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A Zero-Sum Approach to Not-For-Profit Strategic Oversight: A Practical, Uncomplicated Solution

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Many not-for-profits lack an integrated budgeting process. Too often it is ad hoc, top down, and unrelated to an organization's strategic mission. Despite improvements in the economy, the future remains uncertain, and competition for donor funding continues to increase. Organizations that are strategic and financially responsible will have a competitive edge with funders. Zero-Sum Budgeting is a decision-support tool which helps not-for-profits remain on budget without compromising their mission. It is a straightforward approach conceptually based on zero-sum game theory and flows organically from an organization's strategic planning process. Using Zero-Sum Budgeting, a not-for-profit can deliver its most important commitments without having to overburden staff or make unplanned dips into cash reserves. At its core, this approach requires an organization to make strategic trade-offs when revenues fall short or unplanned actions occur that impact a pre-agreed cash position. This cash position is established at the start of the budget year and remains unchanged, acting as a fulcrum, which drives management action throughout the year. The article is written for senior not-for-profit executives who are in need of a fresh approach to strategic planning and budgeting. It provides a good overview of the process and benefits. It is jargon free, contains a step-by-step implementation guide as well as useful charts and templates that are professionally designed.

Key Words: Zero-sum, game theory, budgeting, strategic planning, not-for-profit

Introduction

Most not-for-profits who made it through the 2008 financial meltdown have shifted from survival mode to expansion mode. For many, this entails a different operating mindset after years of retrenchment. Having the right strategic and financial planning tools will help organizations prioritize resources and utilize information more efficiently. Such capabilities are just as important for start-ups in today's post-recession environment because there is still great economic uncertainty and increasing competition for donor support.

Unfortunately, strategic planning in most organizations is poorly structured, producing optimistic assessments of limited strategic or tactical value. This is often compounded by an annual budgeting exercise that fails to take into account the long-term.

Faced with these challenges, small and medium-sized organizations still require useful information, and yet must be conscious of not overburdening staff. Zero-Sum Budgeting is a viable solution, an innovative approach that streamlines the tracking and updating of financial performance using assumptions based on the strategic plan's first year. Zero-Sum Budgeting is easy to implement and execute. It is also an effective way to meet budget commitments by acting quickly when performance diverges from the Annual Budget.

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I developed Zero-Sum Budgeting when I was a CFO for an international not-for-profit, drawing on 20+ years as a senior financial executive and division president at several Fortune 25 companies. I introduced this approach because I wanted to:

- increase the probability of achieving budget commitments
- react quickly to unforeseen impacts on operations, programming and development
- improve revenue forecasting despite the unpredictable nature of fundraising
- avoid unplanned dips into cash reserves.

These capabilities are especially valuable to organizations tight on cash that are dependent on donor support that is highly 'use restricted,' but these attributes can be just as useful to organizations with more substantial balance sheets (e.g. more cash).

Is Zero-Sum Budgeting for You?

Whether you're a community-based group with an annual budget of $200,000 or an international aid organization operating in five countries with a $75m budget, Zero-Sum Budgeting can work for your organization because the basic principles are simple and easy to implement.

What distinguishes Zero-Sum Budgeting from traditional ways of preparing and updating budgets is the principal of maintaining 'balance' throughout the year. The logic comes from Zero-Sum Game Theory. Game theory works in this way: when the game begins, a fixed amount of points is allocated to all players. To win a point another player yields a point because the combined score must remain the same. In the context of Zero-Sum Budgeting, a shortfall of revenue results in a corresponding cut in expenses to maintain the targeted cash levels set at the beginning of the year.

Zero-Sum Budgeting provides timely data for managing without placing an additional reporting burden on staff. It also forces an organization to strategically prioritize spending reductions to maintain cash levels established at the outset of the budget year. How this is accomplished will be illustrated later in this paper.

By integrating Zero-Sum Budgeting with your strategic planning activities, you will maximize Zero-Sum's usefulness and avoid decisions inconsistent with the organization's mission and strategy. The next section provides an overview of the Strategic Plan, the Annual Budget, and how these activities interrelate.

Traditional Budgeting Weaknesses

Traditional budgeting is a "top-down" approach to estimate expenditures and forecast income. The focus is on preceding year's actual results adjusted up or down to reflect the upcoming fiscal year's assumptions.

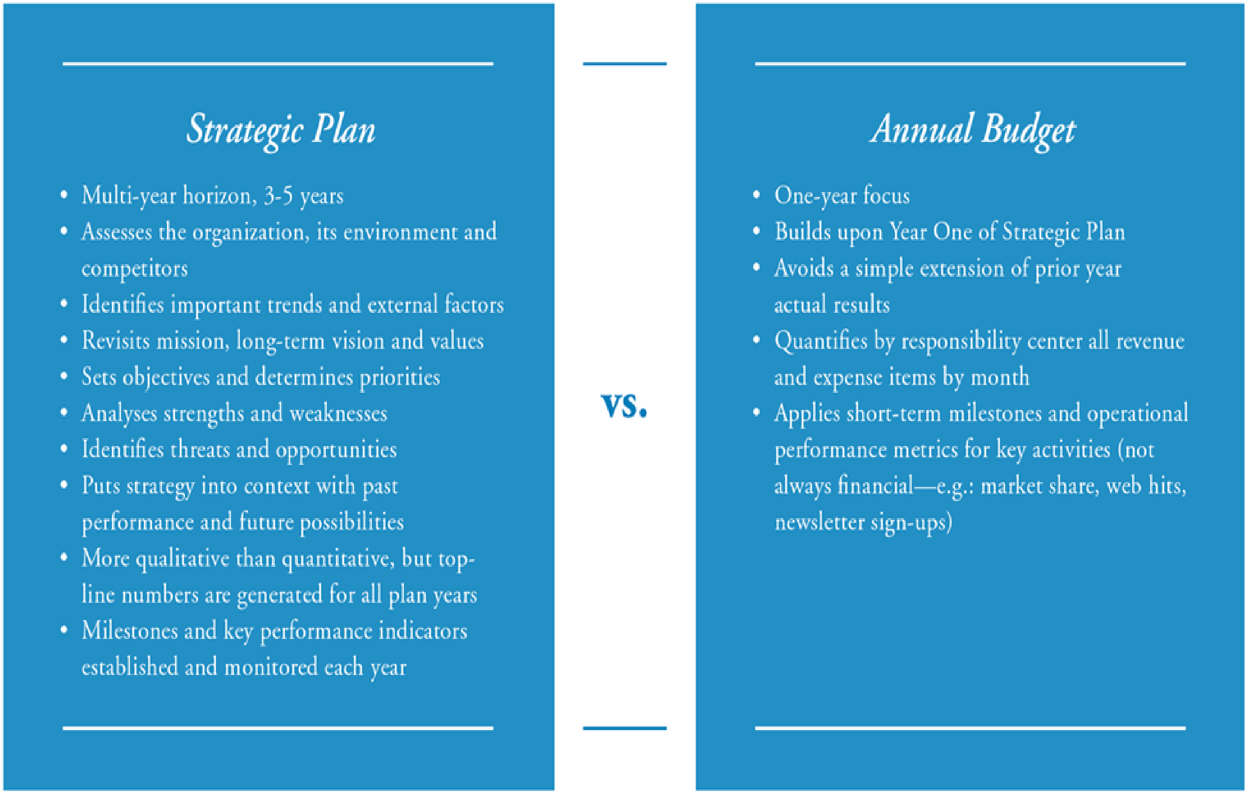
This approach is historically-based, rather than strategic. This limitation is even more acute when business conditions change rapidly and close monitoring of strategic performance is a priority. Weaknesses of traditional budgeting include:

