Evangelical Lutheran Church in America

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Contingency Planning for Congregations

A resource provided by the Office of the Treasurer of the Evangelical Lutheran Church in America

CONTINGENCY PLANNING

Why do contingency planning?

It is both prudent and strategic to develop contingency plans as part of the budget development process. Because any number of factors can impact income and because a large percent of a congregation's operating budget is supported by a "single" source (weekly offerings), small variances in the percentage of income from members can have a large impact on the congregation. The most strategic use of resources happens when we are prepared to answer the question of what we will do if the income received deviates significantly from the approved income budget. Decreases in income often need to be addressed more swiftly than increases in income; however, it is best to have a plan for reacting to either scenario.

Budget contingency plans may never be implemented but have the possibility to affect staff, programs and ministry partners; it is important to think carefully about how and when plans are shared beyond the leadership. Failure to do so can create stress and uncertainty that may have an unintended impact on operations and staff. Attention to staff morale during times of economic uncertainty is vital.

Similar to business continuity plans, budget contingency plans are developed in case they are needed. Some plans will never be used or will only be used partially.

Specific components of contingency planning that are addressed in this document include:

- Operating reserves
- Cash flow projections
- Budget reductions
- Banking relationships

Who does contingency planning?

- Congregation Council
- Staff
- Financial Secretary

OPERATING RESERVES

What are operating reserves?
Operating reserves are unrestricted fund balances. They are similar to retained earnings or equity in other businesses. These funds are developed as a result of operating income exceeding operating expense over a period of time. The net operating income from one fiscal year is added to the congregation's operating reserve, while operating at a deficit in a given fiscal year will result in a reduction to the congregation's operating reserve.

How do operating reserves function?
Operating reserves provide a cushion to help an organization survive lean periods and any unexpected events that could deplete funds. Operating reserves can help congregations to:

- Survive operating shortfalls caused by economic conditions or unexpected disruption in cash flow (i.e., several Sundays of inclement weather which subsequently affect weekly offerings);
- Enhance their capacity to develop new programs or discontinue or retool current programs;
- Obtain favorable financing terms; and
- Achieve steady distribution of support for programs and ministries.

What is the appropriate level of operating reserves?
There is no pre-defined answer to this question, but following are a few factors that congregations should take into consideration:

- When income is derived primarily from a predictable, broad-based membership or body of contributors, the level of operating reserves may generally be lower than if income is derived primarily from a few large contributions.
- If cash flow is irregular, operating reserves should generally be higher than if cash receipts are consistent throughout the year. Seasonal swings in income and expenses should be identified and tracked so they can be anticipated.
- If expenses are primarily fixed or predictable, reserves can generally be lower.
- If the congregation owns fixed assets or equipment that is likely to require renewal or replacement, operating reserves may need to be higher. It is advisable to develop a plan so that as fixed assets age, replacement and repairs can be funded.
- Reserves should be higher for congregations with long-term debt, payables and deferred income, since significant liabilities reduce operating flexibility and increase the risk of penalties and interest for late payments.

Most non-profit organizations maintain an operating reserve of approximately 30 percent of their annual operating budget, or enough to cover all expenses if income completely ceased for three to four months. That might be a good place to start the discussion. The portion of Mission Support income remitted to the respective synod and churchwide ministries should be subtracted from operating expenses before calculating the reserves.

CASH FLOW PROJECTIONS

One factor that should be considered when setting the operating reserve level of the congregation is the schedule of cash flows. Projections of receipts and expenditures, which comprise cash flow, are ideally developed as part of the budget process, so that the congregation is able to anticipate and develop strategies for funding shortages or investing surpluses. A good place to start in developing a schedule of cash flows is to review actual monthly cash flow from the prior year.

How do we develop a schedule of cash flows?

- Estimate how much money will be received each month from each income source.
- Review receipts by month for the previous three years and analyze giving trends.
- Estimate how much will be spent each month in each line item of the budget.
    - Use the prior year's "checkbook" as a basis for projecting the coming year.
    - Note which expenses occur weekly, monthly, quarterly, etc.
    - Adjust for any anticipated changes that will affect the timing and amount of payments and deposits.
- Add items impacting cash flow that are not listed in the budget, such as accounts receivable or payable from the prior year.
- Update the cash flow projections at least quarterly.

How do we address a temporary cash shortage?

Actions that are often considered to address a temporary cash flow issue include:

- Obtain a loan or arrange for a line of credit from a bank to maintain necessary liquidity and avoid unfavorable timing of investment sales.
- Invite members to make short-term loans to the congregation.
- Expedite the collection of receivables.
- Accelerate any planned special funding appeals.
- Consider equipment leasing arrangements.
- Liquidate investments.
- Renegotiate payment terms with vendors and ministry partners.
- Refinance loans or request deferral of principal payments for several months.
- Consider action to change designation of previously designated funds to meet operating needs.
- Consider canceling temporary employee and agency contracts.
- Consider canceling non-essential purchased services.
- Defer non-essential travel and discourage multiple staff traveling to same event; utilize more cost-effective options such as web-conferencing.
- Implement a hiring freeze for new and open positions.
- Freeze approvals of new discretionary grants.
- Freeze new capital expenditure approvals.

