

10 November 2015

To: TREE Fund Finance Committee

Fm: J. Eric Smith, President and Chief Executive Officer

Re: 2016 Budget Proposal

In preparation for our December 1, 2015 Finance Committee Teleconference, I am pleased to provide the attached 2016 TREE Fund Budget Proposal for your review, consideration and comment. This memorandum is submitted to provide explanatory notes beyond the numerical data contained in the attachment. Please hold this document and the budget file itself close, as both contain necessary confidential personnel information that would be detrimental to morale and order were it to be released to other members of the staff. Note that the Excel file contains multiple tabs across the bottom, so all of the supporting elements are contained within a single document.

I am submitting this budget in accordance with the personal performance plan developed pursuant to the Trustee-President Memorandum of Understanding approved at our last full Board teleconference. My performance goals tasked me with conducting a “bottoms up” review of our budgeting process, and submitting my recommendations to the Finance Committee at least two weeks in advance of its meeting to support full, thoughtful review. This submittal meets the required timeline, and I am hopeful that you will find it complete and actionable.

In several areas, I am recommending changes in the ways in which we budget and report our financial activity. I am mindful and respectful of the fact that our current model has been collaboratively developed over the years between management and the Board, but I believe that it can – and should – be improved upon. I believe my proposals will allow us to create more meaningful reports, help staff in managing their own work to budget, and better reflect the mix between program, fundraising and administration in both our internal and external documents.

### **Accounts vs Allocations**

Public reporting via IRS Form 990 requires us to allocate our work between three categories: Program, Fundraising and Administration. Our Program percentage has historically been quite low compared to comparable nonprofits, and while this is in part due to the heavy emphasis of events in our fundraising portfolio, it is also driven by the ways in which we aggregate labor and overhead (L&OH) and material and subcontract (M&S) costs in the budget and our resultant financial reports.

In prior year budgets, we have typically spread expenses related to Tour des Trees and Auction across many accounts (the horizontal rows in the budget). For example, the approved 2015 budget has an account called “Special Event Tour” with a budgeted amount of only \$9,290. The

largest M&S expenses associated with the Tour (e.g. rider and staff accommodations at ~\$45,000, or Paul Wood's management contract at \$40,000) are budgeted in other accounts, along with non-Tour activities and expenses. We have then attempted to capture the total costs of the Tour and Auction by subdividing the IRS required "Fundraising" allocation category (the vertical columns in the budget) into three components: Tour, Auction, and Other.

The problem with this approach is that it effectively forces all expenses associated with the Tour solely into the Fundraising super-category – which fails to recognize the equally important programmatic elements of the Tour. You can clearly see this phenomenon when you look at how staff members have allocated their total time over the past five years: ~50% for fundraising, ~35% for administration, and ~15% for program. With L&OH expenses being as large or larger in most years as our grant and scholarship disbursements, this produces an overall mix that has run about 45% fundraising, 15% administration, and only 40% program. Again, that's a very low program level as far as funders and organizations that rate nonprofits are concerned.

This low program percentage directly contributes to concerns that I have already heard from multiple sources in multiple states about how TREE Fund is not an effective steward of funds entrusted to it. I believe it is essential that we shift our internal philosophy, our budgeting process and our external marketing to aggressively reflect and promote the fact that the Tour is as much an essential education, awareness and outreach initiative (e.g. program) as it is a fundraising activity.

To better present this position, my proposed budget clusters all expenses associated with the Tour and the Auction (more on that in a separate section of this summary later) into single horizontal accounts: every M&S expense that would go away if the Tour goes away should be placed in this Tour account, and likewise with Auction expenses in its own account. The functional allocations should then be collapsed back into the IRS mandated categories – program, fundraising, administration – with Tour and (to a lesser extent) Auction expenses always split between Program and Fundraising, rather than being solely sub-categories of the Fundraising allocation.

For 2016, I am proposing 40% of Tour expenses be allocated to program, and 60% allocated to fundraising. Having seen the Tour and the staff effort associated with developing and executing it, I am comfortable that we can justify this mix through the audit process; I have already discussed allocations with our auditor, and plan to provide this proposal to them as part of our review process in the month ahead to affirm this approach. By treating the Tour this way, we can increase our bottom line program allocation to 52%. It's still not high enough, but it moves us in the right direction. The key to increasing it further in years ahead will be to increase the amount of funding that we provide each year for grants and scholarships while holding other activities constant – and that will come as we grow the endowment and other unrestricted operating support.

When all Tour and Auction expenses are placed into their own budget accounts, we are left with a lot of very small accounts that I propose to merge into the following super-accounts, which are fairly standard in most budgets I've developed and worked with throughout my nonprofit career:

- Board Expense (includes Liaisons)
- Grants and Contracts
- Occupancy and Equipment
- Office Expenses
- Personnel
- Professional Fees
- Service Fees
- Technology
- Travel and Meetings

The "Map of Expense Accounts" tab in the budget spreadsheet provides the reconciliation at the subcategory level to the new super-categories. We will maintain all of the subcategories to allow year-to-year comparisons and to support the audit process, but will simply cluster them differently at the highest level to streamline reporting and support the processes defined above. The "Top Level Budget" tab in the budget shows 2015 budget as originally structured and approved, 2015 budget reallocated into the new rubric, and 2016 proposed budget in the new rubric to demonstrate year-to-year comparisons.