- requires excessive preparation time
- absorbs management resources
- costly to compile and consolidate
- emphasizes financial performance over strategy
- not aligned with strategic planning
- encourages "game playing" by overstating funding requirements to build "cushions" or understating budget targets to make performance appear more extraordinary
- focuses on an annual timeline divided into monthly segments rarely amended as circumstances change
- lack of flexibility generates little information that is actionable

Despite these shortcomings, a lot of organizations still rely on traditional budgeting.

The Strategic Plan and Annual Budget: Integrated. Cohesive. Consistent.

Although the focus of this article is to address the 'why' and 'how' of Zero-Sum Budgeting's advantages as a management tool, it is important to put it into context.



Some organizations confuse strategic planning and the Annual Budget, often bundling them into one exercise, calling it the Annual Plan. This shortcut discounts the value of functional separation and ignores the benefits of integration. An Annual Plan can also be confusing because it serves no strategic purpose, essentially representing a word summary of the Annual Budget with some comments about subsequent years. Strategic planning and budgeting activities must be aligned, but they are different exercises.

Strategic planning focuses on long-term opportunities consistent with the organization's stated mission, assessing them in the context of the organization's core capabilities. The Annual Budget quantifies in detail the activities and programs carried out during the budget year, identifying all associated costs, and then summarizing those results on a monthly basis. If done correctly, the first year of the Strategic Plan and the Annual Budget will be directionally consistent (Refer to Figure 1 and 2 on the following pages for further details).

As previously mentioned, proper integration of these activities significantly improves the planning and budgeting functions, resulting in a clear strategic direction to maximize the social impact of donor dollars. In other words, planning/budgeting alignment helps create long-term value for an organization's constituencies.

Here are some easy steps a not-for-profit can take to create a cohesive process:

- Start the Strategic Plan in advance of the Annual Budget and obtain board approval prior to the start of the budgeting process.
- The key assumptions from Year One of the Strategic Plan should form the foundation of the Annual Budget.
- As part of the strategic planning process, prioritize and update each year's key programs and projects in terms of strategic importance. This ranking helps allocate funding at the start of the budgeted year. It also helps identify the sequence cutbacks occur, if there are revenue short-falls or program overspending.
- Establish minimum cash levels, taking into account monthly burn rate and other external factors that impact cash. Since failure to maintain cash levels has potentially catastrophic implications, it is important to understand how to set appropriate levels. This is also critical to Zero-Sum Budgeting because it establishes the threshold where action is required. A more detailed discussion of how to set appropriate cash levels for an organization is reviewed later in this paper.

