Full Cost Workbook for Backbones of Place-Based Partnerships

About This Workbook

This workbook is intended to support backbones of place-based partnerships[1] calculate their full cost.

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ABOUT THE PROJECT

Nonprofit Finance Fund (NFF), with the support of **Ballmer Group** and in collaboration with **Community Solutions** and **StriveTogether**, embarked on a two-year project to understand how backbones of place-based partnerships operate and to gain insights into the factors that impact their sustainability and success in driving community-level outcomes. This project included analysis of data on over 80 place-based partnerships across the country, interviews with over 85 individuals from 30 of those partnerships, and in-depth consultation with 5 backbone organizations. This resource is part of a toolkit designed to support the work of practitioners within existing place-based partnerships, communities contemplating starting a place-based partnership, and funders that invest in these efforts. **Click here** for more information and to access the toolkit.

[1] **Place-based partnerships** - networks of people and organizations in the same geographic area who work together to change systems, improve community outcomes and achieve shared goals. **Backbones** – structures comprised of a single or multiple organizations that fulfill several core functions and facilitate action and accountability across place-based partnerships.

Introduction to Full Cost

Like any organization, backbones need to cover the full cost of delivering on their missions. In this workbook, we provide a useful framework to identify the full cost needs of your backbone by naming six areas of cost.

Think of each of the six area of cost as a “voice” in your backbone’s financial and strategic planning that asks, “how much do you need from me?” You may need a lot in some areas, and nothing from others. Your needs in each area will change over time. Revisit the six full cost areas each time you engage in financial and strategic planning.

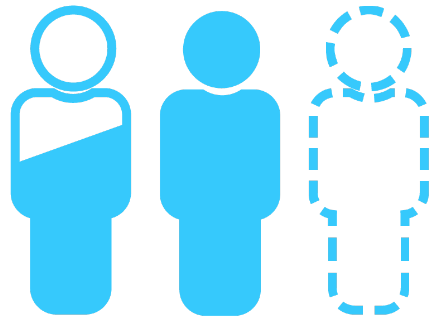
Remember, the full cost of your work extends beyond your annual operating expenses. Frequently, organizations will find that a comprehensive budget that incorporates their full costs is significantly more than their annual operating budget. Therefore, it is important to remember that full cost needs are met over time, and almost never raised in one or two years.

Three practices will help backbones with full cost:

1. Budget to an **annual surplus**
2. Name and effectively **communicate** full cost needs
3. Build full cost over multiple years with a **long-term** plan

Total Expense

Definition



Total expenses are the day-to-day expenses of running your backbone. They include:

- Regular or recurring expenses (i.e., salaries, contractors fees, phone bill, program supplies)
- Pass-through funds to partner organizations
- One-time or extraordinary expenses (i.e., acquisition of a new data system, the cost of launching a capital campaign)
- Depreciation, which is a non-cash expense that estimates the decreasing value of your fixed assets (e.g., building, vehicles, computers) over time until they are expected to need replacement
- Upfront and ongoing cost of impact measurement
- “Direct” program expenses
- “Indirect” or “overhead” expenses
- Unfunded Expenses

Unfunded expenses are those expenses that are not currently incurred, but, if covered, would allow your backbone to work at its *current level* in a way that is reasonable and fair. One common example in the nonprofit sector is overworking and underpaying staff. Other examples of unfunded expenses include making do with outdated software, slow internet, or sub-par supplies.

Example: An Executive Director works 60 hours per week. The backbone should hire a part-time assistant, so the Executive Director can reduce her hours to 40 hours per week (without taking a pay cut). The salary of the assistant would be the unfunded expense.

Unfunded expenses are NOT associated with expanding or doing more; they support what is already being done by your backbone.

