

Creating a Budget That Works



MONEY
MANAGEMENT

A Self-Guided Training Handbook for Nonprofit Community Development Organizations

Launched in 1982 by Jim and Patty Rouse, The Enterprise Foundation is a national, nonprofit housing and community development organization dedicated to bringing lasting improvements to distressed communities.

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About This Manual

What is a budget that works?

Budgets are the financial work plans for projects, programs and organizations. Budgets that work are based on realistic assumptions, use good cost estimates and come from organizational processes that include board and staff members.

Creating a Budget That Works is designed for staff and board members of nonprofit community development organizations who are learning or revisiting the craft of creating and using realistic budgets for their organizations and programs. This manual includes descriptions, cost guides, exercises and examples to help you learn about:

- Operating budgets
- Budget construction — including personnel, fringe benefits, overhead, revenue and assumptions
- The budgeting process
- Budget cost guides
- Budget-to-actual reports
- Program budgets

This manual is one of the books within the *Money Management* series of The Enterprise Foundation's Community Development Library™. The series provides detailed information on:

- Cash flow projections
- Financial statements
- Sound financial management
- Assessing your organization's finances
- Accounting software
- Federal rules of nonprofit money management

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Introduction

A budget has several important functions.

It is a *dollars and cents forecast* of your organization's finances over a certain period of time — usually looking a year or more into the future.

Once adopted, a budget is a *measuring stick for performance*.

As a *forecasting tool*, budgets allow an organization to test various scenarios for programs and other vital initiatives.

Example:

What increases in grants or other revenues are necessary to pay the \$40,000 cost of an added staff person? Or can projected management fees cover the expenses of managing 100 rental apartments?

Once adopted, a budget *embodies organizational goals* of various kinds — for example, how much the organization wants to spend on administration, which programs it intends to operate and what level of effort will be placed into each program. As such, a budget is a policy document used to measure the financial performance of the organization, both how well it is generating revenue and controlling expenses and how well it uses scarce resources to achieve its mission.

Budgets for development projects often become *contractual obligations*.

Example:

If \$2 million is borrowed to build an apartment building, the owner, architect and builder will usually have signed agreements obligating them to stay on budget.

Budgets are the *financial plans* of the organization. For brand-new operations, budgets are usually appendices to a narrative business plan, describing the projected operations, personnel, marketing plans and other activities and functions.

Example:

A new nonprofit group plans to acquire and rehabilitate houses and to offer housing counseling. The founders want to create operating budgets and a development budget. But this cannot be done without studying the market for the homes, deciding on a marketing strategy, estimating the volume of sales, and pricing and making a plan for staffing and contracted services. All of these factors are elements of the business plan and the budget.

TYPES OF BUDGETS

The focus of this manual is the *operating budget*, but we must understand its place among the five major types of forecasting tools:

- **Operating budgets** describe all income and expenses of the business.
- **Capital budgets** describe assets such as equipment and real estate.
- **Real estate development budgets**, often called *pro formas*, describe the sources and uses of development capital, and for rental projects, projected income and expenses.
- **Cash flow projections** can forecast cash receipts and disbursements.
- **Break-even projections** forecast the point in time when revenues from a new operation will equal expenses.

Budget Construction

A *budget* consists of:

- Projected revenue – projected expenses = projected surplus (deficit)
- *Line items* or *accounts*— words or phrases describing individual income and expenses. These are usually the same as the line items in the organization's statement of revenue and expenses.
- *Dollar amounts* next to the projected income and expenses
- The *bottom line*— that is, the projected surplus or deficit. In for-profit businesses, this is called profit or loss.

Operating *income* includes:

- Expected revenues from sales or fees charged
- (Less) expected returns or refunds
- Expected grants earmarked for operations, as opposed to capital projects like a real estate development
- Expected interest or investment income

Operating income does *not* include:

- Loan principal payments expected. This should be shown in a capital budget or a cash flow projection.

Operating *expenses* include:

- Cash operating expenses, often called overhead. These are staff and office costs and other expenses related to normal operations.
- Depreciation expenses. These are noncash or paper expenses that relate to the decline in value of property and other capital items.
- Interest paid on loans, such as a working capital loan or a mortgage loan for purchasing your office or other real estate.

Operating expenses do *not* include:

- Loan principal payments. These are considered capital expenses (an asset transaction) not related to operating costs.
- Disbursements made in acquiring real estate or equipment, or construction costs. These are asset transactions.

PROJECTING LINE-ITEM EXPENSES

There are several ways to project operating expenses.

Factoring up from historical costs. Projecting an individual line-item expense is easier when the organization has developed a track record. For example, after a few years postage and telephone costs are predictable within a certain range.

If the organization is experiencing increased activity or adding a new program, such costs can often be factored in one of several ways:

- By the production of added personnel. For example, if 20 percent more personnel are added (at least in certain categories), one might reasonably assume that telephone, consumable supplies and copier costs would increase by a similar percentage.
- By the proportion of added services or products. Some costs are highly interrelated with output. For example, printing and postage costs for home-buyer training are directly proportional to the number of participants.
- By other factors such as square footage of office space, which typically will result in a proportional rise in rent, utilities and janitorial costs.

The Unit-Cost Method. When there is no historical cost data available for a projected expense category, the unit-cost method can often be used.

The simple math involved is:

Unit cost X Quantity = Projected Expense

There are many applications of this method; for example:

- If two housing counselors are needed, the projected expense can be determined by multiplying the prevailing salary for this position and related fringe costs by two.
- Property insurance costs can be determined by a unit-cost rate (\$x per \$1,000 insured) multiplied by the value of the property.
- Even if office space cannot be identified, the expense can be projected by multiplying the needed office space per staff by typical space costs per square foot.

VERIFYING THE NUMBERS: COST ASSUMPTIONS

Verification of line-item numbers is essential. Bad guesses can get you into serious trouble very quickly. Areas where you need to exercise particular care include:

- Estimating salaries and expenses. Low estimates can make hiring difficult and can limit the benefit packages you can offer.
- Estimating the amount of staff or consultant time needed for a particular project. If you underestimate the time involved, you may have budgeted for only half of a marketing brochure, not the whole one you need.
- Projecting grant funding for your organization. It is easy to be overconfident about your grant requests. After all, your project is terrific. But you need to be realistic here or your project may go nowhere.

The reliability of budget numbers is no better or worse than the raw data on which the numbers are based, a fact that is easy to forget when your numbers are all dressed up in a fancy spreadsheet. These data are called *cost assumptions* or simply *assumptions*. Assumptions fall into three categories:

- *Unit costs* as just described — for example, rental costs per square foot
- *Quantity estimates*— for example, number of square feet
- Any *lump-sum estimates*— such as the amount of an expected (but not committed) grant

The Budget Cost Guides section of the manual can be used as a starting point in estimating unit costs, but these guidelines must be verified for your particular operation in your locale.

There are many ways of verifying unit-cost or lump-sum assumptions:

- Vendors can be called to get unit price quotes, such as for insurance.
- Similar up-and-running organizations can provide invaluable information. This can be obtained from budgets, financial statements and interviews with staff from those organizations.
- If more research is required, you may need to seek expert, outside help. If you cannot find the answer through your own research, outside assistance is invaluable. A day of a consultant's time will cost much less than the consequences of bad assumptions.

CONTINGENCY AND RESERVE ACCOUNTS

The primary purpose of contingency and reserve funds is to serve as a cushion for two possible events:

- Unrealized income or an expected decrease in income
- Unpredicted expenses or expenses that were higher than expected

These events can be purely accidental or unexpected, such as the failure to get a contract from the city renewed because of political upheaval and change. They can also be a result of the fact that financial projections are not an exact science.

On the other hand, poorer than expected financial performance can reflect sloppy planning or program implementation, such as program cost overruns because of faulty cost estimating or slack management of contractors.

A contingency or reserve account is like a savings account. Funds are put away for a certain purpose. If and when the funds are needed for that purpose, they are taken out.

Contingency accounts if used at all in operating budgets, usually amount to no more than 2 to 5 percent of the overall budget, or perhaps somewhat higher in the first year of an organization or program because of the lack of historical data. The danger of contingency accounts is that they can become slush funds for uncontrolled expenses.

Estimating the amount of funds required for contingency accounts or operating reserves requires very sophisticated business planning work and cash flow projections, performed at least every year.

There is no set formula for calculating contingency accounts or operating reserves. One prudent approach is to sock away each year an amount equal to:

- The largest projected negative cash flow during that year, plus
- At least one additional month's operating expenses

The Budgeting Process

Participants in the budgeting process should include the executive director, directors (if any) of individual programs, the fiscal officer (if any), the finance committee, the board, the accountant for technical issues, and possibly outside organizations or consultants used to verify new costs (for example, your insurance agent).

Budgeting should not be an isolated process, because a good budget reflects the organization's goals, objectives, new initiatives and even its abandonment of old efforts. Budgeting should be tied to strategic planning and business planning; therefore, this rough sequence of events is suggested.

- Strategic plan and business plans in place: before budgeting begins
- Draft budgets: referred to the finance committee or budget committee three months prior to the start of the fiscal year
- Finance committee consideration: three months prior to the start of the fiscal year
- Finance committee approval: two months prior to the start of the fiscal year
- Budget approval: one month prior to the start of the fiscal year
- Formal presentation to outside stakeholders: the beginning of the fiscal year

WISH LISTS AND WORK PLANS

Prior to creating even a draft budget, the executive director and any program directors should solidify their work plans for the coming year. This involves answering such questions as:

- What should programs be producing?
- Should any programs be curtailed or abandoned?

- What effect will these changes have on staffing (usually a nonprofit's major expense)?
- What unusual one-time expenses might be expected (such as the purchase of a new computer system or an office move)?