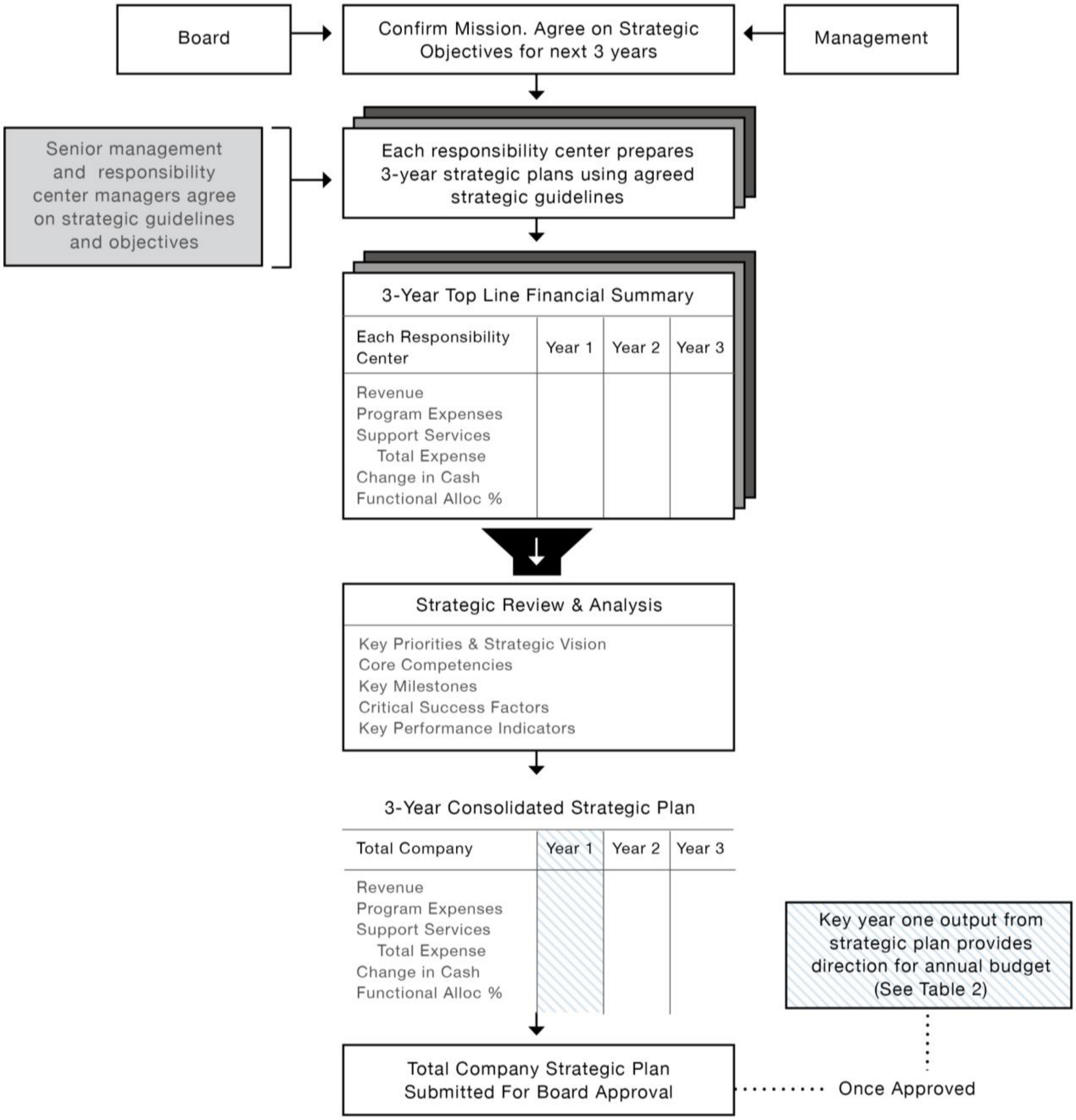


Figure 1. The Strategic Planning Process- Simplified

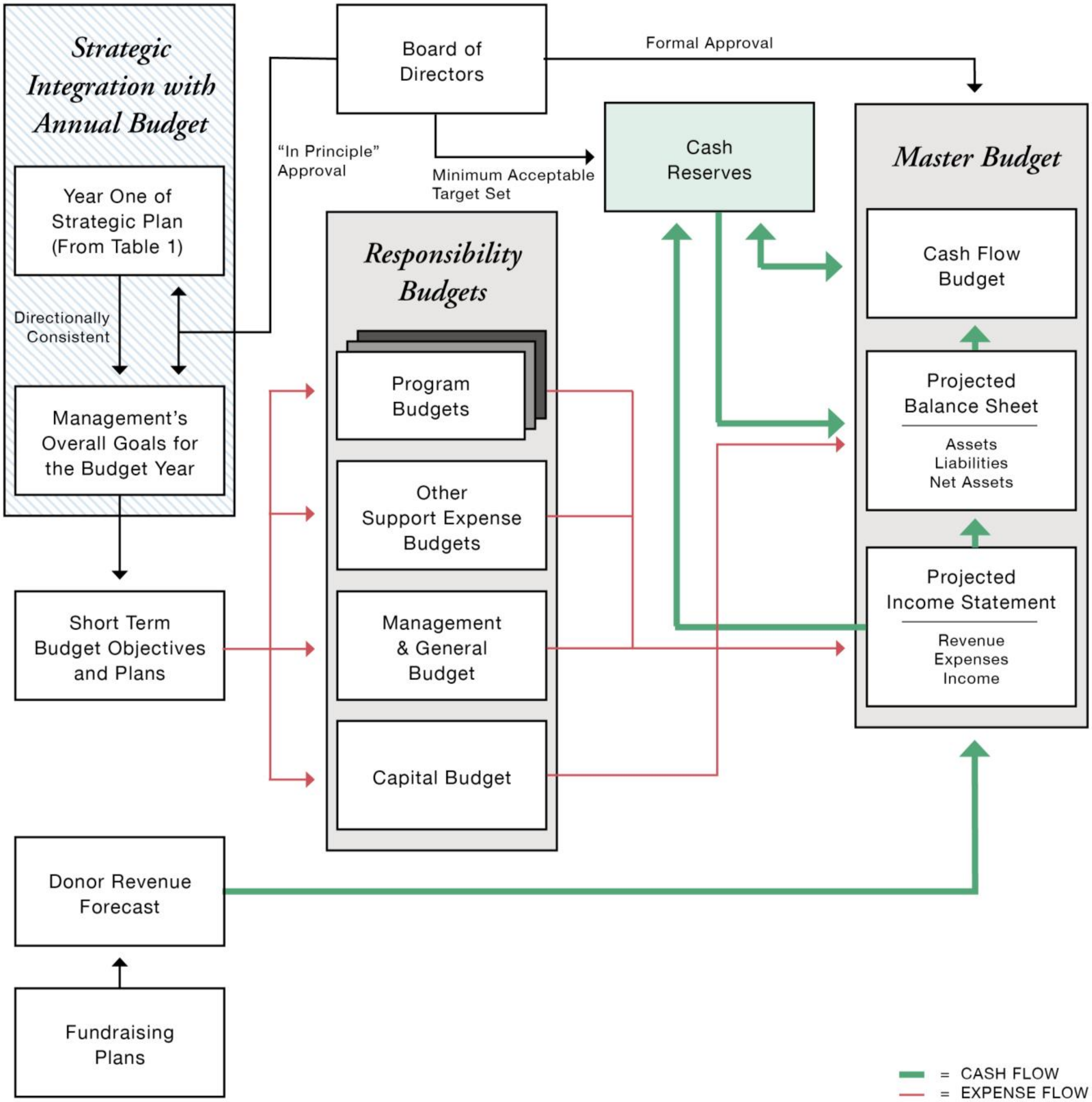


Figure 2. The Annual Budget- Simplified

Getting the Key Decision Makers Involved in Strategy and Budgeting

In many organizations finance is responsible for both the Strategic Plan and Annual Budget. Many times this results in the non-financial team viewing these activities as an obligation, something to get through as fast as possible so that they can get back to the so-called 'real work.' The Strategic Plan and the Annual Budget are not just mechanical, top-down, financial exercises. By integrating the process throughout the organization, you can avoid this common perception. Engage your non-financial executives by implementing the following:

- Plan and budget inputs should originate at the responsibility center level.
- Manager buy-in at such levels is important to make sure the entire organization is on the same page. Moreover, this bottom-up approach keeps everyone focused on achieving the Annual Budget throughout the year.
- Tie performance evaluations to your strategic priorities and attainment of the Annual Budget. Determine specific, quantifiable performance objectives that define success for operating and support staff. Also quantify major program activities so that they can be evaluated throughout the year.
- Finally, the odds of achieving your Annual Budget are greatly improved when the outputs from the Strategic Plan and Annual Budget are aligned with the organization's priorities, spending and performance evaluations. This is so important it needs repeating: The odds of success are greatly improved when the outputs from the Strategic Plan and Annual Budget are aligned with the organization's priorities, spending and performance evaluations.

For Zero-Sum Budgeting to be an effective management tool, the above guidelines should be in place before the budget year commences. When followed carefully, the Annual Budget becomes a valuable reporting mechanism, keeping the organization strategically focused on the priorities established during the planning process.