Total Expense Considerations of Changing Backbone Structure
For backbones considering a change in structure (e.g., transitioning from an embedded entity to a standalone nonprofit), unfunded expenses also include any functions that a host entity fulfilled in the past (typically at low cost or in-kind) such as grant reporting, finance, accounting and tax preparation, communications and/or provision of office space. An estimate of these unfunded expenses would be the cost for the organization to take on these functions internally or hire contractors to serve these functions.

The income statement reflects total expenses, with the exception of unfunded expenses. Unfunded expenses are not captured in financial reports.

Total Expenses do NOT include:

- Any purchase that is capitalized, such as a building or equipment; such purchases are captured in Fixed Asset Additions. See page 12.

- Repaying debt principal; this lives in Debt Principal Repayment. See page 10.

Determining Total Expense Needs in Your Backbone

Calculate Your Unfunded Staff Expenses
For many organizations, the largest unfunded expenses are related to staff and salaries.

Question	Yes or No		
Are staff fairly compensated?		If no, how much more should staff be paid?	$
Are staff offered reasonable benefits?		If no, how much would it cost to offer reasonable benefits?	$
Are you planning to offer cost of living adjustments to salaries?		If no, enter 2% of total annual payroll	$
Are staff regularly working beyond the expectations of their role?		If yes, how much would it cost to add the capacity/ positions to enable staff to maintain a fair and reasonable workload?	$
Are any positions unfilled and unbudgeted?		If yes, enter the salary + benefits package for open positions.	$
		Total unfunded staff expense	$

Note: if you're finding a significant gap between current staffing structure and what your backbone needs, you might consider developing a staffing plan.

Calculate Your Other Unfunded Expenses
In addition to underpaid and/or overworked staff, backbones may have other unfunded expenses like sub-par supplies or slow internet.

Question	If no, list what is needed		
Does the backbone have adequate supplies for a productive staff?		How much more would adequate supplies cost?	$
Does the backbone have adequate internet speed, phone lines, and similar infrastructure?		How much more would it cost to provide adequate infrastructure?	$
Are there other necessary expenses that go unmet, (e.g., program supplies, training)?		How much more would it cost to cover these expenses?	$
Are you paid enough to engage all the community partners that you want to? Are partners fairly compensated for their engagement?		How much more would it cost to engage the right partners and pay them appropriately?	$
		Total other unfunded expense	$

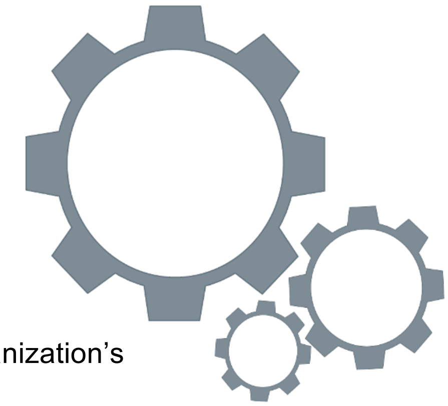
Calculate Your Total Expenses
Use the worksheets above and your backbone's annual budget to determine Total Expenses.

Expense	Where to find	
Total unfunded staff	Worksheet (above)	$
Total other unfunded	Worksheet (above)	$
Budgeted expenses	Approved budget	$
Total Expenses		**$**

Where to Look:
- Budget
- Compensation Study
- Strategic Plan
- Prior year Profit & Loss statements

Working Capital

Definition



Working capital is the dollars to cover the predictable timing of cash ebbs and flows in the normal course of business. Organizations with sufficient working capital are able to pay bills on time, even during months when there are no cash receipts.

Working capital is needed by all organizations. It should be easily accessible to management, without restrictions or strict designation. Working capital dollars are usually held in the organization's main checking account.

The amount of working capital needed is highly variable from organization to organization, as it depends on the unique timing of cash in-flows and out-flows within each nonprofit. Some organizations have minimal gaps between cash in-flows and out-flows. Less than one month of working capital may be sufficient for them. Others have very large gaps between cash in-flows and out-flows. They may need to have 11 months of working capital at their cash high point in the year to make it through their cash low point in the year.