Naturally, all answers to major questions of policy or major new expenditures should be decided by the board of directors. Only when these issues are settled can annual work plans or business plans be adopted. These work plans, in turn, form the basis for the budgets.

FIRST CUTS

The budgeting process typically begins in earnest with the creation of draft budgets by the executive director and any program directors. In larger operations, the fiscal officer or comptroller sometimes directs this process.

There are two basic approaches to these first cuts:

Incremental budgeting This uses the historical approach described earlier. This is a valid method to use if the organization's operations are relatively simple, predictable and successful.

Zero-based budgeting This method essentially throws out the old budget and demands a justification for some, many or all line items. There are no givens — even the cost of office space and telephones can be challenged if conditions demand some downsizing. Used less often, this approach is more appropriate for:

- Organizations with big ups and downs (such as real estate developers)
- Operations that are troubled or undergoing major transformations

SETTING PRIORITIES

So far, these draft budgets are no more than wish lists, because no policy decisions have been made. Often, at this stage, projected expenses outstrip projected income. As a result, far more draft budgets are cut than are increased.

Typically, in the next step, the executive director prepares a balanced budget (income at least meeting expenses) to present to the board. In multiprogram organizations, this can involve discussions and negotiations with program directors. In some organizations, the board's finance committee or budget committee may insert itself in this balancing process.

Most draft budgets are presented to the board using a three-way comparison:

- The proposed budget
- The current-year budget
- The current-year actuals, usually including transactions for the first three quarters of the year

If the board of directors has not been involved earlier, the variances between the proposed budget and the current-year numbers are the major focus of attention. These variances can signal growth or shrinkage in one program or another, or possibly radically changed priorities. The most extreme cases would include ending a program or beginning a new one.

FORMAL APPROVAL

At this point, the proposed budget is often referred to the board's finance or budget committee for one or more meetings. Often a closed-door session is held to discuss personnel changes, projected salary increases, changes in benefits and any other sensitive matters that should be settled before the budget is brought to a vote.

Then the budget is brought to the full board, where the executive director presents it and the chair of the finance or budget committee typically reports on that committee's recommendations. An executive session may be required to discuss and resolve sensitive issues.

Finally, the budget, possibly including some amendments from the proposed version, is ratified by the board. This becomes the organization's financial road map and management's spending authority for the coming fiscal year.

PREPARING THE BUDGET FOR PUBLIC PRESENTATION

Often, an organization does not have a single operating budget. In reality, the budget may be presented in different ways for different audiences, requiring *revised formats*, *revised time frames* and different *levels of detail*. For example:

- Donor A may *insist* on seeing only a budget for Program X.
- Donor B may *demand* that you recast your account titles by some other name — for example, changing “Rent” to “Facilities Costs.”
- The local government may insist on seeing a budget for *its* fiscal year, not yours. This takes some recalculating and may require projecting more months into the future.

For internal use, a budget may have 30 line items, but these may be compressed into 20 items for the benefit of outside readers. For example, Telephone, Water and Gas Service may be summarized as Utilities.

The Budgeting Process — Exercise 1

Place an "X" wherever a person is involved.

Who Is Involved in Your Budgeting Process?	<i>Executive Director</i>	<i>Program Director</i>	<i>Chief Financial Officer</i>	<i>Bookkeeper</i>	<i>Other Staff</i>	<i>Board Chair</i>	<i>Board Treasurer</i>	<i>Other Board Members</i>	<i>Others</i>
Program Wish Lists									
Organizational Wish Lists									
Draft Program Budget									
Draft Organizational Budget									
Final Program Budget									
Final Organizational Budget									
Board Committee Consideration									
Board Committee Approval									
Board Consideration									
Board Approval									
Preparing Budget for Presentation									
Budget Presentation to Public									
Monitoring Operations with Budgets									

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Operating Budgets

An operating budget *describes all the day-to-day income and operating expenses of an organization.*

Most operating budgets *track the fiscal year* of the organization, whether it be the calendar year or some other 12-month period. Many organizations use an October 1 to September 30 fiscal year to mirror the federal fiscal year.

Operating budgets are projections into the future of the line items within an organization's revenue statement.

Finally, operating budgets form the basis for evaluating income/expense reports (also called budget-to-actual reports).

THE BASIC MATH

The basic arithmetic of an operating budget is:

$$\begin{array}{r} \text{Projected income to pay for operating expenses} \\ - \text{Projected operating expenses} \\ \hline \text{Projected operating surplus or deficit} \end{array}$$

On the following pages are operating budgets for a single-family housing developer, a property management company and a supportive services program.

Note the line-by-line assumptions used in creating each budget.

SAMPLE OPERATING BUDGET FOR DEVELOPING 20 SINGLE-FAMILY UNITS

This budget includes all of the *organizational* revenues and expenses estimated for the single-family development program of a community development organization. Notice that the expenses listed do not include purchase of the houses, purchase of construction materials or expenses associated with owning the houses while they are being developed, such as interest costs, taxes, insurance and utilities. These expenses would be part of the *development* not operating, budget.

INCOME	Proceeds of Sale	\$ 50,000
	Grants	187,000
	Total Income	<u>237,000</u>
EXPENSES	Salaries	125,000
	Benefits	36,250
	Office Rent	20,000
	Office Supplies	2,000
	Telephone	1,800
	Utilities	1,500
	Printing	500
	Postage/Mailing	1,500
	Legal	5,000
	Audit	2,000
	Insurance	2,000
	Local Travel	2,808
	Out-of-Town Travel	3,000
	Staff Training	2,000
Subtotal	<u>205,358</u>	
	Contingency	30,804
	Total Expenses	<u>236,162</u>
	SURPLUS (DEFICIT)	<u>\$ 838</u>

Sample Operating Budget Assumptions for Developing 20 Single-Family Units

Assumptions underlie each line item within a budget. Writing down the assumptions makes a budget clear to others and yourself. Testing all of the assumptions in a budget is detailed in the section on Assumptions.

	Budget Assumptions
Proceeds of Sale	Averaging \$2,500 per house, 20 houses
Grants	Plugged in, so that revenues exceed expenses
Salaries	For project manager, construction manager, intake specialist and administrative assistant
Benefits	At 29% of salaries
Office Rent	At 2,000 sq. ft./\$10 per sq. ft.
Office Supplies	At \$2,000 annually
Telephone	At \$150 per month
Utilities	At \$1.00 per sq. ft. annually
Printing	For preparing a quarterly marketing sheet
Postage/Mailing	At \$1,500 annually
Legal	At \$5,000 for any legal disputes, contracts
Audit	Program audit only
Insurance	At \$2,000 annually
Local Travel	At \$0.27/mile, 100 miles/week each for program manager, construction manager
Out-of-Town Travel	Three trips at \$1,000 each
Staff Training	\$500 per staff annually
Contingency	At 15% of budget

SAMPLE OPERATING BUDGET FOR MANAGING 400 UNITS

This is a budget projecting annual income and expenses for a nonprofit property management company. The management fee is based on a percentage (in this case 8 percent) of the rents charged on 400 apartments managed by the company. Even a small change in rent levels or the number of apartments managed will change the income budgets, while these changes may not affect the expense line items as much.

INCOME	Management Fee	<u>\$172,800</u>
	Total Income	172,800
EXPENSES	Salaries	82,000
	Benefits	22,140
	Office Rent	15,000
	Office Supplies	2,000
	Telephone	1,800
	Utilities	1,500
	Printing	2,000
	Postage/Mailing	1,500
	Legal	3,000
	Audit	4,000
	Insurance	2,000
	Banking Fees	500
	Local Travel	1,400
	Out-of-Town Travel	3,000
	Staff Training	<u>1,500</u>
Subtotal	143,340	
	Contingency	<u>21,502</u>
	Total Operating Expenses	164,842
	SURPLUS (DEFICIT)	<u>\$ 7,958</u>

Sample Operating Budget Assumptions for Managing 400 Units

Budget assumptions are most accurate when based on recent experience. This budget projects annual income and expense for a new property management company. The contingency line item in this budget (15 percent of other expenses) is large and protects against the surprises sure to come with a new venture.

Budget Assumptions	
Management Fee	8% of gross potential rents that average \$450 per month
Salaries	For property manager, bookkeeper and administrative assistant — note that on-site manager and maintenance are carried on the property budget
Benefits	At 27% of salaries
Office Rent	At 1,500 sq. ft./\$10 per sq. ft.
Office Supplies	At \$2,000 annually
Telephone	At \$150 per month
Utilities	At \$1.00 per sq. ft. annually
Printing	At \$2,000 annually
Postage/Mailing	At \$1,500 annually
Legal	At \$3,000 for collections, contracts
Audit	At \$4,000
Insurance	At \$2,000 annually
Banking Fees	At \$500 annually
Local Travel	At \$0.27/mile, 100 miles/week for property manager
Out-of-Town Travel	Three trips at \$1,000 each
Staff Training	\$500 per staff annually
Contingency	At 15% of everything else

SAMPLE OPERATING BUDGET FOR SUPPORTIVE HOUSING PROGRAM

This budget is for the *supportive* part of a supportive housing project. Salaries and other expenses are listed for counselors, social workers and other parts of the assistance program, while the expenses for the *housing* part of the supportive housing project would be included within another budget.

INCOME	Supportive Housing Grant	<u>\$175,620</u>
	Total Income	175,620
EXPENSES	Salaries	111,725
	Benefits	22,345
	Office Rent	3,600
	Office Supplies	750
	Telephone	2,400
	Utilities	1,500
	Printing	500
	Postage/Mailing	500
	Legal	1,500
	Audit	5,000
	Bookkeeping/Accounting	1,500
	Insurance	4,800
	Equipment	1,000
	Marketing	1,000
	Travel	1,450
	Publications/Memberships	300
	Staff & Volunteer Training	1,500
	Emergency Client Supplies	1,000
	Client Transportation	750
	Professional Contracts	<u>12,500</u>
	Subtotal	175,620
	Contingency/Reserves	<u>0</u>
	Total Operating Expenses	175,620
	SURPLUS (DEFICIT)	<u>\$ 0</u>

Sample Operating Budget Assumptions for Supportive Housing Program

All income within this budget is expected to be provided through a Supportive Housing Grant contract with a city agency. No contingency or surplus amounts are permitted within the contract, and none are listed in this budget.

