PEJE
Partnership for Excellence in Jewish Education

Spotlight: Financial Management

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The Budget: An Expression of the School's Mission

The annual budget is much more than a blueprint for fiscal oversight. Rather, it's a fundamental expression of a day school's mission. A quick scan should enable you to determine a school's ability or intent to invest in any number of areas, such as financial aid, faculty compensation and professional development, outreach, facilities upkeep and repair, and the endowment.

"The budget is really a very clear indication of the school's values, priorities and objectives for the next period," says Sorrel Paskin, a noted independent school financial management consultant.

Given a budget's central role in reflecting a school's values, transparency is crucial. Educating donors, parents, and faculty about the budget process ensures that everyone has an appropriate stake in the financial well-being of the school.

Tuition increase letters and open forums, among other examples, provide opportunities for open communication between the school and parents, demonstrating just how their tuition dollars are getting spent. "Establishing credibility with donors is essential," says Herb Tobin, PEJE Senior Consultant and fundraising expert. "They have to have a clear sense as to exactly how their funds are being used."

Most school budgets list their revenue items from largest to smallest followed by expenditures largest to smallest (see below). On the income side, tuition is typically the largest revenue line item, followed by various types of contributed income, such as the annual fund. Financial aid and tuition remission are listed on the revenue side as a contra-revenue line below tuition--meaning that financial aid diminishes gross tuition, leaving a net tuition figure.

Ideally, a school's net tuition--that is, total tuition minus financial aid--should cover as many expenses as possible. As previous Financial Spotlights have noted, attracting as many "full payers" as possible permits schools to cross-subsidize others who cannot afford full tuition.

On the expenses side, personnel costs or compensation, including salary, wages, and benefits, often comprise as much as 70 to 80 percent of a budget. Of course, teachers are among a school's most important assets. Though day schools may feel as if they cannot compensate teachers as well as other private, and especially public, schools do, it's important to build compensation increases into multi-year strategic financial plans and budgets.

And though they are not budgeted alongside compensation, professional development opportunities attest to a school's investment in its workforce. Independent School Management (ISM) recommends that 1.5 to 2 percent of a school's budget be earmarked for this use. "Professional Development is the key component of maintaining (or improving) a faculty growth culture. This means a faculty who are constantly pushing themselves to improve, which in turn guarantees better students," says Terry Moore of ISM.

It is also crucial for schools to build up surpluses into their annual budgets in order to develop a cash reserve (a "rainy day fund"). Indeed, ISM recommends that schools build a cash reserve that eventually equals 15 percent of their budget. "This is ISM's number one ranking Stability Marker," says Terry Moore, noting this variable is one most associated with sustainability.

As for facility upkeep, another use of surpluses, Sorrel Paskin says schools should set aside up to 3 percent of their plant replacement cost annually for a facility reserve, with 1.5 to 2 percent for renewal projects (i.e. leaky roofs), and 0.5 to 1.5 percent for adaptation (i.e. remodeling). Noting that these percentages may be unrealistic for many schools, Paskin recommends that schools determine their needs through a professional services audit, and then set a percentage that is viable and won't be compromised as other needs arise.

Short-term deficits are acceptable if monies have been earmarked for a strategic or designated purpose, but continual operating deficits erode a school's net worth and, over a few years, can put the life of the school in jeopardy.

A Simplified School Budget

Revenue and Support

- Tuition and Fees
- Less: Financial Aid and Tuition Remission
- Net Tuition and Fees
- Annual Fund Contributions (event proceeds, contributions, direct donor solicitation)
- Other Income (including program fees, interest and endowment income)

Expenses

- Personnel Costs (includes salary and wages and benefits expenses)
- Instructional Materials and Supplies
- Administration and General
- Development and Fundraising
- Occupancy
- Auxiliary Services

Transfers

- Cash reserves for "rainy days"
- Facility renewal, replacement, and special maintenance
- Other strategic priorities

Developing a Budget

As we noted earlier, the process of planning a budget is inextricably linked with a school's overall mission. Planned expenditures should be developed from the ground up, says Sorrel Paskin, with each department estimating their needs using a careful approach that justifies how the requested funds achieve the goals of the department and the entire school.

"The annual budget provides a preeminent opportunity for administrators to evaluate their programs to determine which components have been effective or not. When a school builds a budget based on an evaluation of current practice, you get not only a financial projection of needs, but also a comprehensive evaluation of what works and what doesn't," says Paskin.

Furthermore, the annual budget should always be prepared within the context of a strategic multiyear financial plan, which should include a financial model to be monitored and updated annually.

"The strategic plan is the beginning of the budget. It predetermines the rate of tuition increases, and it predetermines the total operating budget. Of course, if more resources are needed then the strategic plan makes it easy to for the Board to make an informed choice about tuition increases to support annual changes," says Terry Moore.

Sorrel Paskin's Principles of Financial Equilibrium for Schools

1. Revenues should equal or exceed expenditures. This even includes transfers to plant for routine renovation, reserve funding, and transfers to endowment.
2. Annual rate of growth in revenues equals or exceeds that of expenditures.
3. Value of endowment and board designated funds is preserved or enhanced. Ensure that these funds grow at least at the same rate as annual budget growth.
4. Value of physical plant is preserved or enhanced. Schools should invest 3% of the replacement cost of their facility annually into a reserve account from which the condition of the facility is maintained and adaptation occurs.
5. The value of human capital is preserved or enhanced. That is, funds are set aside to build on existing skills and competencies for professional development.
6. Quality of curriculum, programs, and services to students is preserved or enhanced.

A Budget Calendar

The following sample calendar is adapted from *Business Management for Independent Schools*, 5th Edition, published by the National Association of Independent Schools (NAIS):

November: Each department head along with key administrators are asked to propose preliminary budgets for their areas of responsibility (excluding salary items).

December: Department heads encourage teachers to be creative and forward looking in proposing expenditures that will strengthen their areas within the school. Wish list items can represent goals to work towards over multiple years.

January: Business manager, with head of school's guidance, reviews departmental budget proposals and produces an overall preliminary balanced budget. The draft should be reviewed with the finance committee of the board of trustees. The overall board should vote on the preliminary budget in mid-winter

February: Business manager reports board approval to department heads and professional staff members. Tuition levels are announced, faculty contracts are drawn, and financial aid guidelines are set.

May to September: Final changes to budget are made based on new information concerning enrollment levels, inflation rates, and educational program decisions. Finance committee approves changes and then Board of Trustees makes final decision on budget, as early as June.