Because revenue forecasting significantly affects all aspects of the Annual Budget, developing those targets requires great care. The next section provides tips on how to avoid several pitfalls, because missing revenue targets not only damages management credibility, it hurts the organization in other ways too.

What to Avoid When Projecting Revenue

Every budget starts with a revenue forecast before the more detailed costs for major programs and projects are calculated. This forecast typically begins during the strategic planning process and is further refined during the preparation phase of the Annual Budget. Revenue forecasts can be tricky because they must be realistic, prepared (preferably) on a cash receipt basis, and in most organizations, approved by the Board before the detailed Annual Budget is started.

> **Good to Know**
>
> GAAP accounting requires that donor pledges are booked at the time the pledge is received, even if it covers several years. A pledge contingent on a specific event or a defined passage of time is not booked as revenue until the event occurs or the specified timing elapses. Even if multi-year pledges are booked pursuant to GAAP in the current year, for budget purposes, these pledges should only be reflected in the Annual Budget if all of the cash is expected in the budget year.

Revenue forecasts are an important management commitment because these projections drive spending plans—not the other way around (see Table 1 on page 8 for an example). Overly optimistic forecasts can hurt your organization, but being too cautious can just as easily put your organization at risk. When projecting revenues, the watch word is realism, but when in doubt, conservatism should take precedence. If additional revenues materialize, Zero-Sum Budgeting, via its quarterly projections process explained in the next section, will strategically put these revenues to work.

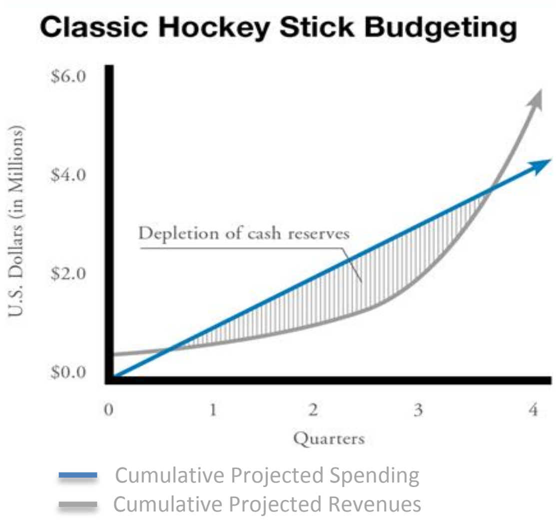
The following are typical examples of how poor revenue projections damage organizational credibility:

- Stretch goals to motivate employees can unwisely end up as budget commitments. Stretch goals are useful for incentive purposes, but should not be used to develop revenue commitments. Over promising and then under delivering undermines management credibility and encourages aggressive spending plans that lead to misunderstandings or contract commitments that cannot be fulfilled. This results in unbudgeted deficits and a depletion of cash reserves when revenues don't materialize.
- Revenue heavily 'back-ended' to the fourth quarter is a major issue and should be avoided (unless it is a direct result of the organization's normal seasonality).
- A 'back-ended' revenue pattern unrelated to seasonality is more common than not, despite

the significant risks such projections pose. Visually, this condition resembles a 'hockey stick' (see chart on this page) and is a well-known indicator of future instability. Of course, an organization can reduce this risk by making sure that spending is closely aligned with receipt of donor revenue.

Good to Know

Budgets with this high risk profile curve may indicate poor donor support expectations, or an organization living beyond its means.



- If a 'hockey stick' budget already exists, it tends to carry over year after year unless a concerted one-time effort is made to reduce expected fourth quarter revenues by an amount that spreads revenue more evenly throughout the following year. This can be difficult because it requires under-performing budget targets, or setting next year's revenues well-below the preceding year's actuals. Neither option is easy since it involves admitting to overly optimistic revenue projections. Showing a year-over-year decline in revenue for the next budget year is especially difficult because management wants to demonstrate year-on-year growth. Underperforming current year budgeted revenue targets does not build confidence either. Unfortunately there is no easy solution for correcting an existing 'hockey stick,' but the sooner corrective actions are taken, the sooner the organization will be better positioned for the long term.
- Another high-risk activity is spending in anticipation of future funding. Some managers establish unrealistic operating goals to impress the Board and/or potential donors with expansion plans in the hopes of new funding. If expected revenues fail to materialize, an unplanned deficit will impact financial performance, which in turn could jeopardize future donor support.

Table 1

Organization XYZ
2014 Quarterly Revenue Forecast
Projections 3x9 vs. 6x6 vs. Actual
(CASH BASIS)

	2014 Q1			2014 Q2			2014 Q3			2014 Q4			2014 Total		
(in $000)	3x9	6x6	Actual	3x9	6x6	Actual	3x9	6x6	Actual	3x9	6x6	Actual	3x9	6x6	Actual
Cash															
Corporation A	–	–	–	56	75	75	–	30	–	–	–	–	56	105	75
Corporation B	500		500	500	500	500	–	–	–	50	–	–	550	1,000	1,000
Foundation A	83		83	20	20	20	–	–	–	825	825	–	928	845	103
Total Cash	**583**	**–**	**583**	**576**	**595**	**595**	**–**	**30**	**–**	**875**	**825**	**–**	**1,534**	**1,950**	**1,178**
Pledges															
Corporation C				150		150	567	250					717	250	150
Major Individual Donor					150	75	100	250					100	400	75
Research Foundation A				50	50								50	50	–
Total Pledges	–	–	–	**200**	**200**	**225**	**667**	**500**	**–**	**–**	**–**	**–**	**867**	**700**	**225**
Total Cash & Pledges	**583**	**–**	**583**	**776**	**795**	**820**	**667**	**530**	**–**	**875**	**825**	**–**	**2,401**	**2,650**	**1,403**
Proposals Submitted															
Corporation H				75	75		75	75					150	150	–
Corporation Y				200	100			100					200	200	–
Federal Agency A					75			75			150		–	300	–
NGO A				100	50			50		60			160	100	–
Major Individual Donor				200	150			150					200	300	–
Total Proposals Submitted	–	–	–	**575**	**450**	**–**	**75**	**450**	–	**60**	**150**	–	**710**	**1,050**	**–**
Proposals in Development															
Corporation R							300	250					300	250	–
Corporation P					50	50				200			200	50	50
Major Individual Donor				250		150				250	200		500	200	100
State Agency A							200	100					200	100	–
NGO B							120	75					150	75	–
Total Proposals in Dev.	–	–	–	**250**	**50**	**150**	**650**	**425**	–	**450**	**200**	–	**1,350**	**675**	**150**
Cultivation															
Major Individual Donors	–	–	–	–	–	–	–	–	–	800	500	–	800	500	–
Other Corporation															
Total Cultivation	–	–	–	–	–	–	–	–		800	500		800	500	–
Total Revenue Forecast (6x6)	**$583**	**–**	**$583**	**$1,601**	**$1,295**	**$970**	**$1,392**	**$1,405**	**–**	**$2,185**	**$1,675**	**–**	**$5,261**	**$4,875**	**$1,553**

NOTE: Demonstrates a "Hockey Stick" budget with more than 67% of revenue expected in the 3rd and 4th Quarters when the 3x9 projection was prepared.