	Budget Assumptions
Supportive Housing Grant	Specified in contract, paid monthly
Salaries	Full-time executive director, social worker and administrative assistant Housing director (1/3 of this position's time) Community outreach worker (1/2 of this position's time)
Benefits	At 20% of salaries
Office Rent	Paid to the parent organization
Office Supplies	At \$750 annually
Telephone	At \$200 per month
Utilities	Water/sewer only, at \$125 per month
Printing	Annual report
Postage/Mailing	Mailing annual report
Legal	For landlord/tenant cases
Audit	Program audit only
Bookkeeping/Accounting	Off-site, at \$125 per month
Insurance	At \$2,000 annually
Equipment	Used desks and chairs, computer upgrade
Marketing	Signs on building
Travel	Travel to trainings, conference
Publications/Memberships	Enterprise-On-Line
Staff and Volunteer Training	One session each for exec., social worker & volunteers
Emergency Client Supplies	Diapers, formula, clothing, etc.
Client Transportation	Vouchers for trips to and from service providers
Professional Contracts	Psychologists, substance abuse counselors, etc.

Personnel

Personnel costs are usually the majority of the expenses within nonprofit organizational budgets — typically, personnel costs (including fringe benefits, described in the next section) are about two-thirds of all expenses.

Budgets for public consumption — those sent to donors or the board of directors — aggregate all personnel within one line item to avoid disclosing each individual's salary. Budgets for internal use may place each individual's salary in a separate line item.

The following is an exercise to list the annual salary costs for all employees within your organization.

Fringe Benefits

Fringe benefits are always part of personnel costs. Fringe benefits *must include*:

- Employer's portion of FICA (Social Security)
- Federal Unemployment Tax (FUTA)
- State Unemployment Tax
- Workers' Compensation Insurance

Fringe benefits that are *optional* include:

- Health insurance
- Dental insurance
- Life insurance
- Disability insurance
- Retirement plans

Fringe benefit costs typically range from 23 percent to 28 percent of salaries.

The following is an exercise to list the annual fringe benefit costs for all employees within your organization.

Fringe Benefits Budget — Exercise 3

Instructions for Exercise 3

Cross off the fringe line items in the chart below that you will **not** be paying. Add any others that should be there. Leave all fringe benefit costs that your organization must budget for.

Typical cost ranges for each fringe line item are already listed in the chart.

List **your** costs for all fringe line items that will be included in the budget. Use the typical cost ranges as a guide if you do not already know the costs.

Fringe Line Items	Typical Cost Range	Your Cost
Employer's share of FICA (Social Security)	7.65% of salary up to \$55,000	
Federal Unemployment Tax (FUTA)	About \$55 per full-time employee annually	
State Unemployment Tax	2% to 7% of salaries	
Workers' Compensation Insurance	2% to 40% of salaries	
Life and Long-Term Disability Insurance	1.5% to 6% of salaries	
Health Insurance	\$1,500 to \$7,000	
Retirement Plans	1% to 5% of salaries	
Other		
Other		
Other		

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Overhead

Overhead costs within an operating budget — often called *General and Administrative*— are the nonpersonnel costs of doing business. Overhead will include space costs (such as rent and utilities), office supplies, accounting services for the organization and so on. Typically these costs will be about one-third of an organization’s operating budget.

The following is an exercise to list all of the annual overhead costs for your organization.

Overhead Budget — Exercise 4

Instructions for Exercise 4

Cross off all overhead line items in the chart below that you will **not** be paying. Add any others that should be there. Leave all overhead costs that your organization must budget for.

Find the typical cost ranges for each overhead line item in the Budget Cost Guides section under “Guidelines for Estimating Operating Costs.” Fill in those spaces in the chart.

List **your** costs for all overhead line items that will be included in the budget. Use the typical cost ranges as a guide if you do not already know the costs.

Overhead Line Items	Typical Cost Range	Your Cost
Rent		
Electric		
Gas		
Water		
Accounting		
Audit		
Legal		
Equipment		
Equipment Repair		
Advertising		
Out-of-Town Travel		
In-Town Travel		
Telephone		
Supplies		
Other		
Other		
Other		

Revenue

Thus far we have looked at *expense* line items within an organization's operating budget. In this section we look at the top part of a budget, the *revenue* line items. *Income* is used interchangeably with revenue.

Nonprofits get revenue from:

- Government contracts
- Foundation grants
- Corporate contributions
- Contributions from individuals
- Fees earned for services rendered
- The sale of goods

Fees earned and goods sold will *always* require incurring expenses. Try to make your "fee and goods sold" revenue assumptions consistent with your expense assumptions.

Example:

Some nonprofits receive fees for counseling prospective home owners. If these organizations budget for fees earned for counseling 50 households in a year, their marketing efforts and expenses should reflect the costs of enrolling enough households to ensure that at least 50 complete the program. Budgeted staffing levels should be sufficient to achieve at least 50 program completions (and many more program starts).

Similarly, getting individual and corporate contributions usually requires significant time to plan and execute fund-raising campaigns. If these efforts are paid through the organization's budget, the level of effort needs to be reasonably consistent with the level of revenue expected.

Government contracts with nonprofits are no longer a sure and predictable line item. Do not assume level funding of your government contract for next year's budget.

The following is an exercise for the revenue side of your budget.

Assumptions

Assumptions underlie each of the line items within any budget. Assumptions define the formula you are using when making the numerical calculations that are listed in the budget.

For example, the salary line item will reflect the *exact* number of people expected to be employed, their wage rates and the amount of time they are expected to be employed within the budget year. Fringe benefit costs, often summarized as a percentage of salaries, will consist of specific costs for each of the benefits provided to each of the employees.

Getting budget assumptions as close as possible to the real situation is the essence of good budgeting.

The following is an exercise to detail all of the assumptions you used in creating a budget for your organization.

Assumptions — Exercise 6

Instructions for Exercise 6

Fill out the assumptions page that follows:

- List all revenue lines from the previous exercise.
- List all expense line items from the personnel, fringe benefit and overhead exercises.
- Write down the **assumptions** used for each line item. The assumptions will tell you how to calculate the **amount** of each item (see the examples cited earlier for single-family development, housing management and supportive housing).

Assumptions — Exercise 6 (continued)

Sometimes unwise assumptions are used in constructing budgets. The most common include:

- Everything will go according to plan (there is no reason to have contingency funds or plans).
- New operations or businesses will throw off profits to fund the core business.
- Last year's expenses will not increase.
- Funds can be raised without a tight, well-executed plan.

Which of the assumptions that you listed are the shakiest?

1.

2.

3.

4.

How can these assumptions be solidified?

1.

2.

3.

4.

Budget Summary

Operating budgets contain three parts: revenue, expenses and *surplus* (or *deficit* if the amount is negative). Surplus is often called *profit*, and deficit is often called *loss*.

Budget Summary — Exercise 7

Instructions for Exercise 7

Fill out the complete budget summary page that follows:

- List all revenue line items and amounts from the previous exercise.
- List all expense line items and amounts from the previous exercise.
- Add revenue amounts and write down the total.
- Add expense amounts and write down the total.
- Subtract the expense total from the income total to get the surplus (deficit if this amount is negative). Write down the surplus or deficit.

Budget Cost Guides

Following are guides to assist in estimating costs. These guides are based on a nationwide survey of costs for small, medium and large community development organizations throughout the country. As a result, there is a wide range across many of the line items listed.

Use these guidelines as a first step in estimating budget line items and then refine the estimates through local research.

Guidelines for Base Staff Costs and Productivity

Position/Base Cost	Typical Output
MANAGEMENT	
Executive Director \$25,000 to \$70,000	<ul style="list-style-type: none"> – Supervise 1 to 6 staff persons or managers – Raise funds – Do some amount of technical work
Office Manager/Bookkeeper \$22,000 to \$30,000	<ul style="list-style-type: none"> – Supervise 1 to 3 clerical and “program” staff persons – Keep books – Reception – Clerical – Some “program” work, such as intake
Clerical Person \$15,000 to \$25,000	<ul style="list-style-type: none"> – Reception – Clerical – Sometimes intake of clients
DEVELOPMENT/CONSTRUCTION	
Project Manager \$25,000 to \$50,000	<ul style="list-style-type: none"> – 10 to 30 single-family units financed and built or acquired/rehabbed per year – 50 to 200 multifamily units/year
Construction Manager/Rehabilitation Specialist \$18,000 to \$50,000 or contract services	<ul style="list-style-type: none"> – Write specifications and supervise architects – Bid work – Monitor work and payments – 20 to 75 single-family units/year – 50 to 300 multifamily units/year
Home Inspector \$50 to \$80 minimum per visit \$100 to \$200 for specs or \$18,000 to \$25,000/year salary	<ul style="list-style-type: none"> – Write delinquency list or specs on home repairs – Certify work completion