In addition to working capital needed to manage cash ebbs and flows in backbone operations, backbones should also consider any additional working capital needed to manage cash in-flows and out-flows associated with dollars passed-through or re-granted to community partners.

Working Capital Considerations of Changing Backbone Structure
Backbones that are fiscally sponsored or embedded in another entity may be accustomed to having their working capital needs covered or supplemented by their host organization. Although a host organization may provide a 'financial backstop,' knowledge of your individual organization's working capital needs is essential for effectively managing operations and planning for the future, particularly if you are considering a change in structure to operate as a standalone, independent nonprofit.

Securing a line of credit from a bank or credit union is one way to manage cash flow. The line of credit can be used to increase working capital during cash low points, and repaid during cash high points. Banks will rarely extend new lines of credit when cash is at a low point. Organizations should establish a line of credit "when they don't need it" so it is available when they do.

Working capital is NOT meant to cover lost revenue, pay for annual deficits, or continue unsustainable activity.

Determining Working Capital Needs in Your Backbone

Your backbone should prepare a **cash flow projection** (see NFF's cash flow resources for guidance) to determine your working capital needs.

What to ask

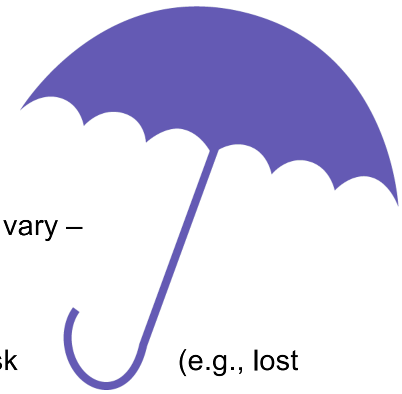
- Were there points in the past year when your backbone could not pay its bills on time or had to delay activity due to lack of cash? If so, how much additional cash would have prevented this situation?
- Does your backbone's cash flow projection show points in the year when the backbone will not be able to meet its monthly bills? If so, what are the additional cash needs?
- If your backbone has plans to grow or change, how much more or less working capital will be needed?
- Does your backbone have access to a line of credit? How has it been used? How large is the line of credit?

Where to Look:

- Cash flow projection
- Contracts with grantors or vendors
- Payroll calendar
- Programing calendar
- Fundraising calendar
- Line of credit agreement with bank

Reserves

Definition



Reserves are savings that mitigate risk for the backbone – whether that be the risk inherent in your funding streams, the risk of trying something new, or the risk that something may go wrong with your building or equipment.

Reserves are needed by all backbones, but the size and purpose vary – there is no one-size-fits-all.

Common examples of reserves:

- Operating reserve: to protect the backbone from short-term risk (e.g., lost funding, unexpected expense, leadership transition) or pursue opportunity
- Facilities reserve: to maintain fixed assets and pay for repairs and/or replacement (e.g., building, equipment, etc.)
- Research and development reserve: to allow for experimentation, risk-taking, trial and error; to investigate a new program or approach
- Investment reserve: To generate revenue through investment vehicles like stocks

You can name and define reserves for your backbone in a way that best supports your mission and vision. An operating reserve is often a good first priority when it comes to reserves. It is possible to have a single reserve that can serve multiple purposes. For example, you could have an operating reserve that can also be used for research and development of new programs. However, you should carefully define the criteria of the reserve and the amounts needed for different purposes. One aggregated reserve can give a false impression that resources are adequate to meet your needs.

Reserves should be accessible to management depending on the immediacy of need. Some may be board-designated and require board approval to spend. They may be held as cash in a bank account or as investments that can be liquidated in a reasonable timeframe. Most reserves are intended to be replenished once they have been used.