Cash Reserves: Zero-Sum Budgeting's Backstop

Zero-Sum Budgeting helps management avoid unplanned dips into cash reserves. To get the most out of this approach, it is important to set an appropriate cash level for your organization. Even though setting a guideline is subjective, organizations should nevertheless specify a threshold that alerts management when it approaches a pre-determined level so that it can proactively respond before things get out of hand.

Since Zero-Sum Budgeting re-projects budgeted financials quarterly while holding cash reserves fixed, it is essential that cash levels are defined by senior management and approved by the Board before the budget year begins. Cash reserve guidelines need sufficient flexibility so that only situations with serious strategic implications are elevated to the Board. Determining the degree of flexibility is a matter for negotiation between the Board and senior management.

Here are a few examples of how a cash reserve guideline can be sensibly structured:

- Prior to the budget year, a minimum acceptable cash reserve is determined which management cannot fall below during that year. Potential breaches of this minimum 'trigger' Board involvement.
- If the above guideline is too restrictive, a variation allowing temporary breaches in the minimum cash reserve during a given month or quarter provides more flexibility, but the Board should still be involved if the expected breach exceeds a preset dollar amount (to be determined by your Board). A further condition could be added requiring a year-end cash position that is at least equal to the level at the start of the year.
- Another reasonable guideline is to require a specific amount of surplus cash by year end (e.g., at least six months of operating expenses), leaving it to management to decide how best to accomplish that target. In this case, at each quarterly Board review, data showing how management is doing versus this cash-reserve guideline would be provided.

No matter what guideline is selected, it is crucial that the monitoring and dissemination of financial information is provided on a timely basis so that necessary corrective actions can be taken without delay (see below for an example).

Again, holding the net-cash position fixed throughout the budget year is the key to Zero-Sum Budgeting. Changing budgeted cash levels in mid-season would be the financial equivalent of telling a baseball team that this year's budget objective to win the World Series has been changed to win only 75 games, without taking corrective actions to cover the cash shortfall.

Organization XYZ
Critical Time Reports with Final Due Dates
for EXCOM and BOD Reviews

	For Completion in 2014								
Due from Entity to Finance Dept.	Last Year Actual 2013	1st Qtr Actual 2014	Projection 3x9 2014	2nd Qtr Actual 2014	Projection 6x6 2014	Strategic Plan 2015	Budget 2015	3rd Qtr Actual 2014	Projection 9x3 2014
Resp. Center #1	Jan 10, 2014	Apr 11, 2014	May 12, 2014	Jul 11, 2014	Aug 11, 2014	Aug/Sep 2014	Oct/Dec 2014	Oct 10, 2014	Nov 11, 2014
Resp. Center #2	Jan 10, 2014	Apr 11, 2014	May 12, 2014	Jul 11, 2014	Aug 11, 2014	Aug/Sep 2014	Oct/Dec 2014	Oct 10, 2014	Nov 11, 2014
Resp. Center #3	Jan 10, 2014	Apr 11, 2014	May 12, 2014	Jul 11, 2014	Aug 11, 2014	Aug/Sep 2014	Oct/Dec 2014	Oct 10, 2014	Nov 11, 2014
Headquarters	Jan 10, 2014	Apr 11, 2014	May 12, 2014	Jul 11, 2014	Aug 11, 2014	Aug/Sep 2014	Oct/Dec 2014	Oct 10, 2014	Nov 11, 2014
Company Consolidation	Jan 15, 2014	Apr 16, 2014	May 14, 2014	Jul 16, 2014	Aug 15, 2014	Aug/Sep 2014	Oct/Dec 2014	Oct 16, 2014	Nov 17, 2014
EXCOM Review	Jan 17, 2014	Apr 18, 2014		Jul 21, 2014			Oct 21, 2014	Oct 21, 2014	
BOD Approval	Jan 24, 2014		May 19, 2014		Sep 16, 2014	Sep 16, 2014	Dec 15, 2014		Nov 21, 2014

Zero-Sum Budgeting: Reforecasting for Improved Decision Making

Now that we've put the Strategic Plan and Annual Budget in context and described how to project revenue and establish appropriate cash reserves for the budget year, it's time to examine the details of Zero-Sum Budgeting and how it can help management achieve budget commitments.

No budget can project the future with one-hundred percent accuracy. Revenues and expenses shift month-to-month. One program starts late; another happens earlier than expected. An unexpected source of income pops up out of nowhere.

I created Zero-Sum Budgeting to address such situations. Through a series of quarterly re-projections of the Annual Budget, Zero-Sum Budgeting enables management to shift gears quickly by evaluating spending alternatives to avoid dipping below agreed upon cash levels.

Zero-Sum Budgeting's dynamic approach helps management: (1) quantify the cash impact of changes in the budget and (2) prioritize counterbalancing actions to ensure that the organization's net cash position remains unchanged.

Zero-Sum Budgeting is Not Rolling-Forecast Budgeting

Zero-Sum Budgeting should not be confused with rolling-forecast budgeting, the common practice of updating budgets continuously in full-year increments. Organizations that use Rolling Forecast Budgeting update monthly or quarterly on a fixed, twelve-month basis, although most update quarterly to minimize effort (see comparison below).