Comments	Verification of Costs
<ul style="list-style-type: none"> - Cost generally varies by number of employees overall, size of budget overseen and technical skills and experience needed. - Need highly creative, technically competent person who can make alliances from corporate to neighborhood level. 	<p>Check other local and national groups</p>
<ul style="list-style-type: none"> - Cost is most dependent upon the market for experienced, competent people. - Need highly organized "people" person. - Most skills not industry specific. 	<p>Check with local businesses</p>
<ul style="list-style-type: none"> - Cost is market driven. - Need outgoing and caring person if dealing with clients. 	<p>Check with local businesses</p>
<ul style="list-style-type: none"> - Cost varies with years of experience, versatility (finance and construction), results expected and supervision needed. - Hard to contract out. - Need creative individual and negotiator. 	<ul style="list-style-type: none"> - Local nonprofits - Local real estate development corporations
<ul style="list-style-type: none"> - Cost varies by the experience and size of jobs handled (\$10,000 rehabilitation versus \$1 million new construction contract). - Sometimes easy to contract out. - Need meticulous individual with good negotiation skills. 	<ul style="list-style-type: none"> - Local construction companies - Local government rehab offices and nonprofits - Independent construction managers
<ul style="list-style-type: none"> - Cost varies by market, experience and licensing/certification. - Need impeccable, careful individual or firm. - Inspectors will be going into homes alone and in possibly tough areas. 	<p>Private home inspection agencies</p>

(chart continued on next page)

Guidelines for Base Staff Costs and Productivity (continued)

Position/Base Cost	Typical Output
PROPERTY MANAGEMENT	
Property Manager \$25,000 to \$60,000	<ul style="list-style-type: none"> – Make maintenance, capital improvement and marketing plans – Oversee finances – Supervise 1 to 6 people/managers – Sometimes does intake and leasing in small operations – Can oversee 200 to 5,000 units
Resident Manager/Site Manager \$5,000 to \$25,000 or some or all of rent rebated (part-time)	<ul style="list-style-type: none"> – Usually does intake and leasing and late payment collection for one property – May order/supervise routine repairs
Maintenance Person/Contractors \$15,000 to \$30,000 salary or \$20 to \$75 minimum per call	<ul style="list-style-type: none"> – Janitorial – Minor repairs – Major repairs – Supervise outside repair persons – Contractors doing “ticket-work” can fill in for higher-skilled work or overload times
Tenant Services Specialist \$18,000 to \$25,000	<ul style="list-style-type: none"> – Defer to service agencies – Organize resident associations/actions – Sometimes coordinate “self-sufficiency” programs – Sometimes deal with late/nonpayment – 100 to 250 households at one time
Case Manager \$20,000 to \$30,000	<ul style="list-style-type: none"> – Individual “life” counseling – Referral to service agencies – Coordination/trading of remedial efforts
SINGLE-FAMILY PROGRAMS	
Loan Underwriter \$20,000 to \$30,000	<ul style="list-style-type: none"> – Underwrite 50 to 100 single-family loans/year – Market program – Provide some credit counseling
Loan Processor \$18,000 to \$25,000	<ul style="list-style-type: none"> – Take 200 to 400 applications/year – Process 50 to 100 loans/year – Limited counseling

Comments	Verification of Costs
<p>Cost varies most by number of units managed, number of employees in division and degree of planning and implementation responsibility.</p>	<ul style="list-style-type: none"> - Local property management companies - Public housing authority - Nonprofit property managers
<p>Cost varies with market and degree of skills and responsibility needed, and whether full or part-time.</p>	<p>Same as above</p>
<ul style="list-style-type: none"> - Cost varies by market and range of experience and skills needed. - With very old housing stock, it may pay to have someone on staff with tools and skills in all trades. 	<p>Same as above plus rehabilitation contractors</p>
<ul style="list-style-type: none"> - Cost varies by market and degree of experience and skills in organizing and counseling and by knowledge of available social service program. - Need outgoing, creative, self-starting individual. 	<ul style="list-style-type: none"> - Local social services/public assistance agencies - Local counseling agencies - Local social work associations - Employment, training and "women's" centers - Religious service agencies
<ul style="list-style-type: none"> - Cost varies by market and ability and depth of experience. - Need self-starting, creative and caring individual. 	<p>Same as above</p>
<p>Cost varies mainly by market and experience of applicant.</p>	<p>Local lenders and public and nonprofit agencies making loans</p>
<p>Cost varies mainly by market and experience of applicant.</p>	<p>Local lenders and public and nonprofit agencies making loans</p>

Guidelines for Calculating Fringe Costs

Item	Current or Typical Cost as a Percentage of Salary
Employer's Half of FICA (Social Security)	7.65% of salary up to \$55,000
Federal Unemployment Tax (FUTA)	About \$55 per full-time employee per year
State Unemployment Tax	2% to 7%
Workers' Compensation Insurance	2% to 40%
Life and Long-Term Disability Insurance	1.5% to 6%
Short-Term Disability Benefits	1% to 2% (budgeted)
Health Insurance	5% to 40% (full cost of policy per year) \$1,500 to \$3,000 for individuals; \$3,000 to \$7,000 for families
Retirement Plans	1% to 2%
Tax-Exempt Contribution Plan	0.5% to 1%
Jury/Military Service/Family Leave Pay	1% to 3% (budgeted)

Comments	How to Verify
One of the biggest mistakes of new businesses is not setting this aside to pay quarterly mandated cost. Also, you may be obligated to pay it on a worker disguised as a “contractor”—that is, full-time and always under your control. If they are not paying their own Self-Employment Tax, you very likely will be obligated, retroactively with penalties , when the IRS catches up with them.	IRS publications or offices
Same as above, add applicants.	Same as above
Depends upon state formula; will be higher if you have claims. Mandated cost.	State Employment Security Office — stay attuned to changes in formula.
Mandated cost. Private or state-owned insurance company issues with rates controlled by law. Rates vary from about 2% for “safe” office work to 40% or more for high-risk construction work like roofing. If you use small-scale subcontractors for risky jobs, make sure they are insured or cover them on your policy and adjust their pricing accordingly.	Issuing companies. In many states, prices are fixed by law. Look out for changes in rates, some of which can be retroactive .
Usually purchased as a package, if both desired. Having people claim disability raises the rate or causes cancellation. Many levels of plans and costs.	Have an experienced business person advise you on what to get, then bid it out. Better: Use an insurance consultant.
This covers the 2- to 4-week period someone is disabled and not covered by typical disability policies. You eat the cost if you offer the benefit.	Experience of other nonprofits on the prevalence and cost of this benefit. It is definitely unpredictable.
Usually split between employer and employee, if offered. Pays to offer “buyouts” to employees whose spouses have it. Claims will increase your rates.	Costs vary widely. Look for “umbrella” groups like the United Way to let you into their deal. Buying individual Blue Cross policies for employees is sometimes surprisingly cheaper than alternatives.
Small organizations usually buy in a package with life and disability insurance. Hard for small businesses to explain and administer. Small operations should work only with portable, defined contribution plans.	Get advice from experienced business person or, better yet, a consultant. Then bid it out.
Usually “tacked on” to the company retirement plan. Your organization matches employee tax-exempt contributions to a retirement plan, something like 1 to 4. Great deal for employees — up to 60% after-tax annual return on their investment. Difficult for small businesses to explain, market and administer.	Same as above
Some organizations limit wages for these events. Costs can be a black hole if offered and not limited.	Check nonprofits and businesses for local practices. Very unpredictable cost.

NOTES: It is imperative to have a personnel manual that spells out rights and obligations. Create no open-ended liabilities.

These are guidelines only. All of the estimated costs should be verified for the unique business that is proposed. Specialized costs like tool or uniform allowances are not included here.

Guidelines for Estimating Start-Up Costs — General Office/Administrative Costs

Item	Typical Costs
Typewriters	\$250 will buy a good one (new)
Fax Machine	\$700 to \$1,000 for heavy-use models
Answering Machine	\$100
Phone System	\$160 for phones only to \$2,000 for a 4-line switching system including wiring up the office
Stock of Supplies	\$500 to \$1,500 — includes \$25 to \$50 for each desk set-up
Advertising	\$100 to \$500
Travel	\$0 to \$3,000
Legal	<ul style="list-style-type: none"> – \$0 to \$400 for filing incorporation – \$375 to IRS for tax-exempt filing – \$1,000 to \$5,000 for legal costs
Accounting	\$1,000 to \$10,000
Furniture	Minimum \$200 (used) and \$500 (new) for modest desk set-up for one person
Copiers	<ul style="list-style-type: none"> – \$1,500 for an office-grade non-auto-feed – \$6,000 to \$8,000 for a good auto-feed/collator (new) – \$500 to \$2,500 for a year's lease

Comments	Verification of Costs
<p>You will need at least one for typing envelopes and filling out forms.</p>	<ul style="list-style-type: none"> – Office supplies – Look for used IBM Selectrics.
<ul style="list-style-type: none"> – Avoid “consumer” models. – Get a multiple-page feeder model — a must. 	<ul style="list-style-type: none"> – Office supplies – Call around for deals.
<p>A must for lean-staffed offices.</p>	<p>Discount stores</p>
<p>Always have enough lines if you are marketing to lots of clients.</p>	<ul style="list-style-type: none"> – Phone company – Other vendors of switching equipment – Look to discount outlets for the phone sets themselves for simple systems.
<ul style="list-style-type: none"> – Printed stationery, forms, business cards, etc. – Graphic design costs. – Stock of regular office supplies and desk set-ups. 	<ul style="list-style-type: none"> – Make a list. – Biggest cost may be printing — sketch out everything you want and get bids.
<p>Advertise initial personnel openings.</p>	<p>Check newspapers and national journals</p>
<p>Bringing in out-of-town candidates.</p>	<p>See “Guidelines for Regular Operating Costs,” which follows.</p>
<p>Legal costs will vary based on the complexity of licenses, contracts and financing agreements needed to set up the business.</p>	<ul style="list-style-type: none"> – State corporations office – IRS – See “Guidelines for Regular Operating Costs,” which follows.
<ul style="list-style-type: none"> – Low figure is for setting up chart of accounts, simple reporting system and minimal training of bookkeeper. – High figure is for above plus extensive training in complicated systems such as sophisticated software. 	<p>See “Guidelines for Regular Operating Costs,” which follows.</p>
<ul style="list-style-type: none"> – Don’t forget work tables, conference tables, chairs and light fixtures. – Ask large companies for free, cast-off furniture — look for office closings or moving. – Get good work chairs or risk disabled employee. 	<ul style="list-style-type: none"> – New and used furniture companies – Discount outlets – Auctions – Ask United Way about free furniture sources.
<ul style="list-style-type: none"> – If you are lean on staff and have a lot of paperwork requirements, go for the auto model or be prepared to send big jobs out. – Shop for used auto-feeds. – Late model repossessions are a good bet; however, beware of lemons. 	<p>Office supply companies — get bids from those that offer good service and preferably loaners when yours breaks down.</p>

