CAPINCROUSE LLP

In the Budget? That Doesn't Necessarily Mean You Can Spend It

You have heard it said before — "cash is king." But what does that really mean? Can you be "budget rich" but "cash poor"? What are the appropriate levels of reserves for your church, and how do you determine them? Why is it even important to have appropriate reserve levels?

If your church has too little liquidity, it will continually be in a financially stressed position. Financially stressed churches:

- Won't be able to respond to ministry-related opportunities on a timely basis
- Will continually face cash shortfalls
- May pay bills late and put off budgeted expenditures, including salary increases
- May be forced to pay high interest rates on an operating line of credit to meet short-term cash needs

Reserves and cash flow projections are important. Just keep in mind that while many churches use operating budgets, many church employees confuse operating expenses with cash expenses.

Consider the example of a ministry that was strapped for cash during the summer and deferred all May and June expenditures until the next fiscal year, which began on July 1. The staff didn't understand, however, that the start of a new fiscal year and new operating budget is not the same as a new cash flow budget. The ministry did not magically generate sufficient cash reserves on July 1.

In addition, some staff decided that because they were not allowed to spend the remainder of their budgets late in the prior fiscal year, they would correct that by spending their budgets early in the new fiscal year. They did this without telling management, and the result was disastrous. The ministry incurred an unusually high level of expenditures in July and early August, and did not have sufficient cash to fund these accelerated expenses. This caused management to initiate another spending freeze, which confused the staff further because they were in a new budget year. Unfortunately, management did not clearly explain the difference between a new operating budget and the timing of spending that budget because of cash needs, so that the staff could understand why expenditures were deferred. That created a lot of confusion and mistrust.

An *operating budget* shows planned revenues and expenses over a period of time, usually one year. A *cash budget* shows planned cash inflows, cash outflows, and the amount and duration of cash shortages or surpluses over a certain period of time, usually 12 months. The main purpose of a cash budget is to highlight the periods of disparity between cash coming in and cash going out so the manager can take early action to manage the cash position.

Projecting cash inflows, outflows, and the resulting net cash position is the first place to start improving the short-term financial management of your church. It will be impossible to determine the appropriate level of reserves if you don't know your projected cash surpluses and shortfalls throughout the year.

Where to Start

First, you must identify overall factors that impact the right level of reserves for your church:

- Board objectives – Does your board state that your primary objective is to strive for financial breakeven or a small positive net revenue, which would provide a boost to your church's liquidity?
- Seasonal donations or revenue inflows – Consider the times of year where you have larger inflows of cash, such as December.

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- Time-restricted and use-restricted donations – Matching cash inflows to outflows becomes more difficult if you have a large proportion of time-restricted or use-restricted donations.
- "Borrowing" from restricted funds – Some churches use the practice of "borrowing" from restricted funds for liquidity management. This problem is aggravated when these "borrowings" are continual, since they limit the church's ability to spend the funds on the purposes for which they were donated.

Factors that should be used to determine the right level of liquidity include:

- The church's level of net assets
- Level of administrative costs
- Operating margin
- Diversified revenue sources

Higher levels of these factors give you church more flexibility to cope with unexpected financial expenditures.

Sample Cash Budget and How to Use It

Below is a very simplified version of a cash budget:

	January	**February**
Beginning Cash	$ 500	$ 350
+ Cash Receipts	200	300
'- Cash disbursements	(350)	(200)
= Ending Cash (Net Cash Flow)	$ 350	$ 450
'- Minimum Cash Reserves	400	400
= Cash Surplus ***or***	---	**$ 50**
Cash Shortage	**($ 50)**	

Net Cash Flow = Cash Receipts – Cash Disbursements

The cash budget will help you identify the mismatched nature of inflows and outflows and seasonality patterns of cash flows. (For example, in most local churches donations run higher around Easter and especially so between Thanksgiving and Christmas.) It will also help you see how long the surpluses or shortfalls will last on a monthly basis. This will enable you to identify how much additional cash is available for short-term investment purposes. Conversely, it will also allow you to plan short-term borrowing levels and adjust expense levels and the timing of expenditures.

To use the cash budget, you must first look at the low point in the fiscal year. For most churches, this is the summer months. Set a liquidity level for your peak season (probably early January) that is sufficient to cover your church through the low points. This is where the cash budget is so helpful. It encourages you to study the cash flow patterns carefully and determine when cash deficits will come, as well as how much liquidity should be held earlier in the year to carry the church through periods of deficits. The degree of flexibility your church has in managing reserves off the cash budget will also help you determine the size of your safety buffer or reserves.

By tracking and learning the habits of your cash inflows and outflows, you will be able to develop adequate reserve levels and successfully navigate the high and low points of the year without taking sudden and unexpected actions that impact your ministry.

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