Zero-Sum Budgeting vs. Rolling Forecast Budgeting

Zero-Sum Budgeting – Current Year Quarterly Rolling Projections	Year X – (Current Year)				Year X + 1			
	1st Q	2nd Q	3rd Q	4th Q	1st Q	2nd Q	3rd Q	4th Q
Year X Budget	B	B	B	B				
3 x 9 Projection	A	Projection	Projection	Projection				
6 x 6 Projection	A	A	Projection	Projection				
9 x 3 Projection	A	A	A	Projection				
Year X + 1 Budget	A	A	A	A	B	B	B	B

Four-Quarter Rolling Forecast Budgeting	Year X				Year X + 1			
	1st Q	2nd Q	3rd Q	4th Q	1st Q	2nd Q	3rd Q	4th Q
Year X Budget	B	B	B	B				
1st Review	A	B	B	B	B			
2nd Review	A	A	B	B	B	B		
3rd Review	A	A	A	B	B	B	B	
Year X + 1 Budget	A	A	A	A	B	B	B	B

A = Actual; B = Budget

A company on a calendar-year cycle, using a twelve-month, rolling forecast, rolls forward after the first quarter, one full quarter into the next calendar year, resulting in what is actually a new Annual Budget. This twelve-month reforecast is repeated every quarter throughout the year. While Rolling Forecast Budgeting was developed to keep management more strategically 'in touch' by viewing the business in twelve month increments, in reality, it works in reverse, limiting effectiveness by bogging down management in endless budget negotiations.

Here are some of the more important differences between Rolling Forecast Budgeting and Zero-Sum Budgeting:

- Twelve month Rolling Forecast Budgets distract because they require approval of full-year budgets every quarter.
- Twelve month rolling budgets result in fluctuating targets that are confusing and make performance evaluations difficult.
- Changing budget commitments every quarter provides managers opportunities to renegotiate short-term targets or position for additional funding, which takes time away from focusing on important, operational initiatives.
- Strategic planning and budget functions should be compatible, but twelve-month rolling budgets make this unattainable. In comparison, Zero-Sum does not extend projections into a new year; Zero-Sum Budgeting's quarterly projections are refinements of the current year, and help to maintain the integrity of the Strategic Plan and the Annual Budget process.
- Zero-Sum Budgeting focuses on a diminishing number of quarters resulting in progressively more accurate current-year assessments, and less time wasted in budget reviews at every roll-forward period. As a result, management can focus on those actions required to keep performance on track.

How Zero-Sum Budgeting Works

Zero-Sum Budgeting is a simple concept. After first quarter actual results are in, a '3x9' projection is prepared: three months actual, plus a projection by month for the remaining nine months of the budget year. While revenues and expenses in the '3x9' are likely to change from the original budget, the net cash position, as explained earlier, remains unchanged for the year. Each month the annual cash position is projected and depending on the cash reserve guideline, actions may be required.

These quarterly projections start 'bottom-up,' emanating from those responsible for delivering department, program, or division budgets, depending on how your organization is structured. The information is then compiled and summarized by finance. This 'bottom-up' method parallels the creation of the original budget to ensure that everyone involved is committed. This should also alleviate some of the inevitable disappointment if cut-backs are required to meet commitments, because everyone was part of the process right from the start.

Once top management signs off on the new projection, it replaces the original budget with the exception of the cash position at the start of the year. Over the next quarter, for variance reporting, actual results are compared with the new current year projection, not the original budget. Similarly, after midyear, a '6x6' projection is prepared, replacing the '3x9'. This involves adding actual results for the last three months and re-projecting the next six. Again, this new projection becomes the controlling 'budget' until another quarterly projection is developed, and so on. While the original budget will no longer be the operative budget after the first quarter, at each quarterly Board review, the original budget will still appear as a reference point, alongside the most current projection.

Each time a new projection is prepared, a helpful exercise is to compare the new projection (based on updated actuals) to the previous estimate for the same period (see Tables 2 and 3 on the following page for examples). This provides insight into the organization's skill at projecting accurately over short time periods. Wide projection variances may indicate that certain managers are not in control or that an unexpected development occurred.

In either case, this feedback provides the opportunity to take corrective action if necessary. Moreover, by questioning the accuracy of managers' projections, an organization's predictive capabilities are likely to improve over time.

Table 2

Organization XYZ
Consolidated Statement of Activities
6x6 Projection
For Period Ended June 30, 2014

			(E)	(F)	(G)	(H)
	Full Year – Cash Basis					
			2014 Projection		2014 $	2014 %
Income/Expense	2013 Actual	2014 Budget	3x9	6x6	Variance (F-E)	Variance (G/E)
Support						
Contributions						
Grants and Contract Fees						
Miscellaneous Revenue						
Total Support						
Major Program Expenses						
Major Program A						
Major Program B						
Major Program C						
Major Program D						
Major Program E						
Program Service Expenses						
Fundraising						
Management & General						
Support Services Expenses						
Total Expenses From Operations						
Functional Allocation						
Program Services – %						
Support Services – %						
Total Change in Cash Position						
Cash Position – Beginning of Year						
Total Change in Cash Position						
Cash Position – End of Year						

Table 3.

Organization XYZ
Consolidated Statement of Activities
6x6 Projection
For Period Ended June 30, 2014

Functional Expenses	2014 Budget	(E) 2014 3x9 Proj.	(F) 2014 6x6 Proj.	$ Variance (F-E)	2014 Budget	(P) 2014 3x9 Proj.	(Q) 2014 6x6 Proj.	(T) $ Variance (Q-P)	% Variance (T/P)
	Six Month YTD – Cash Basis				Full Year 2014 Projection– Cash Basis				
Support									
Contributions									
Grants and Contract Fees									
Miscellaneous Revenue									
Total Support									
Expenses									
Major Program A									
Major Program B									
Major Program C									
Major Program D									
Major Program E									
Program Service Expenses									
Fundraising									
Management & General									
Support Services Expenses									
Total Expenses From Operations									
Functional Allocation									
Program Services – %									
Support Services – %									
Total Change in Cash Position									
Cash Position – Beginning of Year									
Total Change in Cash Position									
Cash Position – End of Quarter									

Regional Breakdown	Head-Quarters	Country X	Country Y	Total	Head-Quarters	Country X	Country Y	Total
	Functional Expenses After Allocation YTD 6 mos. 2014 Projection 3x9				Functional Expenses After Allocation YTD 6 mos. 2014 Projection 6x6			
Major Program A								
Major Program B								
Major Program C								
Major Program D								
Major Program E								
Fundraising								
Management & General								
Total Expenses From Operations								

Using Zero-Sum Budgeting to Prioritize Spending and Programming Cutbacks

Although cutbacks are never easy, Zero-Sum Budgeting makes reexamining key spending activities to offset a revenue shortfall less painful if options are identified by department/cost-centers that won't compromise the long-term mission of the organization. There are of course, always exceptions to rules—unique opportunities do not always present themselves neatly during planning cycles. Zero-Sum Budgeting is a tool to support decision making. It is not intended to prevent the organization from taking unplanned action, if such action is strategically prudent and approved by the Board. Such approval is necessary if an actual depletion in cash reserves will result. In these instances, the organization should be 'officially' released from its original cash commitment by its Board.