(chart continued on next page)

Guidelines for Estimating Start-Up Costs — General Office/Administrative Costs (continued)

Item	Typical Costs
Personal Computers, Printers and Basic Software	<ul style="list-style-type: none"> – \$1,800 for a decent brand complete with cables and operating software – \$400 to \$500 for a good printer – \$1,100 for a good letter-quality printer – \$400 for brand-name word processing and spreadsheet software, per package
Network Systems	\$2,000 to \$5,000 for small shops (vary greatly)
Accounting Software	\$300 to \$2,499
“One-Write” Checkbook Accounting System	\$250 to \$400
Operating or Working Capital Reserve	<ul style="list-style-type: none"> – Minimum: Largest accumulated cash deficit in any month – Better: Add to that one average month’s cash disbursements
Deposits	<ul style="list-style-type: none"> – Two months’ rent – Phone — \$0 to \$200 – Possibly other utilities
Licenses, Fees	\$0 to \$1,000
Contingency	<ul style="list-style-type: none"> – 5% of start-up budget (excluding capital reserve) after verifications – 15% of start-up budget if no verifications done
“Inherited” Costs	Nonexistent to variable

Comments	Verification of Costs
<ul style="list-style-type: none"> – Vendors are fiercely competitive. – Look for a vendor that has been around and has good service. – Don't skimp on this. 	<p>Get advice from a business person who has used them for a while — on specs and vendors.</p>
<ul style="list-style-type: none"> – Can have real advantages in quick access to all the organization's most current information. – They break down; could be risky and expensive for small shops. 	<p>See above</p>
<p>Higher costs for organizations with more business lines, having affiliates, solely owned corporations, and more funding sources.</p>	<ul style="list-style-type: none"> – Get advice from an accountant or business advisor on best system. – Call vendors.
<ul style="list-style-type: none"> – For small operations with few transactions, can do your book-keeping while you write a check. – Special editions include a great one for property management operations. 	<p>Same as above</p>
<ul style="list-style-type: none"> – To cover cash "dips" discovered in cash flow analysis. – To guard against unexpected delays in receipts or unexpected expenses. 	<p>Your own cash flow analysis with conservative cost and income assumptions</p>
<p>Sometimes negotiable.</p>	<ul style="list-style-type: none"> – Landlords – Utility companies
<ul style="list-style-type: none"> – Building contractor's license – Real estate license – Lender or business registration – Corporate fee to state (if any) 	<ul style="list-style-type: none"> – Licensing bureaus – State corporations office – Ask about exemptions for nonprofits
<p>Covers unexpected costs and unverified cost estimates.</p>	<p>Your own judgment</p>
<ul style="list-style-type: none"> – Some new unincorporated ventures have "angels" who front certain start-up costs and need to be repaid later. – Some planning consultants work on contingency. 	<p>Find out what you owe the "angels."</p>

NOTES: These are guidelines only. All of the estimated costs should be verified for the unique business that is proposed.

No cost estimates are included for specialized areas like construction, manufacturing, etc.

Guidelines for Estimating Regular Operating Costs (Overhead)

Item	Typical Cost Range
Liability Insurance, including Directors' and Officers' Insurance	<ul style="list-style-type: none"> - \$3,000 to \$6,000 base per year plus a percentage of the dollar volume (or risk exposure) of "risky" products/services - Rental housing operations are facing costs as high as 10% of rents
Property Insurance (Equipment, Vehicles, Buildings, etc.)	0.25% to 1% a year of value of insured property
Equipment Maintenance	<ul style="list-style-type: none"> - \$75 to \$300 a year per machine for normal office equipment - 5% to 10% of original cost per year for other equipment (like construction equipment)
Office Rent	\$3 to \$12 per sq. ft. per year
Office Utilities (Electric, Heat Source, Water and Sewers)	\$0.75 to \$2.00 per sq. ft. per year
Janitorial, Trash Removal	\$40 to \$100 a month for small offices
Phone	<ul style="list-style-type: none"> - Minimum \$50 to \$100 a month. - Usually a base business rate, a cost per line and extras, line and equipment maintenance and (in some areas) a cost per minute even for local calls.
Printing/Reproduction	\$500 to \$2,000 a year for small operations

Comments	Verification of Costs
<ul style="list-style-type: none"> - If you are involved in risk-prone activities like construction or rental housing, your directors and officers should be insured. - Lead paint hazards are a new wild card — look out for policies that exclude coverage if you may be exposed through construction or property ownership. - Have a risk control plan. - As with Workers' Compensation, you may want to "umbrella" your smaller contractors, but you will pay extra. 	<ul style="list-style-type: none"> - Get advice from experienced business people in the "businesses" you are (will be) in or from an insurance consultant. - Bid it out (often bought in package with other insurance). - Finding out about exclusions requires discretion. - Don't hide any real known risks. - An insurance consultant may save you much more than his or her fee.
<ul style="list-style-type: none"> - Office equipment is a minor cost. - Fire and theft insurance in distressed areas may be a problem and cost more. 	Same as above
<ul style="list-style-type: none"> - Don't get a maintenance contract until the warranty runs out. - Pieces under \$500 are usually not worth getting contracts on. 	Check service companies.
<ul style="list-style-type: none"> - Low figure is for very low value commercial space; high figure is for better-trafficked locations. - Rough rule of thumb: 200 sq. ft. per person, plus storage areas. - If downtown, check parking costs. - High visibility, ability to access at all hours and security are pluses. 	<ul style="list-style-type: none"> - Call real estate agents. - Check churches, service agencies and municipal centers for low-cost or donated space.
Depends upon lease agreement, local rates, energy efficiency of building.	<ul style="list-style-type: none"> - Utility companies - Real estate agents - Building owner - Best: former tenant
Depends upon lease agreement, municipal policies on fees.	<ul style="list-style-type: none"> - Cleaning services - Trash removal company or agency
<ul style="list-style-type: none"> - With multiple lines, using a phone company central switching system like Centrex can avoid having to buy and maintain your own switching equipment. - Get a dedicated fax line for dealing with lenders, attorneys, accountants, etc. 	<ul style="list-style-type: none"> - Local phone company - Shop long distance service by estimating areas called most frequently and volumes of calls there.
<ul style="list-style-type: none"> - Brochures - Forms - Flyers - Outside photocopying - Letterhead stationery - Printed envelopes - Business cards - Invoices 	<ul style="list-style-type: none"> - Estimate how many items, number of pages and number of copies needed. - Shop costs from printers. - Don't forget layout costs.

(chart continued on next page)

Guidelines for Estimating Regular Operating Costs (Overhead) (continued)

Item	Typical Cost Range
Supplies and Postage	Minimum \$400 to \$600 a year for 3- to 4-person shops; add more for lots of mailings.
Publications, Subscriptions, Books, Software	\$100 to \$800 a year
Advertising	\$100 to \$500 a year
Licenses, Fees	\$0 to \$1,000
Donations for Good Causes	\$100 to \$500 a year for small operations
Taxes	\$0 to variable
Local Travel	\$0.26 to \$0.32 per mile plus tolls plus parking
Out-of-Town Travel	– \$300 to \$500 for across-the-country, cut-rate airfares – \$80 to \$200 per day cost for other expenses
Conferences, Training, Memberships	– \$200 to \$800 per event registration and tuition costs – \$60 to \$200 for membership in national/regional organizations
Legal Costs	\$65 to \$150 an hour plus phone, mileage and reproduction

Comments	Verification of Costs
Estimate volume of mail per year.	Talk to people in a similar business or businesses.
Estimate needs.	Call sellers.
<ul style="list-style-type: none"> – Advertising jobs – Apartments/houses for rent – Products/services 	<ul style="list-style-type: none"> – Estimate number, type and frequency. – Find similar ads you like in local media and price them out. – Get news or human interest coverage or free ads for products or services.
<ul style="list-style-type: none"> – Building contractor’s license – Real estate license – Lender registration – Corporate fee to state (if any) 	<ul style="list-style-type: none"> – Licensing bureaus – State corporations office – Ask about exemption or cut rates for nonprofits.
<ul style="list-style-type: none"> – Some nonprofits find it inappropriate to give away money when they have to raise money themselves. – If you’re doing business in a neighborhood, you may feel obligated to support the Little League or an emergency medical fund. 	Your decision
<ul style="list-style-type: none"> – Inventory taxes – Property taxes (office, other real estate) – Property taxes – Tax exemption of nonprofits may vary by activity, state law and local companies’ policies. 	<ul style="list-style-type: none"> – Taxing agencies – Sometimes you have to push a little for exemptions.
Estimate all reimbursed local travel; envisioning a typical work-week for all employees is a good way to estimate.	Check with similar businesses.
<ul style="list-style-type: none"> – For airfare, ground transportation, meals and lodging. – Figure all the necessary conferences and training events that might come up. 	<ul style="list-style-type: none"> – Airlines – Hotels
<ul style="list-style-type: none"> – Figure your necessary membership and training events. – Can connect organizations with national or regional sources of funds and increase knowledge and skills of staff. 	Relevant organizations
<ul style="list-style-type: none"> – Low rate is sometimes offered by good attorneys to nonprofits; high rate is for specialists. – Large firms often offer cut rates, some pro bono work and the variety of skills needed by some nonprofits. Must have nonprofit experience. – Possible tasks include reviewing contracts and financing agreements, title work, client or contractor litigation, and evictions. – <i>Don’t</i> charge project-related costs to the administrative budget — these should be chargeable to grants or loans for a project or program. 	<ul style="list-style-type: none"> – Get advice on good firms from people in similar businesses. – Property management companies can recommend cheaper process servers for evictions.

