How To Rebound From A Nonprofit Budget Deficit

9 min read

Key Takeaways

- **Define Deficit Type:** There are 3 common deficits we see: One-Time Deficits, Recurring Deficits, and Residual Deficits
- **Identify an Immediate Remedy:** Take a look at your current expenses budget to identify creative ways you can cut back current expenses to re-allocate those funds to your deficit..
- **Hone In on Your Unit Economics:** Which of your programs are actually raising money? Which are better serving your mission? And on the flip side- which programs are eating up your budget and not getting results?

Walking into a board meeting knowing you have a budget deficit can be stressful. Because it's *particularly* challenging for nonprofits to pull themselves out of this type of loss.

Luckily, there are ways to help mitigate the risk of your nonprofit experiencing budget deficits, and immediate steps to take...

Budget Surpluses Vs. Deficits

In the for-profit world, we call them "profits" and "losses," in a nonprofit organization, the number represented on the bottom line of your organization's Statement of Functional Expenses is either a surplus (a positive figure) or a deficit (a negative figure).

In a perfect world, a nonprofit would end every financial year with a bottom line of exactly zero, having spent the exact amount of money they brought it. However, operating with that kind of budget perfection is highly unlikely. As a result, most nonprofits finish the year with either a surplus or a deficit.

Ending the year with a surplus is obviously ideal. That money can be reinvested in the nonprofit and used to help further the organization's mission.

Deficits, on the other hand, present several challenges, the severity of which depends on the deficit size and type. For example, a small deficit can likely be recovered and remedied quickly, but larger deficits, recurring deficits, and residual deficits can threaten the organization's ability to continue functioning.

So, what should you and your board of directors do, if your nonprofit's statement of financial position reveals a loss?

How to Survive a Nonprofit Deficit

Define Deficit Type

When you encounter a deficit, the first thing you and your board of directors should do is to evaluate the deficit to better understand why or how it occurred and what you need to do to fix the problem.

Here are 3 common deficits we see...

1. One-Time Deficits: Some deficits occur as a result of a one-time, unexpected problem such as incurring a large, unexpected cost. For example, the sprinkler system sprung a leak and required a costly repair. In these cases, deficits can usually be quickly resolved and do not indicate a deeper problem – except perhaps the need for a reserve of emergency-use funds.

2. Recurring Deficits: Recurring deficits are those that continue to crop up in your budgets vs. actuals. Whether you're looking at the end of the year or at a profit and loss statement from an annual event, do not ignore recurring deficits as they expose weaknesses in your organization and operations.

Any recurring deficit is symptomatic of a greater problem, which should be immediately identified and addressed with strategic improvements.

3. Residual Deficits: Residual deficits include previous losses from which your organization has yet to recover. These can occur due to either one-time expenses or recurring budget problems that have not been resolved.

You might expect to operate with a residual deficit for a short period while recuperating from a substantial previous loss. However, you should always be wary of allowing these financial problems to linger too long, as they expose your organization, making you more vulnerable to financial risk.

Identify an Immediate Remedy

When you have a deficit, you'll need to respond with an action plan or risk your organization's wellbeing.

To start, you should research options, but also discuss with a trusted advisor some good solutions so when you explain it to the board, you will also provide remedies to ease the situation.

There are several immediate strategies to which nonprofits can turn:

- **Re-allocate Core Funds** - Take a look at your current expenses budget to identify creative ways you can cut back current expenses to re-allocate those funds to your deficit. (Just be sure you're looking at core funds and not restricted funds when you decide to reallocate money in the budget.)

- **Special Fundraising** - Ramp up your fundraising with a special, one-time campaign or event designed to compel current or past donors to pitch in to help keep the cause they care so much about afloat.
- **Loan or Line of Credit -** You might be able to cover a recurring expense or one-time expense that causes a deficit with either a line of credit or a loan from your organization's bank or credit union. Since these solutions come with added expenses of their own (loan origination fees and interest), their true costs and benefits need to be carefully considered before you and your board of directors decide to remedy a deficit with debt.

How Accurate Reporting Helps Nonprofit Wheelchair For Warrior Open The Door To Larger Grants

Improve Operations for Long-Term Recovery

Whether a one-time cost results in a deficit or a recurring shortage has you coming up repeated with losses, you need to resolve the deficit and address the problem to prevent it from recurring in the future.

This might involve developing a strategy to create an emergency fund, considering strategically restructuring your operations, or perhaps canceling a fundraising event that repeatedly costs the organization more money than it generates.

Maintain Positive Morale

Throughout the entire process of handling a deficit in a nonprofit, it's essential that you work hard to maintain positive morale in your organization and among your people. Depending on what types of changes and cuts are necessary to keep the nonprofit operating, make an effort to let your people know how much they are appreciated, how much good they are doing, and what you are doing to ensure the nonprofit's strength and their job security.

