., once every five years).

Each program chair and/or staff member is asked to assume the program is new and has received no funding previously. This means that program groups must take an in-depth look at their programs and how their activities are conducted.

Other Budgeting Methods

Other budget methods include:

- Scenario Budgeting – which involves the creation of multiple versions of a budget by making variations to a base (or the most likely budget). The most frequent variations are **optimistic**, **realistic (base)** and **pessimistic** scenarios. The different budget scenarios enable you to test and analyze the alternatives before adapting a final budget;
- Dynamic Budgeting – which involves revising and adopting a budget as circumstances change. This can be done periodically or constantly, though the process becomes less meaningful as the frequency of revisions increases; and
- Contingency budgeting – which allows management the flexibility of reacting to uncertainties without seeking additional approval from the board. Management may typically be allowed a certain percentage (e.g., 5%) over the adopted budget. An advantage of a contingency budget is that it may encourage managers not to exaggerate their budgets and may discourage the ‘use it or lose it’ spending mentality at year end.

Section B. Budget Process

Each year, using information provided by the finance and stewardship committees, the Vestry should establish a plan and timeline for its budget process and stewardship campaign.

Budget preparation will always involve estimates, especially estimates of income and contributions. If the congregation conducts its stewardship campaign before preparing and voting a budget, budget preparation is made easier.

Discerning the congregation's mission and ministry is the foundation of budget building and should involve all members of a parish, where possible. When many people share ideas and opinions about congregation-sponsored programs, their acceptance and support for the budget will likely be enhanced. When members of the congregation participate in the formulation of the budget, they are also more inclined to make sure that the budgeted programs are implemented and provided with necessary resources.

Following the mission discernment phase, the finance committee drafts a tentative budget to present to the Vestry, which reviews, discusses, makes changes, adopts and presents the budget to the congregation.

Effective communication and explanation of the budget require different techniques designed to address the different ways that people learn. Some people learn through pictures. For them, a graphic presentation of the budget is useful; pie charts, bar graphs and line graphs are helpful. Other people love numerical detail; a line by line presentation of the numbers along with a brief narrative description of each line could be ideal.

Any budget presentation should include amounts and sources of income, line item expenditures with narrative descriptions, a summary page or chart, a timeline of the budget process, and a roster of finance committee and Vestry members.

The budget presentation goal is to have the congregation consider and embrace the budget as its own – not the Vestry's budget or the rector's budget.

Section C. Budget Implementation and Review

If possible, the treasurer should prepare a month-by-month budget, incorporating as much information about the timing of receipts and expenditures as possible (e.g., Is income expected in 12 equal amounts or does income decline during the summer months? Are utilities payments higher during January and February than in July and August or *vice versa*?). The result of this exercise is a cash flow forecast which is used by the treasurer and finance committee (see Section E of this Chapter 1).

The approved budget should be incorporated into the monthly financial statements presented to the Vestry. Each line item should show the budgeted amount and the actual receipts or expenditures (see the example in Chapter III).

An approved budget serves as authorization to expend funds for the purposes allocated within it. Individuals or committees responsible for line items should not exceed the budgeted amount without the Vestry's approval. Adjustments during the year may be necessary due to unanticipated costs, changes in income and new programs. All modifications to the budget should be approved by and included in the Minutes of the Vestry.

The budget should be a flexible document, which reflects the sources and uses of resources in order to accomplish the mission and ministry of the congregation. Periodic reviews assure that the budget reflects current financial conditions. Any deviations from budgeted amounts should be fully understood. A budget that is consistently "on target" may indicate that programs are static (or worse, uninspiring for program directors and the program beneficiaries) and that unnecessary expenditures are being made just to conform to the budget.

Section D. Capital Budgeting

Every financial plan should include consideration of the need to acquire, replace or renovate long-lived assets. The congregation's overall plan should include a reasonable anticipation of all but the most unusual future needs. Planning for these "capital needs" is often reflected in the operating budget each year (e.g., a reserve or allowance for depreciation and replacement of plant and equipment). When capital items are budgeted through the operating budget, however, there is a tendency to plan only for the next year, rather than for longer periods of time. An alternative, though not required, is to have a separate capital budget or a restricted endowment or savings account to fund future expenditures for such items as building renovation or a balloon mortgage repayment.

Section E. Cash Management

Cash inflow and outflow rarely occur in equal amounts or during the same time period. Because no organization wants to jeopardize its reputation as a result of unpaid legitimate bills, it is critical that the organization's treasurer maintains adequate cash to facilitate bill payments in periods when cash inflow is less than outflow. Forecasts of cash flows can be made either by comparing the monthly expense budgets to the monthly cash flow estimates or by analyzing activity from prior years or quarters.

The amount of cash a treasurer plans to keep in the checking account may depend upon the following factors:

1. Timing of the cash flows, pledge payments, investment or endowment income versus expenses, monthly bills, and, more particularly, large expenditures and quarterly bills;
2. Available borrowing power of the congregation to meet emergencies; and
3. Maintenance of a good banking relationship by complying with minimum balance requirements.

Interest-bearing checking accounts make it possible for every treasurer to see that funds on deposit earn money. The treasurer should be aware of the minimum balance required, the bank's fee structure and interest rate, and whether investing monies in the same bank will be rewarded with special banking services. Good banking relationships bear fruit when the congregation is seeking a long-term loan. Banks will often work creatively with good customers to develop favorable loan packages, which might include a line of credit.

Money that will not be called upon for short-term cash flow can be invested for the long term, generally earning a higher return.

Section F. Long-Term Financing

Long-term financing may be derived from loans from individuals, financial institutions and