(chart continued on next page)

Guidelines for Estimating Regular Operating Costs (Overhead) (continued)

Item	Typical Cost Range
Accounting	<ul style="list-style-type: none">– Costs \$2,000 to \$4,000 minimum a year for small operations.– Senior accountants in firms get \$80 to \$120 per hour; junior, \$40 to \$60 per hour; support staff, \$25 to \$35 an hour. You will need them all for start-ups and complicated deals.– Larger real-estate-oriented operations can spend \$20,000 or more a year, particularly with complicated financings.
Audit	<ul style="list-style-type: none">– \$2,000 to \$6,000 a year– Up to \$20,000 to \$30,000 if you really mess up the accounting
New Equipment	<ul style="list-style-type: none">– Varies greatly– Don't forget new furniture, equipment and possibly a computer for new staff to be added.
Replacement Reserve	15% to 30% of original cost of equipment
Contingency	<ul style="list-style-type: none">– 2% to 5% if business planning and verifications have been done well– 10% to 20% until those steps are done

Comments	Verification of Costs
<ul style="list-style-type: none"> – Accountant <i>must</i> know nonprofit accounting. – If your number of transactions and form of accounting are uncertain, shop for pro bono hourly rates. – Careful business planning and anticipation of needed reports will save time and cost later. – Computerized bookkeeping will cut costs. – Using federal funds and complicated financings requires an accountant experienced in these areas. – <i>Don't</i> include project-related costs in administrative budget — these should be chargeable to grants or loans for a project or program. 	<ul style="list-style-type: none"> – Get recommendations from similar businesses. – Try to get an accountant on your board to do the shopping. – Don't be afraid to try larger, very experienced firms. They may give you pro bono rates. – Decide whether you will have an in-house bookkeeper (usually advisable) before shopping.
<ul style="list-style-type: none"> – Varies with numbers of transactions, complexity of businesses. – <i>Much</i> cheaper if accounting system conforms to the demands of agency requesting audit (HUD). – Separate organization's audit from project audit if required by donors. Latter should be chargeable to the grant or loan. 	Same as accounting
See "Guidelines for Start-Up Budgets."	
It's smart to set aside a reserve fund for replacements.	IRS depreciation tables are a guide.
<ul style="list-style-type: none"> – Can be used to budget funds for salary increases without identifying them to a position. – Sloppy organizations use a slush fund; beware! 	

Budget-to-Actual Reports

What is a budget-to-actual report? Income statements are one of several standard *financial reports* that organizations produce on a monthly, quarterly or annual basis. They show revenues, expenses and profits over a period of time.

A *budget-to-actual report* is simply a name for an income statement that contains extra information:

- Budgeted amounts for each income and expense line item
- Variance between the budgeted amount and actual amount
- The percentage variance between the budgeted amount and actual amount

In a budget-to-actual report, the budgeted amounts are usually prorated for the amount of the year that has elapsed. This way, the reader sees a comparison between what amounts *should* have been received or spent by this point in the fiscal year and what was *actually* received or spent.

The budgeted amounts are usually changed for each reporting period. First-quarter reports will show one-fourth of the budgeted amount, second-quarter reports one-half the amount and so on. Usually, only the year-end report shows the full targeted amount for each income and expense line item.

Using this financial tool, managers and board members get a revealing snapshot of the organization's financial health.

Example:

ABC Housing, Inc., managers are looking at their first-quarter budget versus the actual report. Telephone expenses were budgeted at \$1,200 for the first three months and actual expenses were \$1,057, a negative variance of \$143, or -12 percent. With expenses, negative amounts are good and positive amounts are bad.

But net revenues from home sales were budgeted at \$10,000 for the first quarter, while actual revenues were only \$5,237, a negative variance of \$4,763, or -48 percent. With revenue, negative amounts are bad and positive amounts are good. ABC Housing had better do something about home sales, or it will not be able to pay its staff!

Keep in mind, though, that this system of comparisons is distorted by expenses that occur only once or twice a year. For example, ABC Housing may have budgeted \$2,000 for insurance by the end of the first quarter and paid out \$4,000, a positive variance of 100 percent, or twice what was budgeted. But this occurred because only half the annual bill was due in the first quarter.

HOW OFTEN ARE THESE REPORTS GENERATED?

Typically, budget-to-actual reports are generated at least monthly, with the last report being the year-end report.

The actuals in the year-end report should be the same as those presented in the organization's annual financial statements.

Managers may want to (or need to) look at budget-to-actual reports prepared more frequently than monthly, particularly if the organization is engaged in a volatile business, such as real estate development, or is experiencing financial difficulties.

WHAT TO LOOK FOR

Amount of Variances

- Look at categories before specific line items.
- Check for variances that are plus or minus 10 percent of budget.
- Check for amounts that could have a sizable impact on your ability to maintain normal operations.

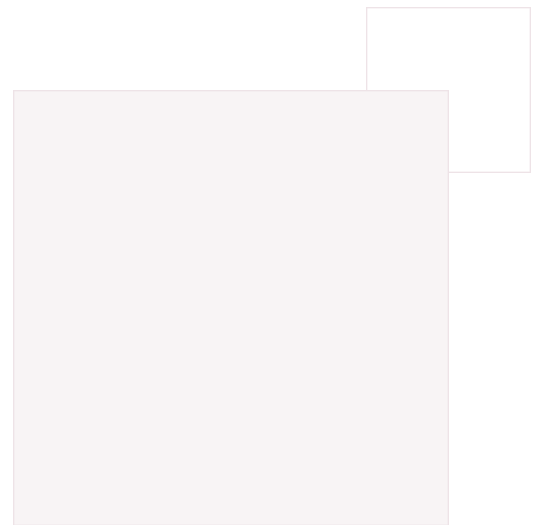
Trend of Variances

- Check if variances are continuing, in the same direction, over two or more periods.

What the Variances Really Mean

- Some variances occur because of poor planning, others because of poor operations. You should know the reason behind each budget variance.

On the next page is an exercise in comparing actual results with budgets.



Budget-to-Actual Reports — Exercise 8

For each **revenue** line item:

- Actual amount – budgeted amount = variance
- (Variance ÷ budgeted amount) X 100 = percent variance

For each **expense** line item:

- Budgeted amount – actual amount = variance
- (Variance ÷ budgeted amount) X 100 = percent variance

Note: Forever Homes CDC is a fictitious community development organization.

Forever Homes CDC – Budget to Actual — for the Year Ended Dec. 31, 2000

	Budget	Actual	Variance	Percent Variance
REVENUES				
Grants (unrestricted)	\$ 150,000	\$ 75,000		
Grants (restricted)	200,000	220,000		
Contributions	0	32,744		
Fund-Raising Event	10,000	722		
Sale of Property	25,000	1,780		
Total Revenues	<u>385,000</u>	<u>330,246</u>		
EXPENSES				
Salaries	238,000	201,588		
Benefits	52,360	44,349		
Staff Training	2,000	125		
Marketing/Advertising	0	1,344		
Printing & Reproduction	1,000	2,400		
Travel	2,350	4,500		
Fund-Raising & Event Costs	1,500	2,000		
Rent	18,500	18,500		
Utilities	2,400	2,100		
Telephone	3,950	3,900		
Insurance	5,000	5,000		
Office Supplies	5,775	5,500		
Postage & Delivery	2,750	3,500		
Legal Fees	2,500	4,000		
Accounting & Auditing	4,000	4,000		
Fees	0	0		
Interest	0	960		
Depreciation	13,500	13,500		
Total Expenses	<u>355,585</u>	<u>317,266</u>		
NET INCOME	<u>\$ 29,415</u>	<u>\$ 12,980</u>		

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There are two ways to calculate the variance and the percent variance. The method shown here yields a negative variance when:

- Actual revenues are lower than originally projected.
- Actual expenses are higher than originally projected.

In other words, a negative is typically not good.

Did you notice that the equation used to calculate expense variances is the reverse of that used for revenue variances? This is what yields a variance that is “intuitively” comfortable for many people: “Negative variances are bad.”

The other way to calculate variances is to use the following formula for both revenue and expense variances:

- Budgeted amount – actual amount = variance

Using this method you must remember that a negative variance is good for revenues and bad for expenses. We use the more intuitive method throughout this section.

Budget-to-Actual Reports — Exercise 8 (continued)

Which are the three *most important* variances?

1.

2.

3.

Why?

1.

2.

3.