Determining Reserve Needs in Your Backbone

What to ask

- What are the likely revenue risks your backbone would need reserves to weather (i.e., changes in foundation priorities, contract non-renewal, annual gala cannot be held, leadership transition)?
- What amount would adequately protect your backbone in the event of revenue losses? How long would it take to enact a new plan?
- If your backbone already has an operating reserve, how much has been saved? Is this amount adequate to meet the likely risks facing your backbone?
- For what other purposes might your backbone need reserves? How much is needed?

Where to Look

- Strategic Plan
- Your knowledge of the market

Debt Principal Repayment

Definition

Debt principal repayments are the dollars to pay down debt (e.g., line of credit, mortgage, loans, other forms of borrowing, etc.).

Debt can be a valuable financing tool if used strategically. It may seem obvious that when you borrow money, you need a plan to pay it back. But the structure of financial reporting can obscure debt repayment. If an organization makes a monthly mortgage payment, the principal reduction does not appear on the income statement (or profit & loss statement) as an expense. Only the interest appears as an expense. Instead, principal repayment appears on the organization’s statement of financial position (or balance sheet) as a reduction in cash and a reduction in the mortgage principal due. In other words: repayment is commonly financed through year-over-year surpluses.

Consider how quickly your backbone’s existing or planned debt needs to be repaid.

Determining Debt Principal Repayment Needs in Your Backbone

What to ask

- Does your backbone have debt?
- If so, what is the nature of the debt?
- How quickly does the debt need to be repaid? Are there plans to refinance? What are our plans for repayment?

- How much is due this year?

Where to Look
- Balance sheet
- Mortgage contract
- Line of credit contract

Fixed Asset Additions

Definition

Fixed asset additions are the dollars to purchase *new* equipment, buildings, furniture, land, leaseholder improvements or other fixed assets. Fixed asset additions are NOT replacement or simple maintenance of existing fixed assets (this lives in a reserve) or small equipment purchases that are expensed.

Determining Fixed Asset Addition Needs in Your Backbone

What to Ask

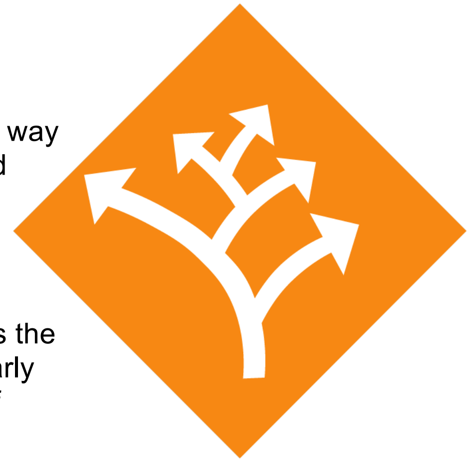
- What additional fixed assets are needed? How will they support the backbone and its mission?
- How will you pay for fixed asset additions (i.e., debt, special campaign, surpluses)? Over what period of time?
- How did you determine the cost of the fixed asset additions (i.e., vendor quotes)?

Where to Look

- Strategic plan, vision
- Market analysis
- Vendor or contractor quotes

Change Capital

Definition



Change capital is a large, *periodic*, investment into an organization to change the business model in a significant way (e.g., the size or reach of mission and/or how it makes and spends money).

Change capital should be large enough to cover up-front costs of change *and* deficits incurred until the change is complete, when the new business model revenue exceeds the new expenses. For this reason, change capital should nearly always include adequate funds for the launch or scaling of contributed or earned revenue generating activities.

Change capital that seeks to scale programs, but does not invest in revenue generating activities, will result in short-term program expansion, followed by program contraction when the change capital runs out. This is an improper structuring of change capital.

Change Capital Considerations of Changing Backbone Structure
Backbones contemplating a change in structure should consider whether anticipated changes associated with restructuring are incremental and fairly manageable to fund with existing savings, or whether building new capacities to operate in a different arrangement would require dedicated, change capital.

Change capital typically comes from an external source and is ideally large, flexible, and multi-year. Capital campaigns are one way to raise change capital dollars. Change capital is not often sourced through year-over-year surpluses.

