Evangelical Lutheran Church in America

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Contingency Planning for Synods

Basic Components of Budget Contingency Planning

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

CONTINGENCY PLANNING

Why do Contingency Planning?
The churchwide organization has found that 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 approximately 80 percent of the churchwide operating budget is supported by a "single" source (mission support income), small variances in the percentage of income from congregations can have a large impact on synods and the churchwide organization. The most strategic use of resources happens when we are prepared to answer the question of what we will do if income deviates significantly from the approved income budget. Because decreases in income often need to be addressed more swiftly than increases in income, that is the emphasis of this document; although it is best to have a plan for reacting to either potential.

Because budget contingency plans may never be implemented but have the potential to affect staff, programs, and ministry partners, it's important to think carefully about when and how the plans are shared beyond the planning group. Failure to do this with care and attention to staff morale may create organizational uncertainty that could have an unintended impact on operations and staff. Like business continuity plans, budget contingency plans are developed in case they are needed. If budget development is done well, most of the plans will never be used or will only be used in part.

Specific components of contingency planning that are addressed in this document include Operating Reserves, Cash Flow Projections, Budget Reductions and Banking Relationships.

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. Historically, both synods and the churchwide organization have intentionally maintained low levels of operating reserves.

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

- Survive operating shortfalls caused by economic conditions or management error.
- Enhance their capacity to develop new programs, discontinue or retool current programs or expand their services.
- To obtain favorable financing terms, should that be necessary or desirable.
- Achieve even distribution of program support to recipients.

What is the appropriate level of operating reserves?

There is no set answer to this question, but following are a few factors that synods might take into account:

- When income is derived primarily from a predictable, broad-based membership or body of contributors, as is the case with synods, the level of operating reserves may generally be lower than if income is derived primarily from a few large grants or contributions.
- If cash flow is irregular, operating reserves should generally be higher than if cash receipts are consistent throughout the year.
    - For synods, a higher percentage of annual income is normally received in the final quarter of the year compared to the third quarter in particular (30.2% vs. 22.8% on average).
- If expenses are primarily fixed or predictable, reserves can generally be lower.
- If the synod owns fixed assets that are 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 synods 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% 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 passed on to the churchwide organization should be subtracted before calculating.

<u>ELCA constitution on operating reserves</u>
Synod operating reserves are addressed in the synod model constitution under S15.14. It reads:

"*Except when such procedures would jeopardize current operations, a reserve amounting to no more than 16 percent of the sum of the amounts scheduled in the next year's budget for regular distribution to synodical causes shall be carried forward annually for disbursement in the following year in the interest of making possible a more even flow of income to such causes. The exact number of dollars to be held in reserve shall be determined by the Synod Council.*"

This language suggests that it should not be the practice that net income in excess of expenses be carried from year to year and be used to build up reserves. It does, however, give some responsibility back to the Synod Council to determine the exact amount of operating reserve that is required by the synod in order to ensure that the synod can operate while meeting its legal obligations and providing for a reasonably even distribution of funds.

CASH FLOW

One factor that should be considered when setting the operating reserve level of the synod 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 synod can anticipate and develop strategies for funding shortages or investing the surpluses. A good place to start in developing a schedule of cash flows is looking at 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.
- 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 the projection for the coming year.
  - Adjust for any anticipated changes that will affect the timing and amount of payments and deposits.
- Add in 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.
- Speed up the collection of receivables.
- Move up any special, planned funding appeals.
- Consider equipment leasing arrangements.
- Liquidate investments.
- Request a delay in payments to 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.
- Cancel all temporary employee and agency contracts.
- Cancel non-essential purchased services.
- Defer non-essential travel and discourage multiple staff traveling to same event.
- Implement hiring freeze for new and open positions.
- Freeze approvals of new discretionary grants.
- Freeze new capital expenditure approvals.

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 risky to assume an increase in revenue and not adjust expenditures to within projected income. It is best to not count on new

sources of revenue until they have proven reliable. It is particularly inadvisable to run an operating deficit for successive years. The fundamental issues causing the cash flow or deficit need to be addressed in budget planning. The topic of budget reductions is addressed in the following section.

BUDGET REDUCTIONS

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

Across-the-Board Cuts: This method of reducing costs is the easiest to administer. Managers are asked to develop proposals for achieving the cuts in their areas, giving them the flexibility to make the cuts where they will do the least damage to their programs and operations. The request can include multiple levels of reduction proposals, such as asking for budget reduction proposals at the levels of 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, in their starting level of budget flexibility, or, most importantly, in how strategically aligned the programs are to the organization's mission.

Targeted Cuts: Using this method, targeted reductions are identified by leadership or through a participatory process. Decisions should be consistent with the organization'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. Often positions that can be held vacant without undue disruption to program and services are targeted. A participatory approach may require more cooperation, voluntary sacrifice and objective analysis than can be expected of program managers. It could also involve major restructuring, 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 the operating budget to capital or special appeal funding, which eases pressure on the operating budget, but can strain the synod's cash balances.

Are there other things to consider when reducing budgets?
Following is a list of other factors synods may want to consider when preparing to reduce their budget:

- The nature of the deficit should be clearly understood.
    - Is it a cash deficit, an operating deficit, or both? Most operating statements will include non-cash items such as depreciation. 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 less room for error in assessing the situation and developing a response.
- Budget rules should be reviewed.
    - Review the synod constitution and other governing documents and policies that pertain to budget approval and revisions.
- A time available for achieving a change in results should be determined.
    - Does the synod 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 congregations' members' confidence in the synod's management.
- Consider risk of failure.
    - Some strategies for cutting budgets carry more risk than others. For example, cost-savings returns may not equal the investment; disruption of services due to restructuring may occur; hoped-for increases in revenue may not materialize.
- Consider impact on external partners.
    - Assess the ways in which reductions would influence relations and the viability of other partners and programs.
- Attend to 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 their impact on achieving the synod's mission and goals.

Communicating Budget Cuts

It is important to develop a plan for how to communicate budget reductions to staff, congregations, members and partners. The communication plan should identify the audiences for communications (including external partners), the particular information they should receive, and the timing and means for communicating. These 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 drop what they are doing and address the problems, or if people need to simply be aware 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 careful about what is promised, and deliver on those promises.

- Do not expect to achieve 100% consensus or support for the plan.

BANKING RELATIONSHIPS

When the economy is experiencing turmoil or when an organization experiences a change in its own financial welfare, it is important to increase contact with the financial institutions with which it does business. This is especially true if the synod 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 ensure that funds are available if and when they are needed.