

Pulse Check: Is it Time to Update Your Spending Policy?

By Michaela Kay, CPA, BDO USA

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2020 was quite the year. While we started off with record highs in the stock market, by mid-March, we saw the fastest 30% decline in the S&P 500 in the history of the index. Since then, we have continued to see many ups and downs, but we still saw overall gains in the stock market.

What does this mean for your organization's spending policy? Is it time for an update?

Most financial experts advise sticking to your plan during tumultuous financial times and embracing volatility, as it can be an organization's best tool to beat inflation and maintain the spending power of invested funds.

However, the events of the past year have shed light on some reasons why an organization should update its spending plan. Here are a few examples of scenarios that might trigger a policy revision:

- 1. The investment fund is underwater.** Just like with your personal finances, an organization should not live paycheck to paycheck. If an organization has withdrawn all the income from an investment fund, they may want to consider revising the spending policy to decrease spending. It is healthy to have a cushion of accumulated earnings. That way, when future losses come, it will not be necessary to dip into the corpus in order to keep funding program services.
- 2. The spending policy doesn't include a smoothing policy.** The most common type of smoothing policy is a simple moving average based on the average balance of the account over a specified period of time (often three years). This helps stabilize spending compared to a policy that focuses on fully spending the annual income or a fixed rate. It also helps to preserve corpus in the long run.
- 3. The organization's goals and needs have changed.** Depending on an organization's mission, operations may have changed drastically in the past year. Some organizations, especially in arts and culture, have been shut down. Other organizations, especially those who serve basic needs, may have seen the biggest year in the organization's history. All of these changes have likely led to shifts in financial needs. As a result, it may be necessary to adjust spending in order to use funds responsibly.
- 4. The organization received a financial windfall.** From time to time, organizations receive bequests or other large contributions. Often these gifts are hard to predict and come at unexpected times. While it is always tempting to spend money, executive management and the board should strongly consider the best use for the funds over the long term. If the contribution is invested, organizations may be able to support programs with very stable funding for years into the future.

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Best Practices for Updating Your Organization's Spending Policy

Investment committees should regularly review their organization's investment policies and spending policy with help from a professional investment advisor. If organizations decide that it is time for a policy update, here are a few next steps:

- 1. Understand the organization's needs.** When designing a new policy, it is best to start from the ground and work your way up. What are the organization's needs? What is or is not working with the current policy? What is the primary goal for the investment fund? Don't rush into a solution before carefully considering the needs and issues.
- 2. Seek professional guidance.** Even if the organization has board members or others within the organization with strong financial backgrounds, it may be helpful to seek guidance from a third-party investment advisor. An investment advisor, especially one with a strong background in serving nonprofit organizations, may be able to offer an alternative viewpoint or provide additional ideas about how to meet the organization's objectives. An investment advisor may also be able to model investment and spending policies to give the organization a better idea of how these policies may play out in the future.
- 3. Start writing.** For any policy to be effective, it must be clear, consistent, specific and realistic. This will likely require several drafts and reviews from multiple people. When drafting, organizations should make sure to compare the new policy with other existing policies for consistency.
- 4. Seek approval from the board of directors.** Important policies such as spending policies should be approved by the board of directors prior to implementation. It's important for organizations to document policy approval in the board of directors meeting minutes and save the policy in a place where it can easily be accessed.

That said, there is no one-size-fits-all spending policy or process to update policies. Each nonprofit is unique and has unique needs for its spending policy. Thus, organizations should consider their options carefully, seek advice and input from others and, if an update is needed, begin writing a new policy with their specific needs in mind.

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