Financial Scenario Planning in a COVID-19 World: A 5-step process

"*The best way to predict the future is to create it*"

Peter Drucker

- The current crisis presents nonprofits an opportunity to stop surviving and to start succeeding (or succeeding to a much greater extent than pre-COVID19).

- Financial scenario planning is most effective when based on a return to core mission and organizational values, a clear understanding of priorities, and a metrics-based approach to budgeting and decision-making.

- This webinar will outline a simple -though far from easy- process to enable an organization to create the future instead of reacting to it.

The 5 R's

- ReAffirm - *What is our mission?*
- ReFocus - *Concentration & Abandonment*
- ReSource - *The Right Funders & Vendors*
- ReAssess - *How long do we have?*
- ReBudget - *Zero-based, Metrics-driven & Multi-year*

ReAffirm –
What is our mission?

- What are our core mission deliverables?
  - Not programs, but measurable results & outcomes

ReFocus – Concentration & Abandonment

- What programs & work must we continue in order to meet our mission deliverables?

- What programs & work should we stop doing because they do not contribute to our core mission deliverables?
  - What are we doing only because we have always done it or because our current funders require it?

ReSource-
The right funders and vendors

Funders

- Negotiate with current funders to modify funding to align with core mission deliverables
  - Which funders fully support our mission work (including overhead)
- Find new funders more aligned with our mission
  - Which funders can we work with that are a better match for our core mission deliverables?
  - Which funders should we separate from?

Vendors

- Negotiate with current vendors (landlords, service providers, employees, contractors) for better terms
- Find new vendors better aligned with our mission

ReAssess –
1. How long do we have on our current path?

1. <u>What is our cash position, or our Liquid, Unrestricted Net Assets (LUNA):</u>

For organizations with little or no reserves:

- Cash in bank accounts
- Available lines of credit
- Investments

For organizations with reserves, a better approach is to calculate:

- Liquid, unrestricted net assets (LUNA), generally:
  - Unrestricted net assets less equity in fixed assets
- LUNA Liquidity in months (LUNA-L), generally:
  - LUNA divided by average monthly budgeted expenses for the next 12 months
- Perform these calculations for each of the last 3 years and for each month of the current fiscal year to date i.e. historical LUNA-L
- Establish a target for the minimum # of months of LUNA-L to stay above (LUNA-L floor)

ReAssess –
2. How long do we have on our current path?

2. <u>What is our cash burn (or net asset burn) rate?</u>

- For organizations without reserves, project daily, weekly, monthly, quarterly, annual cash inflows and outflows. Assign probabilities for each and be conservative
    - Contracts, donations, fees for services
    - Payroll, taxes, rent, debt payments, utilities, etc.
    - Add-in new expense related to COVID-19 (PPE, cleaning cost, etc.)
    - Cash burn rate is the net of the inflows and outflows for each period i.e. per week, month, quarter, etc.

- For organizations with reserves, project revenues & expenses & debt payments for each month for the next 12 months.
    - Calculate the monthly average net asset burn rate i.e. net loss per month

ReAssess – 3. How long do we have on our current path?

3. <u>When will we run out of cash, or hit our target LUNA-L floor?</u>

- From the starting balance of either cash or LUNA, add/ subtract each period's cash/ net asset burn
  - From now until cash goes to zero, or the LUNA-L floor is met, that is the amount of time available to make additional changes to the revenue or expense picture