Once an organization has received an infusion of change capital, we would not expect them to need change capital again for a long time: 10, 20, or even 30 years! The total amount of change capital needed can be difficult to calculate, because it is based on future projections of how the change will roll out, including how quickly new or expanded sources of revenue will be generated.

Determining Change Capital Needs in Your Backbone

Change capital needs are identified through a lengthy and rigorous planning process, often with the support of an external consultant, and must include multi-year projections for revenue and expenses. The questions offered below can be used along with NFF's scenario projections tool within a larger change capital planning process.

What to Ask

- What change is your backbone undertaking? Why? Will change capital be needed to achieve the planned change?
- What are the projected start-up/one-time costs? What costs will be on-going/part of our new expense base?
- What may be the sizes of future annual operating deficits en route to change or growth?
- How long before the change is sustained by a profitable business model?

Where to Look

- Strategic Plan
- Multi-year projection
- Market analysis
- Feasibility studies

Applying and Prioritizing Full Cost Needs

Application
Many find it overwhelming to approach their backbone's financial needs through the full cost framework – especially when we consider that the sector struggles to cover day-to-day expenses and offer market wages and benefits to staff! Keep the following in mind:

- Full cost needs will not be met in one year. Use a full cost mind-set to plan for the future over many years, or even decades.
- Avoid breakeven budgeting. Plan to generate a surplus each year to save toward your full cost needs.
- Prioritize. Decide which full cost needs are most important, and plan to meet those first.

How to Prioritize Your Full Cost Needs
Total expenses are typically our first priority. Total expenses allow us to deliver on our mission day-to-day and month-to-month. After total expenses, there is a hierarchy of need that remains true for every organization.

1. **Liquidity: adequate cash to meet its month-to-month operating needs**

   Balancing day-to-day expenses and liquidity needs is a common challenge in the sector. Leaders may have to decide between paying people fairly and paying them on time. The right balance for your backbone depends on your organizational culture, values, and plans for the future. Many leaders build their liquidity at the same time they increase their total expenses.
   Once liquidity needs are met, backbones can think about adaptability. If an organization is struggling to pay its regular bills on time, it will be unable to spend money on plans for growth or change. Even if dollars are intentionally set aside for other purposes, the pressures of needing to make payroll this month will usually win out over longer-term ideals.

2. **Adaptability: flexible funds that allow for adjustments, growth, or change**

   Once adaptability needs are met, backbones can think about durability. If an organization cannot adapt to a changing marketplace, it will not be durable well into the future.

3. **Durability: funds to address a variety of future needs to deliver mission over the long-term**

   Durability needs are often met with the purchase of facilities or setting up an investment reserve. Not all organizations need durability. For some, mission is best supported by having adequate liquidity and adaptability that will allow them to be nimble. For instance, advocacy organizations are a common example of nonprofits with little or no durability needs but high adaptability needs.

Full Cost Planning

Annual surpluses will help you cover your backbone's full costs, but you may need one-time infusions of capital as well. Estimate each element of your backbone's full cost based on your current needs and plans for the future. Knowing it is unlikely that all full cost needs will be met with this year's revenue and capital opportunities, think about how long you will need to finance your full costs.

What are Your Full Costs?	Total Amount	Years to Accomplish	Amount Budgeted This Year
***Total Expenses**: Consider your budgeted annual expenses + unfunded expenses*	--------------	*Annually*	
***Working Capital**: Do you have the cash on hand needed to manage cash flow?*			
***Reserves**: What reserves do you need to build the backbone's adaptability or durability?*			
***Debt Principal Repayment**: If you have debt, how much needs to be repaid and when?*			
***Fixed Asset Additions**: Are there significant fixed assets you plan to purchase? When?*			
Total:		---------	

This is your total balance sheet needs. Plan to cover these over many years.

This is your revenue goal for the year that covers a portion of highest priority balance sheet needs.