Keep in mind, increasing projected revenue to avoid an expense reduction is risky if there is no evidence to support such a move. It is always easier to avoid cutbacks by postponing decisions in hopes of a 'revenue bailout' later in the year, but this rarely turns out well.

Zero-Sum Budgeting can also flag when managers attempt to shift expenses forward from the back end of the year without a change in the revenue timing. This often gets organizations into trouble when program spending is brought forward ahead of the money projected to cover associated expenses. This can occur because of pressure to 'get going' with a project before the cash to support it is confirmed.

Not all Changes Require Spending Cuts

Shifts in spending from one quarter to another within the budget year do not require program or project cuts, but simply an adjustment showing how spending is re-phased. For example, let's say in month three a training program is brought forward from the third quarter to the second because the instructor's schedule changed. The '3x9' would reflect this shift in training expenses from the third quarter to the second. Table 4 on the following page illustrates how such a timing difference is recorded in the '3x9' projection. If the organization was generating revenue from this program, those revenues also shift. But if this change results in higher costs or decreases in revenue, those changes must also be reflected. If there's a negative cash impact, an offset must be found, either a specific cutback or an increase in revenue from a confirmed, reliable source.

Sometimes donor revenues exceed expectations. And this is great news, but unless those funds are restricted for a specific use, they may be spent in ways that are sub-optimal to the organization's strategic mission. Zero-Sum Budgeting's quarterly re-projections help management strategically allocate those funds.

Table 4

Organization XYZ
Illustration of Re-Phasing Adjustment
Responsibility Center Level – Project Summary
3x9 Projection

	Before Adjustment		Annual Budget									
COA Codes	Major Project Summary	Actual 1st Quarter	2nd Quarter			3rd Quarter			4th Quarter			9 months Budget
			Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	
950	Project Foxtrot		13,000	20,000	25,000	21,000		15,000	—	30,000		124,000
911	Project Golf						12,500		5,000		5,000	22,500
951	Project Hotel		8,000	25,000			30,000		12,000	10,000	12,000	97,000
970	Project India				—	—				75,000	25,000	100,000
942	Project Kilo	64,379	30,000	3,000	5,000	700			140,000		5,000	183,700
960	Project Lima		500	1,000	500	41,000	60,000	40,000	50,000	150,000	60,000	403,000
965	Project Mike		2,000	1,500	1,500	20,000	50,000	30,000	20,000	100,000	50,000	275,000
939	Project November	14,705	700	15,000	2,500	1,000	2,000	1,000	1,000	4,000	5,000	32,200
934												—
	Total Projects	79,084	54,200	65,500	34,500	83,700	154,500	86,000	228,000	369,000	162,000	1,237,400

	After Adjustment		3x9 Projection by Month										
COA Codes	Major Project Summary	Actual 1st Quarter	2nd Quarter			3rd Quarter			4th Quarter			9 months Projection	2014 3x9 Projection
			Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec		
950	Project Foxtrot		13,000	20,000	25,000	21,000		15,000	—	30,000		124,000	124,000
911	Project Golf			**12,500**			**0**		5,000		5,000	22,500	22,500
951	Project Hotel		8,000	25,000			30,000		12,000	10,000	12,000	97,000	97,000
970	Project India				—	—				75,000	25,000	100,000	100,000
942	Project Kilo	64,379	30,000	3,000	5,000	700			140,000		5,000	183,700	248,079
960	Project Lima		500	**42,000**	500	**0**	60,000	40,000	50,000	150,000	60,000	403,000	403,000
965	Project Mike		2,000	1,500	1,500	20,000	50,000	30,000	20,000	100,000	50,000	275,000	275,000
939	Project November	14,705	700	15,000	2,500	1,000	2,000	1,000	1,000	4,000	5,000	32,200	46,905
												—	—
	Total Projects	79,084	54,200	119,000	34,500	42,700	14,000	86,000	228,000	369,000	162,000	1,237,400	**1,316,484**

NOTE: In order to demonstrate a re-phasing adjustment, the above chart assumes no change in expense, timing, or amount between the annual budget and the 3x9 projection (for the 2nd, 3rd, and 4th Quarters) except the two rephasing adjustments highlighted above.

Zero-Sum Budgeting Improves Forecasting Overseas Operations

If a nonprofit organization operates in world markets through subsidiaries, divisions or other entity configurations, Zero-Sum Budgeting can be helpful in monitoring activities and improving cash management practices. Since overseas operations typically do not generate revenue or in-country donor funding sufficient to sustain operations, support is normally provided from the U.S. at pre-planned intervals to cover activities.

Often these entities are located and doing business in countries where the local currency is weak and subject to frequent devaluations against the U.S. dollar. For this reason, it is important to accurately project expenses to avoid an excess cash build-up.

Many organizations faced with this issue establish two accounts, one in local currency, one in U.S. dollars. The fund transfers are made from the parent company in U.S. dollars directly to the local U.S. dollar account. In-country management make transfers from that account into their local-currency account as needed. Although this avoids unnecessary foreign exchange losses, from a total organizational cash management perspective, it does not properly assess the cash needs of the foreign entity.

Zero-Sum Budgeting helps improve matching fund transfers with operational needs, by providing accurate cash projections. The template (refer to Table 5 on the following page) cross references the Zero-Sum quarterly projection, with information that projects by key project/activities the country's current and future cash needs. If transfer requests from overseas managers are not consistent with the latest quarterly projection, clarification is required before the funds are released. This disciplined procedure will influence projection accuracy over time and improve cash-management proficiency.

In cases where a responsibility center wants to add a minor project or incurs expenses not projected in the most recent projection, the responsibility center must specify the funding sources and timing (see Table 5, footnote 2). If the source does not come from expense reductions in the current month, a guarantee must be issued by the responsibility center acceptable to senior management that effectively encumbers these savings in order for the funding to be advanced. The encumbrance would be eliminated either by reducing the expenses when agreed, or earlier by finding an equivalent income source.

Zero-Sum Budgeting Helps Complete Form 990

Most nonprofits must file Form 990 on a yearly basis. For this reason, it is advisable when designing budget and actual reporting formats to consider the IRS information requirements. Unless the company's chart of accounts is organized in such a way that recognizes the IRS reporting requirements, data collection for 990 purposes can be onerous. An example of a budget or projection reporting format that is both compatible with Zero-Sum budgeting and the information required by Form 990 can be found on Table 6.