	4/30/2020	5/31/2020	6/30/2020	7/31/2020	8/31/2020	9/30/2020	10/31/2020	11/30/2020	12/31/2020	1/31/2021	2/28/2021	3/31/2021	4/30/2021
Beg cash or LUNA	100,000	95,000	95,000	105,000	90,000	75,000	65,000	35,000	15,000	-	(15,000)	(25,000)	
Cash in or Revenue	35,000	40,000	50,000	25,000	25,000	30,000	10,000	20,000	25,000	25,000	30,000	35,000	40,000
Cash out or expenses	40,000	40,000	40,000	40,000	40,000	40,000	40,000	40,000	40,000	40,000	40,000	40,000	40,000
Net cash or Net Asset burn	(5,000)	-	10,000	(15,000)	(15,000)	(10,000)	(30,000)	(20,000)	(15,000)	(15,000)	(10,000)	(5,000)	-
Ending cash or LUNA	95,000	95,000	105,000	90,000	75,000	65,000	35,000	15,000	-	(15,000)	(25,000)	(30,000)	-
Average monthly expense next 12 months	40,000	40,000	40,000	40,000	40,000	40,000	40,000	40,000	40,000	40,000	40,000	40,000	40,000
LUNA-L	2.375	2.375	2.625	2.25	1.875	1.625	0.875	0.375	0	-0.375	-0.625	-0.75	0
Target LUNA-L	1.500	1.500	1.500	1.500	1.500	1.500	1.500	1.500	1.500	1.500	1.500	1.500	1.500
	OK	OK	OK	OK	OK	OK	Uh-Oh	Uh-Oh	Uh-Oh	Uh-Oh	Uh-Oh	Uh-Oh	Uh-Oh

ReBudget – Zero-based

- Zero-based budgeting (or modify existing budget)
  - Link expense line items to revenues; those that can't be linked are quasi-fixed and represent a target list for cost reduction
  - Identify line items that are primarily affected by COVID-19 i.e.
    - Ability to hold gatherings which impact revenue/ mission deliverables
    - Ability to retain sufficient staff to meet contract requirements
    - Additional PPE and other materials/service expense related to maintaining safe workspaces
    - Impact of additional sick / PTO requirements/ training
    - New technology expense to replace /maintain revenue & mission deliverables
  - Using April 2020 as a representative month, modify your revenue projections to reflect future months. Upward adjustments should be made based on your best estimates of returning to work (be conservative)
  - For salaries, on a separate schedule list each person's name, salary, variable benefits / taxes (fixed % per salary $ i.e. FICA), fixed benefits (flat $ per person i.e. medical); link this schedule to the main budget
  - For all other expense lines, create separate schedules for details behind each expense line
  - For all such schedules, create columns that allow you to change any of the details and those changes will flow out to the main budget into the proper month
  - Update the model each month as actual results occur

ReBudget – Metrics-driven

- Metrics based budgeting
  - Calculate the relationship between each expense line and a financial output i.e. fundraising expense to fundraising results, reimbursable expense to contract revenue
  - Using the calculations, look for the factors that are driving net cash into the organization and determine if any expense line items need to be re-evaluated i.e.
    - if fundraising expense is equal to or greater than fundraising results, a change is likely needed
    - If overhead costs are not covered by new lower revenue projections, consider the possibility of salary cuts or reducing positions. Essentially, start with largest items because "that's where the money is"
  - For these key expense lines, incorporate formulas into the underlying schedules that force the expense total to be based on the metric relationship. This will allow you to perform "what-if" scenarios based on the metrics
  - Manage expense lines by managing the underlying metrics i.e. if fundraising results are 2X expenses, and next month they fall to 1.9X, apply the 1.9X to future expenses.
  - At this point, we can identify changes to underlying metrics and analyze how to improve the ultimate results, and can start to predict when underlying results will begin to change
  - Ultimately, this process will flow to overall cost per mission deliverable

ReBudget – Multi-year

- Multi-year budgeting
  – 2 year minimum, 3-5 is better
    - Build it month by month based on underlying metrics
    - Include a monthly cash-based budget that includes LUNA-L results when different assumptions are made
    - Show the underlying metrics for key line items over time
  – This will reveal – and allow the Board and other Stakeholders to focus on - the relationship between mission deliverables, productivity, and liquidity during and after the COVID-19 crisis
  – When summarized, the MY budget will tell a story – a "flight plan" – for how your organization is managing through and beyond the immediate crisis and how the mission will be met, which is likely to attract new and better funders