Staff can be helpful in making recommendations regarding cash flow and expense timing.

What if the situation is not expected to improve quickly?
If the cash shortage is due to more than temporary cash flow, it must be addressed through raising income or reducing expenses. It is best not to count on new sources of revenue until they are proven to be reliable. The fundamental issues causing the cash flow or deficit need to be addressed during the budget planning process and reductions may have to be considered. It is not advisable to run an operating deficit for successive years.

BUDGET REDUCTIONS

There are several ways that most congregations make cost reductions, some more strategic than others, including:

Across-the-Board Cuts: This method of reducing costs is the easiest to administer. Staff and volunteer program leaders are asked to develop proposals for achieving the cuts in their areas. This gives them the flexibility to make the cuts where they will do the least damage to their programs and ministries. The request can include multiple levels of reduction proposals, such as asking for budget reduction proposals at the various levels (e.g., 10 percent, 15 percent and 20 percent). The disadvantage of this method is that it does not account for differences in the programs' ability to absorb cuts, level of budget flexibility and most importantly, in how strategically aligned the programs are to the congregation's mission.

Targeted Cuts: Targeted reductions are identified by leadership or through a participatory process. Decisions should be consistent with the congregation's core strategies and the interests of key constituencies. Reductions start with funding that is not entirely necessary to maintain programs and services at a minimally acceptable level. Positions that can be held vacant without undue disruption to the congregation's mission and operation are often targeted. A participatory approach may require more cooperation, voluntary sacrifice and objective analysis than can be expected of staff and leaders. It could also involve major restructuring of staff and programs, especially if funding adjustments are expected to continue beyond the current year.

Operations, Process or Technology-Driven Cuts: This method seeks to analyze processes to identify ways to change procedures or apply technology that will reduce the work required. There may be upfront costs of investing in technology, but once processes are changed and technology is installed, positions and other costs can be eliminated or reduced. This strategy may also involve a shift from operating costs to capital costs funded from reserves or special offerings. This might ease pressure on the annual budget, but can strain the congregation's cash balances in the short-term.

Are there other things to consider when reducing budgets?
Congregations may want to consider the following factors when preparing to reduce their budget:

- The nature of the deficit

  - Is it a cash deficit, an operating deficit or both? Some congregational operating statements include non-cash items such as depreciation. Others do not capitalize and depreciate any fixed assets. While a non-cash deficit is a serious matter because the organization is not generating the resources to replenish itself, the negative effects may play out over a longer time frame, allowing it more time to develop a response.
  - How strong are cash balances? Deficits pose a more immediate threat to an organization with low cash balances, leaving it with fewer options to analyze the situation and develop a response.
- Budget development rules
  - Review the congregational constitution and other governing documents and policies that pertain to budget approval and revisions.
- Timeline for achieving the desired results
  - Does the congregation need to avoid a deficit in the current period, create a balanced budget for next year, or develop a multi-year recovery strategy?
  - Consideration should be given to the level of cash balances, policies and the impact of operating at a deficit on the congregation's and members' confidence in the congregation's management.
  - Assess whether current obligations and commitments are being met. If not, an immediate response is required.
- Risk of failure
  - Some strategies for cutting budgets carry more risk than others. In some cases, projected cost-savings may not outweigh the investments required to improve business processes. As such, disruption of services due to restructuring may occur and projected increases in revenue may not materialize.
- Impact on related ministry partners
  - Assess the ways in which reductions would influence relations and the viability of other partners and programs.
- Quality of information
  - Understand the sources of the deficits and costs well enough to identify areas which might be better places to cut or which can be restructured through process and technology changes. Analyze the connection between program costs and the impact on achieving the congregation's mission and goals.

Communicating budget cuts

It is important to develop a plan for how to communicate budget reduction proposals to staff members, ministry partners and other stakeholders. The communication plan should identify the audiences for communications, the particular information they should receive, and the timing and means for communicating. Here are a few points to consider:

- Speak to the reasons for taking action and about the process leading to a proposal.
- Determine the appropriate tone and level of urgency that will be communicated. Consider whether it is a situation in which everyone needs to pay full attention to the problem and focus on a solution or if people need to simply be cognizant of the issue and have the confidence that it is being addressed.

- Assume that everyone wants to know how it will impact them personally. Keep the message clear. Nuanced language is often misunderstood or missed in situations where they may be personally affected, so communicate clearly and specifically.
- Be attentive and cautious about what is promised, and deliver on those promises.
- Do not expect to achieve 100 percent consensus or support for the plan.

BANKING RELATIONSHIPS

During periods of economic downturn or when an organization experiences a change in its own financial situation, it is important to increase contact with the financial institutions with which it transacts business. This is especially true if the congregation has outstanding loans or depends on a line of credit with its bank. It may also be good to discuss whether a committed line of credit is advisable, even at a small cost, in order to address periodic cash flow needs and to ensure that funds are available if and when they are needed.

Concluding considerations:

The creation of a contingency plan should begin with prayer and thanksgiving for the blessings of life already bestowed by God. Discussions of a congregation's income, cash flow, debt and expense management are vital to a congregation's ministry. God's promise of new life through Jesus Christ is the foundation of all congregational deliberations. As a result of this promise we continue to minister faithfully even in times of economic turmoil and uncertainty.