Table 5

Organization XYZ
Sample Wire Transfer Request Pro Forma
6x6 Projection

Country A Wire Transfer Request August 2014	Country Office Support	Projects						
		Alpha	Beta	Charlie	Delta	Echo	Foxtrot	Total
Chart of Account Code	Various	950	940	919	942	951	965	
August – 2014 6x6 Projected Expenses	38,058	60,000	10,000	30,000	–	2,000	13,000	**153,058**
Add: Expenses Not Projected in 6x6 Projection (A)	1,776	–	–	–	–	–	–	**1,776**
Add: New Projects Not Projected in 6x6 Projection (B)		–	–	–	15,000	–	–	**15,000**
Specific funding guarantee to offset cash impact (A+B)								
– Current month cash impact offset (specify funding source)	-1,776				-3,000			**-4,776**
– Subsequent months cash impact offset (see note 2)					-12,000			
Less: Expenses Projected but not Expected to be Paid in the Month but will be incurred during the year (specify details)	–	-15,166	–	-30,000	–	-2,000	-13,000	**-60,166**
Less: Unfilled Positions Projected in 6x6	-9,660	–	–	–	–	–	–	**-9,660**
Less: Total Other Net (Minor Items)	–	–	–	–	–	–	–	**–**
August – 2014 Revised Expense Projection	28,398	44,834	10,000	–	12,000	–	–	**95,232**
July 31, 2014 Cash Balance (Book + Bank) (@2.50/US$) (C)								**29,950**
Less: August 2014 Revised Expense Projection (D)								**95,232**
Projected August 31, 2014 Cash Balance (C-D)								**-65,282**
Desired Cushion								**-5,000**
Wire Transfer Required (see note 1)								**-70,282**

NOTES:
(1) Minus sign indicates wire transfer required.
(2) Must specify timing and source of funds. When funding is based on future savings, senior management sign-off required and finance must create a formal encumbrance so that savings are not double counted in subsequent projections. Encumbrances carry over from projection to projection until satisfied. In this example, the $12,000 is treated as a "guaranteed" advance to Country A.

Table 6

Organization XYZ
Consolidated Statement of Functional Expenses
Projection 6x6
Period Ended June 30, 2014

Functional Expenses	Program Services							Support Services			Total 2014 6x6 Projection
	Program A						Total Program Services	Fund-raising	Mgmt & General	Total Support Services	
	Project A	Project B	Program B	Program C	Program D	Program E					
Contract Service Expenses											
IT Services											
Accounting and Audit Fees											
Legal Fees											
Other Professional Fees (e.g. freelance)											
Outside Payroll Services											
Consultancy Contracts											
Donated Professional Services – GAAP											
Total Contract Services											
Non-Personnel Related Expenses											
Supplies											
Telephone & Communications											
Postage, Shipping, Couriers											
Printing & Copying											
In-House Publication											
Repairs & Maintenance (non-capital)											
Rent & Other Occupancy											
Utilities											
Equipment Rental & Maintenance											
Research & Reference Materials											
Travel											
Conferences, Conventions, Events											
Staff Training & Development											
Bank Fees											
Advertising											
Taxes – Non-Payroll											
Insurance											
Miscellaneous Expenses											
Total Non-Personnel Expenses											
Total Expenses Before Personnel Costs and Other Expenses											
Personnel Related Expenses											
Salaries											
Employee Benefits											
Payroll Taxes											
Total Personnel Costs											
Other Expenses											
Interest											
Depreciation											
Total Other Expenses											
Total Expenses From Operations											

Conclusion: Improving Planning and Budgeting Effectiveness with the Zero-Sum Approach

A budgeting process that doesn't overburden staff in small to medium sized not-for-profit organizations has long been elusive. Countless organizations are frustrated with the traditional planning and budgeting approach because its time consuming, and lacks strategic focus and actions that drive performance. Moreover, annual budgets typically remain fixed throughout the year despite being out of date by the end of month one.

How to overcome these weaknesses is an issue of great debate. This paper explains one way to overcome the shortcomings of traditional budgeting, proposing an innovative approach that ensures strategic and budget commitments are met. By integrating the strategic planning and budgeting processes, an organization can better create long-term value for its stakeholders.

The Zero-Sum approach is a straightforward, systematic process, focused on actions to improve performance or close gaps in projections. Focused on managing future results, rather than past performance, this method helps management remain strategic when unexpected changes threaten stated objectives. Zero-Sum Budgeting is most effective when the Annual Budget is directionally consistent with the first year of the Strategic Plan.

Zero-Sum Budgeting utilizes updated projections to align spending so that cash levels committed at the start of the budget year are maintained. This involves three forecasts, one after each quarter: a ‘3x9’, ‘6x6’ and ‘9x3’. Each projection is progressively revised using the latest year-to-date data, and a re-projection for the remainder of the year by month.

Unexpected changes that cause a decline in management’s fixed cash commitment require timely actions to offset deficits by an equivalent spending reduction. Depending on the magnitude of the shortfall, the required counterbalancing may have strategic implications that cut across responsibility lines, which must be prioritized, based on the organization’s mission and long-term objectives.

Accurate revenue forecasts are important because they impact management credibility, donor communications, strategy formulation, and execution. Avoiding common pitfalls that lead to overly optimistic targets is crucial. When budget commitments are separated from the motivational process (i.e., setting stretch goals for incentive purposes) revenue forecasts greatly improve.

Likewise, a revenue projection resembling a ‘hockey stick’ is usually artificial and threatens organizational stability if not modified. In the end, accountability is the key to better forecasting—holding those responsible for setting revenue targets also responsible for their accuracy is crucial.

Cash guidelines are important for all organizations, but they become even more so when using Zero-Sum because cash levels trigger management action. Cash reserves vary by organization, but guidelines should be clearly established based on such criteria as the current amount of cash on hand, the monthly burn rate, and the past reliability of your donor-revenue projections. Zero-Sum Budgeting is a helpful decision-support tool, especially in small to medium sized not-for-profit organizations with a history of missing business objectives. Of course, the key to success is not just the development of a well-formulated strategy, but ensuring that the strategy is properly executed. At the end of the day, the true measure of any management team is how it acts when things don’t go as planned. The Zero-Sum approach is responsive to the unexpected, providing management with a robust process to meet its financial commitments while limiting the strategic impact of significant loss of revenue or program overspending.

The Zero-Sum approach strengthens management’s ability to deliver for all its stakeholders: the people who depend on the programs and services it provides, the employees, who provide insight and muscle to make things happen; the board, who provide vision, funding and oversight; and the donors, who generously provide funding with an expectation that what they support will be delivered as promised.

References

No work of others was used in preparing this article only direct experience of the author of the paper.