5 Strategies for Preventing Nonprofit Deficits

1. Cut Costs and Avoid Unnecessary Expenses

It's time to go through your expenses with a fine tooth comb.

Review all overhead and indirect costs-these are items that were nice to have, but were not vital in keeping your company alive.

- Onsite costs are decreasing: Technology has enabled a remote working environment. Take advantage of this and cut as many onsite costs as possible. For example, cut the cleaning crew down to once or twice a week!
- Go digital: Clunky printers are becoming a thing of the past. With the digital landscape, we no longer have a need to pay for a paper shredder/ extra paper- everything can be on the cloud.
- Cut non-essential company events: Make cuts to company meetings, parties, or any extracurricular events.

💡 **TIP**: It starts by making sure you have accurate and up-to-date reporting to make the right decisions. Having a robust bookkeeping and accounting system will help you better identify costs that can be cut while also helping you avoid unnecessary expenses due to internal fraud, tax penalties, non-compliance, or penalties due to missed changes to GAAP or other regulations governing your organization.

2. Hone In On Your Unit Economics

Speaking of actionable reporting…

Which of your programs are actually raising money? Which are better serving your mission? And on the flip side- which programs are eating up your budget and not getting results.

Looking at your nonprofit's unit economics shows you the relationship between revenue and costs. Drilling down to these financial metris will help you compare the ROI of each of programs, clients, and services.

For example...

Donation ROI = Total Fundraising Costs / Total Dollars Raised

Use the donation ROI equation to determine how much your organization spends to bring in donation dollars. Using this metric, you can determine your most successful events, fundraising channels, and donor types. You can also see whether any fundraising channels are costing your organization more money than they're generating. This information will help you strategize which channel to target.

With meaning behind their financials, they are now able to use these numbers to tell a story, and show donors the ROI of their investment. This led to a higher frequency and higher average of gifts. For the first time ever, The Village Learning Center saw a **$1 Million Dollar surplus in funds.** Read the full story **HERE**.

"As a Nonprofit, we're in the trenches every day. We provide services to clients with disabilities. The most frustrating part of our job is when we have to stop what we're doing and worry about making decisions on bad information."

- Kristy Conrad, CFO, Village Learning Center

Having these insights at your fingertips will help you see which programs you should cut, and which programs you should allocate more of your budget towards. Focusing on the programs that produce the most outcomes will help your nonprofit rebound the deficit quickly.

3. Always Know Your True Bottom Line

In a nonprofit, your bottom line can be fuzzy. Just having money in the bank, doesn't mean you can use them to cover operational costs. When you have funds available to spend, they aren't always available to spend on anything.

It's important that you establish a bookkeeping and accounting system that helps you keep restricted and unrestricted funds straight. So, you always know exactly how much you have available for payroll, office expenses, and unexpected overhead costs and how much of your bottom line is earmarked for specific expenses.

4. Don't Sleep On Employee Retention

One sneaky, creeping cost is the expense of employee turnover. Nonprofits tend to face high rates of turnover due to a lack of career growth opportunities and capped employee compensation.

Although nonprofits usually can't afford to pay enormous salaries, they can offer a lot in terms of the intrinsic reward of doing meaningful work. Even if you can't give your employees the monetary raises you think they so deserve, you can make an extra effort to amp up the intrinsic value of working for a nonprofit by recognizing the good they do in your organization and community.

4. Data Optimization is key this year for nonprofits - Outsource the financials

If your back office isn't up to par, then you're likely spending more time on the books and on operations than necessary. This excess expenditure of resources is likely to cost you way more than the price of a decent back office with streamlined technology and tools designed to save time and improve your operations.

With an outsourced back office, you'll not only save time, but you'll also benefit from a wealth of financial data that can help you improve your budgets vs. actuals, understand the true cost of operating your organization, and even help you begin forecasting cash flow to avoid future deficits with better planning and financial management.

Avoid Nonprofit Deficits With a Robust, Yet Affordable, Back Office

Operating with a lean budget is inevitable in most nonprofit organizations. Despite budgetary concerns, nonprofits can still afford to invest their back office bookkeeping and accounting functions to make all the above strategies for avoiding deficits possible. With an outsourced accounting solution, your nonprofit will have the benefit of a complete, high-functioning back office that's outfitted with the tools and technology necessary to stay on top of your financials, without the high price tag of hiring full-time, in-house accounting employees.

With the right systems in place, you'll be able to budget more accurately, predict cash flow shortages before they occur, and always have a transparent view of your organization's financial health. As a result, you'll be able to spend less time on the books and more time turning your mission into a reality.