Budget-to-Actual Reports — Exercise 8 (Answers)

Forever Homes CDC – Budget to Actual — for the Year Ended Dec. 31, 2000

	Budget	Actual	Variance	Percent Variance
REVENUES				
Grants (unrestricted)	\$ 150,000	\$ 75,000	\$(75,000)	(50%)
Grants (restricted)	200,000	220,000	20,000	10%
Contributions	0	32,744	32,744	
Fund-Raising Event	10,000	722	(9,278)	(93%)
Sale of Property	25,000	1,780	(23,220)	(93%)
Total Revenues	385,000	330,246	(54,754)	(14%)
EXPENSES				
Salaries	238,000	201,588	36,412	15%
Benefits	52,360	44,349	8,011	15%
Staff Training	2,000	125	1,875	94%
Marketing/Advertising	0	1,344	(1,344)	
Printing & Reproduction	1,000	2,400	(1,400)	(140%)
Travel	2,350	4,500	(2,150)	(91%)
Fund-Raising & Event Costs	1,500	2,000	(500)	(33%)
Rent	18,500	18,500	0	0%
Utilities	2,400	2,100	300	13%
Telephone	3,950	3,900	50	1%
Insurance	5,000	5,000	0	0%
Office Supplies	5,775	5,500	275	5%
Postage & Delivery	2,750	3,500	(750)	(27%)
Legal Fees	2,500	4,000	(1,500)	(60%)
Accounting & Auditing	4,000	4,000	0	0%
Fees	0	0	0	0%
Interest	0	960	(960)	
Depreciation	13,500	13,500	0	0%
Total Expenses	355,585	317,266	\$ 38,319	11%
NET INCOME	\$ 29,415	\$ 12,980		

Which are the three *most important* variances?

1. **total revenues**
2. **salaries**
3. **sale of property**

Why?

1. **\$54,754 lower than budgeted**
2. **\$36,412 lower — helps make up for revenue shortfall**
3. **93% lower than budgeted — serious forecasting error**

Budget-to-Actual Reports — Exercise 9

Use the chart on the next page.

- Use your organization's latest annual income statement, if available.
- Fill in all line items in the chart from the income statement.
- Find the corresponding budget line item and fill in the budgeted amount (**Budgeted Amount**).
- *If the budget period is different from the accounting period, convert the budget amount to correspond to the accounting period (**Budgeted Amount for Accounting Period**).*

For example, if the accounting period is three months, and the budget period is 12 months, divide the budgeted amount by four, and enter for each line item.

- Fill in the actual amount of income or expense, from the income statement (**Actual Amount**).
- Subtract the actual amount of **expenses** from the budgeted expense amounts, for each line item, and enter the results in the chart (**\$ Variance**). For **revenues**, subtract the budgeted amount from the actual amount and enter the results as **\$ Variance**.
- Divide the **\$ Variance** amount by the budgeted amount for each revenue and expense line item, and multiply by 100 (**% Variance**).
- If **% Variance** is greater than 10% for any line item, or if **\$ Variance** is greater than \$1,000, enter **Yes** for Significant Difference.

These are the budget variations that you need to explain.

Program Budgets

Program budgets reflect the costs and revenues of programs (or departments) run by an organization. Program budgets are a combination of *direct* revenues and expenses (costs and incomes that are completely caused by the program) and *indirect* revenues and expenses (not caused by any program but by general activities of the organization).

For example, the salary of a housing construction specialist who works only on the single-family rehabilitation program will be a direct cost of that program. The salary of the executive director, who attends board meetings, raises funds and does other administrative tasks, but who does not work on any of the programs, will be an indirect cost to all of the programs.

In many organizations, normal operating indirect expenses are known as *general and administrative (G&A)* expenses.

Program budgets are created by:

- Listing the *direct* expenses of any program
- Listing the *direct* revenues of the program
- Computing an *allocation percentage* (described below) for that program

and then

- Multiplying the organization's G&A expenses by that allocation percentage
- Multiplying the organization's unattributed revenue by that allocation percentage

The program budget — also called a department or cost-center budget — is a variation of the operating budget that breaks down costs by program.

- They still contain line-item descriptions, or accounts.
- The accounts are determined in the same way.
- Each column still has a bottom line.

Much as budgets are projections of future revenue statements, program budgets are projections of future statements of functional expenses.

Determining when and how to create a program budget is sometimes a judgment call and sometimes required by a donor or the organization's accountant. These are some of the major factors that go into deciding when cost-center budgets (as well as cost-center-based financial reporting) are required:

- The organization has multiple operations that are so distinctly different that their financial status should be tracked separately. The tracking helps determine whether they are winning or losing financially. Some clear signs that this is the case are:
 - The programs have fairly separate or completely separate staffs.
 - A program (such as rental property management) has a number of unique kinds of income or expenses (such as rents, property maintenance, property taxes, etc.).
- At least one program is somewhat, or solely, self-supporting from the revenue from sales or services, so that its financial status should be tracked separately in order to determine if self-sufficiency is being achieved.
- A nonprofit organization has a for-profit business, the income from which the Internal Revenue Service (IRS) considers unrelated business income. This has to be tracked separately to report the operation's finances to the IRS and other income-taxing jurisdictions.
- A program relies heavily or solely on funding from a single outside source, and that source requires a separate accounting from the program.

However, breaking operations into separate programs can easily be overdone. This can create needless complexity in tracking and allocating income, personnel time and other expenses.

To Think About: In your organization's next operating budget, should you be thinking about converting to a cost-center format, or adding cost centers?

ALLOCATION OF INCOME AND EXPENSES

Program budgets require allocation of both income and expenses, which can be a complex task. Projected costs can be both *direct expenses* and *indirect expenses*.

Personnel costs that are clearly attributable to a program are direct expenses, whether they amount to 100 percent of an employee's time or 10 percent. Direct expenses include any other expense that has a clear and identifiable benefit to a particular program.

However, some of the working hours of an executive director and other administrative personnel cannot be clearly attributed to one program or another. This might be time spent on fund raising, accounting, next year's budget, etc. These indirect expenses must be allocated to the appropriate program. Expenses such as rent, utilities, directors' and officers' insurance and others fall in this category.

ALLOCATION METHODS

The allocation of indirect expenses and revenues can occur using a number of different methods. The three most common methods are described below.

Direct Allocation

Under the direct allocation method, overhead costs are treated as though they are direct costs of a financial area. For example, all general and administrative expenses are considered costs of their own distinct department or program. This essentially transforms traditionally indirect cost items into direct cost items for a department or project.

Notice the example on the following page:

- The organization runs two programs: supportive housing and single-family housing development; additionally, there are general and administrative (G&A) costs (overhead) that support the general operations of the business.

- Grants received to support each program are directly allocated to the programs; additionally, the development program receives revenue from the proceeds of house sales.
- An unrestricted grant is received to support the general operations or functions of the organization. It is directly allocated to G&A.
- Staff salaries and benefits are directly allocated to each functional area; the executive director and her administrative assistant are budgeted to G&A.
- Program costs are attributed to each program, and all other costs that cannot be directly attributed to one program (such as rent, utilities, general supplies, etc.) are attributed to G&A.

Notice that in the direct allocation method, indirect costs are captured within their own distinct functional area much like direct program costs are captured within their respective programs. In this example, the G&A costs associated with running the office or conducting other nonprogram operations are reported separately from the program costs.

Direct Allocation Method

	Supportive Housing	Development	G&A	Total
REVENUES				
Restricted Grants	\$ 140,000	\$ 150,000		\$ 290,000
Unrestricted Grants			\$ 135,000	135,000
Proceeds from Sales		50,000		50,000
Total Revenues	140,000	200,000	135,000	475,000
EXPENSES				
Salaries	110,660	125,000	80,000	315,600
Benefits	22,000	36,000	20,000	78,000
Office Rent			4,500	4,500
Supplies	500	1,500	2,500	4,500
Telephone			3,000	3,000
Utilities			2,000	2,000
Printing	500	500	1,500	2,500
Postage			750	750
Legal	1,500	5,000	4,000	10,500
Audit			5,000	5,000
Insurance			2,000	2,000
Equipment	1,000	800	1,200	3,000
Marketing	1,000	1,200	300	2,500
Travel	1,500	5,000	1,500	8,000
Publications	400	500	200	1,100
Training	1,000	2,500	500	4,000
Total Expenses	140,000	178,000	128,950	446,950
SURPLUS (DEFICIT)	\$ 0	\$ 22,000	\$ 6,050	\$ 28,050

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Simple Allocation

This method uses a *single factor* to divide general and overhead costs between programs, departments or cost centers. Consider the following example:

An organization has two activities: supportive housing and housing development. A *single factor*— in this case, “Percentage of Total Direct Cost” — is used to derive overhead rates for each activity. Then, using the respective rates, G&A costs are divided between the activities.

Calculating Percentage of Total Direct Cost — Let’s begin by determining the organization’s Total Direct Cost — or the cost of both of the organization’s activities. It equals the direct cost associated with supportive housing, plus the direct cost associated with housing development.

$$\text{Supportive Housing Direct Cost} + \text{Housing Development Direct Cost} = \text{TOTAL DIRECT COST}$$

One way of thinking about Percentage of Total Direct Cost is to consider what proportion of the organization’s costs pays for supportive housing (SH) and what proportion pays for housing development (HD). The calculation of Percentage of Total Direct Cost for each activity equals the Direct Cost associated with that activity, divided by Total Direct Cost, and multiplied by 100.

$$(\text{Supportive Housing Direct Cost} \div \text{Total Direct Cost}) \times 100 = \text{Percentage of Total Direct Cost, SH}$$

$$(\text{Housing Development Direct Cost} \div \text{Total Direct Cost}) \times 100 = \text{Percentage of Total Direct Cost, HD}$$

$$\text{Percent of Total Direct Cost, SH} + \text{Percent of Total Direct Cost, HD} = 100\%$$

Now let’s apply this formula to our example using the following information:

- The supportive housing program has a total of \$140,000 in direct expenses, and the development program has \$178,000 in direct expenses.
- The total direct program costs overall is \$318,000.
- The overhead rates for each program are calculated as follows:

Supportive Housing	Development
$\frac{140,000}{318,000} = 44\%$	$\frac{178,000}{318,000} = 56\%$

- The total indirect costs for the organization are \$128,950.
- Each G&A line item is then allocated to the programs based on the overhead rate.

