Risk Management, Budgeting and Forecasting

What is risk management?
- "...a discipline for dealing with uncertainty."

Budgeting + Risk Management
The Science of Mistakes (to err really is human)

- Did you know:
  - That when something goes wrong, the cause is overwhelmingly attributed to human error
    - Airplane crashes (70%)
    - Car wrecks (90%)
    - Workplace accidents (90%)
  - That our first instinct is to blame people...
  - The misattribution of blame = lost opportunity to learn and cause of repeat mistakes ("fix blame, or fix the problem")

BIASES may be responsible.

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More About Biases

- Quick-Fire Bias – confidence in “sizing up a situation”
  - Consequence: we miss critical details
- Change Bias – failure to detect changes in a scene
  - Example: continuity errors in movies.
    - www.moviemistakes.com
- Hindsight Bias – knowing how things turn out influences our memory of past events
  - “we saw it coming!”

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Built to Quit

“If you don’t find it often, you often don’t find it.”

- According to the Transportation Security Administration 650 million passengers traveled by air in the U.S. in 2004.
  - Screeners found 586 firearms. That’s one firearm per million passengers screened at security checkpoints.
  - The error rate is high. During a test in Newark in 2004 the error rate was 25%.
  - Even worse news: in 2006 screeners at O’Hare missed 60% of hidden bomb materials and explosives; at LAX screeners missed 75% of bomb materials.

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The leading cause of human error is...

You Need to Know...

• We consistently underestimate the chance of catastrophic outcomes (e.g., our worst year ever).
• We become more risk tolerant each time we dodge a disaster.
• We fail to see “near misses” as losses.

What's a Budget?

• “A budget is a planning tool that reflects an organization’s programs, mission, and strategic plan.”
  • www.nonprofitsassistancefund.org
Budgeting Basics

• A shared, strategic vision of the future is the starting point for sound budgeting.
  o Challenges, opportunities, strengths and weakness

• The budget should illustrate how resources will be spent to accomplish the vision.

Budgeting Basics

• Getting on the same page is essential:
  ▪ Program delivery goals
  ▪ The nonprofit’s financial goals (e.g., building a reserve fund, increasing funds in an endowment, operating key programs on a break even basis, etc.)

Budgeting Basics

• Before moving on to NEXT YEAR, how did we do this year and WHY?
  ▪ Have we forecasted to year-end?
  ▪ Do we understand our budget variances?
Budgeting Basics

• How comfortable are we with the "unknown"?

More Budgeting Basics

• An inclusive annual budgeting process is:
  o essential to good organizational planning
  o helps the organization monitor results
  o a work in progress


• Staff (and volunteers) with revenue generation/spending authority participate
• Benefits:
  ▪ First step in holding personnel accountable
  ▪ Participation leads to appreciation of overall financial plans and constraints
Inclusive Budgeting Process: The Board’s Role

- Consider involving the Board at two stages:
  - 1st stage – to approve the overall parameters for the budget
  - 2nd stage – to review and approve the budget

Start the Process Early

- Starting early:
  - Enables meaningful input – allow time for each step – including review and discussion!
  - Ensures adoption BEFORE beginning of the fiscal year

“Typically the budgeting process should begin at least three months before the end of the fiscal year to ensure the budget is approved by the board of directors before the start of the new year.”

Ensure Accurate Forecasting

- Budget forecasts for next year should be based on:
  - Historical results
  - Anticipated changes in the organization’s environment, activities and strategies
Elements of Sound Budget Forecasting

- "Sound" forecasts reflect:
  - A shared understanding of assumptions;
  - A shared view of what constitutes acceptable uncertainty; and
  - Corresponding action plans that bring the forecasts to life.

Forecasting Income Continuum

- Where are we on the continuum?
- Where do we want to be?
- Are we in agreement?
- One approach*: tiered income projections
  - Tier (a) – Very certain
  - Tier (b) – Likely, but not certain
  - Tier (c) – Possible, but unknown
  - Tier (d) – Unknown

*Nonprofit Assistance Fund
Forecasting Tips

• Consider “discounting” funding source projections based on likelihood of receipt
• Budget for growth in individual contributions and special event income only if there is a corresponding plan (with action steps and assigned responsibilities)

Forecasting Basics

• An external scan (for opportunities and threats) is essential to effective forecasting:
  • Are there opportunities to expand successful programs, save dollars or grow revenue through a partnership? Are there viable untapped revenue streams?
  • Are we facing tangible threats such as loss of a key revenue source, a competing nonprofit, or unfavorable changes in policy or funder interest?