G&A Line Items	Supportive Housing	Housing Development	TOTALS
Office Rent	\$1,000 X 44% = \$ 440	\$1,000 X 56% = \$ 560	\$1,000
Office Supplies	1,200 X 44% = 528	1,200 X 56% = 672	1,200
Utilities	3,600 X 44% = <u>1,584</u>	3,600 X 56% = <u>2,016</u>	<u>3,600</u>
	<u>\$2,552</u>	<u>\$3,248</u>	<u>\$5,800</u>

Choosing the Single Factor — The Simple Allocation calculation is easy; what’s more involved is choosing the most appropriate *single factor*. Other common factors include “percentage of total labor” and “percentage of space” attributable to the activities. Consult with your treasurer or accountant to identify the best single factor to use in dividing your G&A costs across programs.

Simple Allocation Method —
Indirect Costs Assigned Based on Allocation Rates

		Housing Counseling	Housing Rehabilitation
		Allocation Basis: 30% of Direct Cost	Allocation Basis: 70% of Direct Cost
REVENUES			
Community Development Block Grant	\$ 210,000	\$ 63,000	\$ 147,000
ABCD Foundation Grant	148,950	44,685	104,265
Fund-Raising Proceeds	88,000	26,400	61,600
TOTAL REVENUES	<u>\$ 446,950</u>	<u>\$ 134,085</u>	<u>\$ 312,865</u>
EXPENSES			
Salaries	\$ 315,600	\$ 94,680	\$ 220,920
Benefits	78,000	23,400	54,600
Office Rent	4,500	1,350	3,150
Supplies	4,500	1,350	3,150
Telephone	3,000	900	2,100
Utilities	2,000	600	1,400
Printing	2,500	750	1,750
Postage	750	225	525
Legal	10,500	3,150	7,350
Audit	5,000	1,500	3,500
Insurance	2,000	600	1,400
Equipment	3,000	900	2,100
Marketing	2,500	750	1,750
Travel	8,000	2,400	5,600
Publications	1,100	330	770
Training	4,000	1,200	2,800
TOTAL EXPENSES	<u>\$ 446,950</u>	<u>\$ 134,085</u>	<u>\$ 312,865</u>

In this simplified example, both programs are housing programs that serve low-income people and are eligible Community Development Block Grant activities. CDBG funds are technically “restricted” funds, but both of this organization’s activities are CDBG-eligible. Both are eligible for the foundation funds, too, and the remaining revenues are “unrestricted.” This means that this organization can treat all its revenues like unrestricted funds, using them to cover any of the expenses included in this budget. So, for added simplicity we’ve allocated revenues across the programs using the indirect cost allocation percentages.

NOTE: Only your working budget would include the second column above, which shows total unallocated G&A costs.

Multiple Allocation

The multiple allocation method employs the use of several allocation bases to spread the indirect cost items across the programs. Typically, the expense line items are grouped into indirect cost pools such as personnel expenses, marketing costs, fund raising or office expenses. An allocation basis is then determined for each pool. For example, office expense line items (rent, utilities, phone, etc.) may be allocated based on the percentage of total office space for each program. Personnel expenses may be allocated based on actual labor hours worked as reported on a time sheet.

In the example that follows, the organization allocated the indirect costs to the programs based on the following assumptions.

- The expense line items were grouped as follows (into three distinct cost pools):

Personnel	Office Admin.	Business Operations
Salaries	Rent	Printing
Benefits	Supplies	Legal
Training	Telephone	Audit
	Utilities	Insurance
	Postage	Marketing
	Equipment	Travel
		Publications

- The unrestricted grant is allocated evenly to the programs.
- G&A salaries consist of the executive director and her administrative assistant, both of whom divide their time equally to the programs.
- Office space is used as a basis to allocate office-related expenses including rent, phone, utilities, supplies, postage and equipment; it is determined that supportive housing uses approximately 60 percent and development uses 40 percent of the office space.
- All other costs are divided evenly between the programs.

Let's consider one line item to illustrate. Staff training for each of the two programs consists of the training costs for the staff of that program plus half of the training costs for the executive director and her administrative assistant:

Supportive Housing	
Direct	\$ 1,000
Indirect (50% of \$500)	<u>250</u>
	\$ 1,250
Development	
Direct	\$ 2,500
Indirect (50% of \$500)	<u>250</u>
	\$ 2,750

Multiple Allocation Method —
Indirect Costs Allocated to Programs — Based on Assumptions

	Supportive Housing	Development	Total Costs
REVENUES			
Restricted Grants	\$ 140,000	\$ 150,000	\$ 290,000
Unrestricted Grants	67,500	67,500	135,000
Proceeds from Sales		50,000	50,000
Total Revenues	<u>207,500</u>	<u>267,500</u>	<u>475,000</u>
EXPENSES			
Salaries	150,600	165,000	315,600
Benefits	32,000	46,000	78,000
Office Rent	2,700	1,800	4,500
Supplies	2,000	2,500	4,500
Telephone	1,800	1,200	3,000
Utilities	1,200	800	2,000
Printing	1,250	1,250	2,500
Postage	450	300	750
Legal	3,500	7,000	10,500
Audit	2,500	2,500	5,000
Insurance	1,000	1,000	2,000
Equipment	1,720	1,280	3,000
Marketing	1,150	1,350	2,500
Travel	2,250	5,750	8,000
Publications	500	600	1,100
Training	1,250	2,750	4,000
Total Expenses	<u>205,870</u>	<u>241,080</u>	<u>446,950</u>
SURPLUS (DEFICIT)	<u>\$ 1,630</u>	<u>\$ 26,420</u>	<u>\$ 28,050</u>

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Notes

Notes

THE ENTERPRISE FOUNDATION

The Foundation's mission is to see that all low-income people in the United States have access to fit and affordable housing and an opportunity to move out of poverty and into the mainstream of American life. To achieve that mission, we strive to:

- Build a national community revitalization movement.
- Demonstrate what is possible in low-income communities.
- Communicate and advocate what works in community development.

As the nation's leader in community development, Enterprise cultivates, collects and disseminates expertise and resources to help communities across America successfully improve the quality of life for low-income people.

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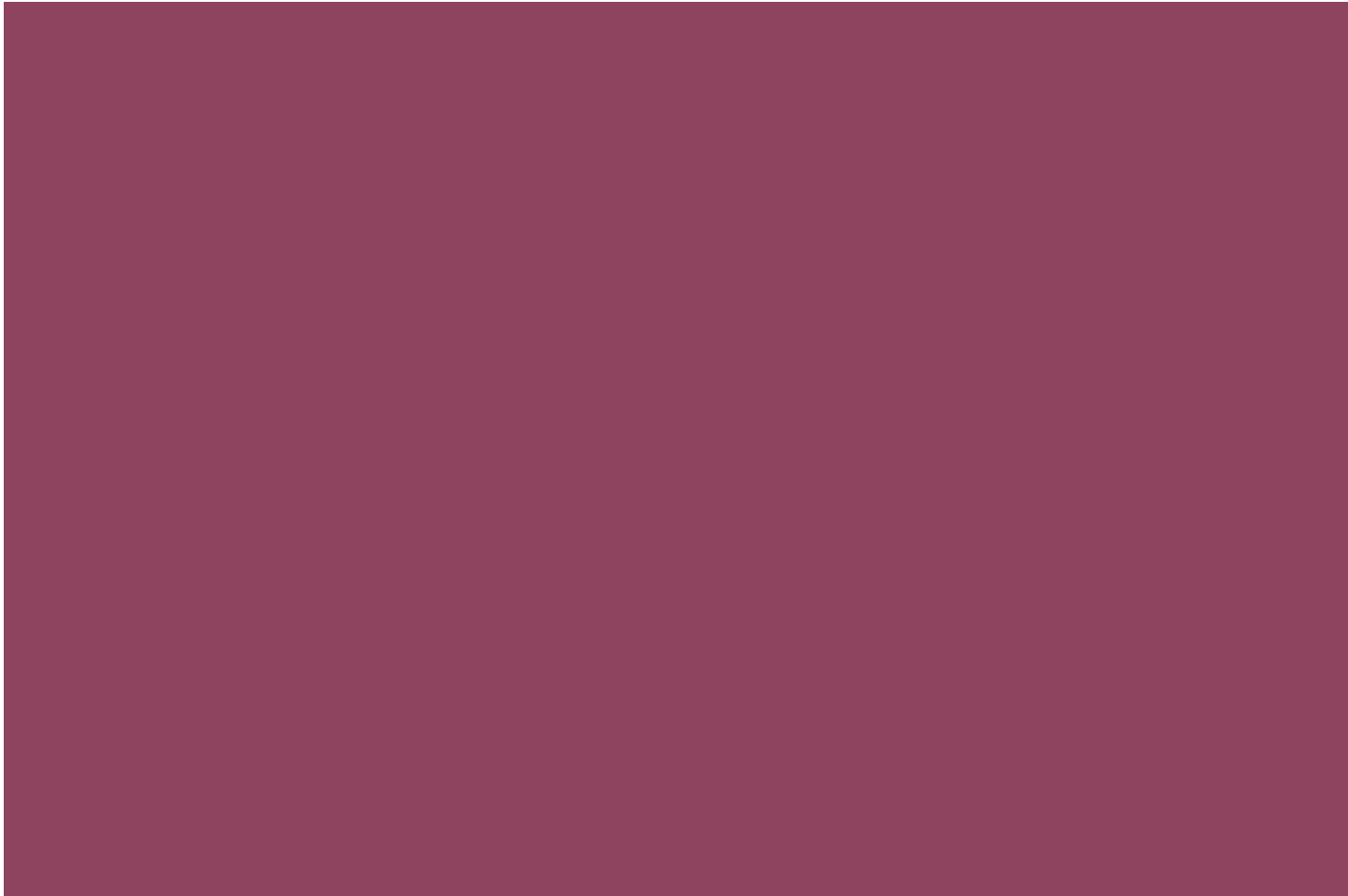
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