Sample Budget Goals/Objectives

<table>
<thead>
<tr>
<th>Overall Goal</th>
<th>20XX-20 Objective</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stability, programs and ensure high quality</td>
<td>• Salary increases to all staff  • Replace computers and equipment  • Increase direct mail support</td>
</tr>
<tr>
<td>Improve on key financial health indicators</td>
<td>• Increase operating cash flow  • Reduce overhead rate  • Volunteer or peers</td>
</tr>
<tr>
<td>Increase fundraising effectiveness</td>
<td>• Increase endowed fund income  • Support board role in fundraising  • Maintain unrestricted balance  • Increase cash recovery for foundation grants</td>
</tr>
</tbody>
</table>

Source: "Two Guiding Principles for Effective Budgeting," fieldstonealliance.org
Scenario Planning
(Nonprofits Assistance Fund)

**Common Budgeting Missteps**
- “Faith-based Budgeting”
  - Plugging in income projections to match expense projections without a corresponding, realistic plan
- Failure to forecast changes in funder appetites/capacity
- Silo budget oversight – “use it or lose it” perspective within departments, programs
- Failure to question assumptions

**Recap**
- Failing to budget and forecast responsibly puts your nonprofit at great risk
- Uncertainty increases when budgeting is on autopilot
- Effective budgeting should be an inclusive process
- Start early!
- Budgeting should include core principles + a process
- A shared vision and shared goals are key to success
- Consider programmatic as well as financial goals
- Forecasting requires looking at external factors
Resources

• Annual Budgeting Checklist
  - www.nonprofitsassistancefund.org/pages/Resources_AnnualBudgetingChecklist

• The Nonprofit Budgeting Process

My Reading List…

• **Why We Make Mistakes: How We Look Without Seeing, Forget Things in Seconds, and Are All Pretty Sure We Are Way Above Average**, by Joseph T. Hallinan
• **Stumbling on Happiness**, by Daniel Gilbert
• **Struck by Lightning: the curious world of probabilities**, by Jeffrey S. Rosenthal
• **The Flaw of Averages**, by Sam Savage
• **Predictably Irrational**, by Dan Ariely
• **A Complaint is a Gift-2nd Edition**

New from the Center
My Financial Management Plan

Welcome!
Welcome to My Financial Management Plan, the online tool that helps you make a customized finance management plan for your nonprofit.

If you want to integrate your priorities, accounting, budgeting and reporting policies and practices into a comprehensive plan, you'll click to the right and start your plan. Using the easy-to-follow modules in My Financial Management Plan, you will create, update and/or standardize your key policies, enhance accountability, improve communication between staff, board, funders and other stakeholders, and save time by streamlining your financial management.

My Financial Management Plan is brought to you by Nonprofit Risk Management Center in appreciation for helping nonprofits make a difference while managing resources effectively.

To start, click "Start" below. If you're here for the first time, click "Start". You may also sign-up to receive periodic emails and announcements from My Financial Management Plan by clicking "Subscribe."


www.nonprofitrisk.org

Plan Modules

Use this section to complete the questionnaires for each plan module. Your responses to the questionnaires will form the basis for creating your financial management plan. Click the heading below to begin or to continue working with the modules. The modules to build your financial management plan are shown below. You may click on the link below the name of the module to begin the module questionnaire. The color of the module determines your overall plan progress by the color of the module name and link. If the color is:

Green - you have completed all module questions.

Orange - you have answered some questions but not all module questions.

Red - you are ready to start.

Orange - you have answered none of the questions.

Get Started Complete/Review

Board & Executive Responsibility

Managing Risk

Financial Literacy

www.nonprofitrisk.org
Thank you!

• Melanie Lockwood Herman
  • Melanie@nonprofitrisk.org
  • www.nonprofitrisk.org

Next Month’s Webinar

• Back to the Future: Long Term Planning and Investment Strategies
• May 5, 2010 – 2:00 pm Eastern