## Revenue

The "Revenue Projections" tab in the budget spreadsheet provides detailed discussion of our expected revenue streams for operations. Note that this does *not* include potential planned gifts or gifts made directly to the general endowment. We will seek such gifts, obviously, but they are not part of the operating budget. Key items to note in the revenue tab include:

- I have zeroed out the "Grants Management Fee" lines in the budget as they have been double counted in prior presentations: they are the retained part of the total sponsored grant amount, not an additive amount on top of the sponsored grants, as is implied by prior presentation. Our expense line for these sponsored grants is decreased by the offsetting amount.
- I have included a new grant line from Pacific Gas & Electric via the Utility Arborists Association in the amount of \$250,000. We expect this funding in second quarter 2016 based on conversations with UAA. We will manage the program as a sponsored grant; UAA has indicated that PG&E would like 80% of the funding to be devoted to a project within their service area, with the remnant being available for other TREE Fund selected programs. We will know more about the details of this grant in the months ahead.

- I have reduced the amount of funding expected from the Auction, as we are already in discussions with ISA Texas on creating a more widely attended event that can work as a “friend-raiser” as much as it serves as a fundraiser. The Silent Auction is incredibly time consuming for limited returns, and we will scale it back significantly, while also reducing the number of Live Auction items, better balancing high value and affordable items. If we can get more people at this event, we can offer greater value to its sponsors, while also freeing staff time to work on new development initiatives on the endowment building and unrestricted operating side.
- I am increasing both corporate and individual contributions for unrestricted operations. I plan to implement an ongoing “Annual Operating Campaign” approach to unrestricted fundraising, rather than depending solely on a year-end “Annual Appeal” model. We will also work to transition some of the funding that has been acquired through the very labor-intensive Auction into less onerous unrestricted operating support.
- I am slightly reducing the expected Tour revenue to reflect a second year of decoupling from the ISA International Conference and International Tree Climbing Championship, potentially taking a further toll on current and future riders who cannot make the time for all three events. Our approved budget amount in 2015 was lower than our public “stretch” goal, and we will take the same approach in 2016, so the amount I am budgeting is admittedly conservative.
- I am zeroing out the Chicago Community Trust (CCT) draw in the budget. We have used this line to force a balanced budget in recent years, e.g. it fills the shortfall between expected revenues and expected expenses. I consider this to be the wrong approach as we move into an endowment building phase. We have typically taken two draws per year from CCT, parked the funds in an operating reserve bank account that earns close to nothing, then reinvested all or some portion of the funding at year’s end. Our current operating reserves are, I believe, overly high. (We had to evaluate opening a third account this autumn as both of our current accounts were over the \$250,000 FDIC insured levels). Rather than taking CCT funding and losing growth opportunities and incurring transactional costs during the time when the funding is removed from the account, I would rather plan to draw down the current operating reserves over the course of 2016 to satisfy any operating shortfalls. This is reflected in the “Top Level Budget” tab in the budget spreadsheet. I have also requested an agenda item at the Board meeting to discuss operating reserves, as I would like us to all be in agreement on an appropriate amount.

### **Expenses: Labor and Overhead**

The “Compensation (Confidential)” line in the budget incorporates all human resource expenses for 2016. Key elements to note include:

- We already received healthcare quotes for 2016; they are down from what we paid in 2015, though 2015 actuals were much higher than 2015 budget, so there is little budget change.

- The 403b section reflects the proposed changes I submitted to governance committee earlier this year. They will be voted on at the Board meeting.
- *[Section regarding specific staff salary levels and changes thereto was provided to the Finance Committee, but deleted here to protect this sensitive information from widespread distribution].*
- I have not budgeted an increase in my own salary, as changes to my compensation are the Board's prerogative, and I do not wish to include any assumptions about them in the budget. There is enough wiggle room on the expense side to accommodate increases should the Board wish to provide them.
- Our current book-keeper, Carol Holmes, is working for us as an independent contractor. Her contract expires on December 31, and she will transition out after that point, though I have asked her for a consulting proposal that will allow us to work with her on an hourly basis at least through transition and the audit. The budget includes a part time book-keeper being added to staff as an employee, though we may still explore another independent contractor model should the right candidate present him/herself through that approach, which could reduce costs slightly due to eliminating payroll taxes.

### **Grants and Contracts**

I have budgeted a total pay-out of grants and contracts of \$450,000, which reflects payment on current programs, first year payments under the new UAA grant, and first year payments for an additional \$100,000 fellowship. The latter element will be discussed at our Board meeting; should the Board elect not to authorize such a fellowship, these expenses will be reduced.

### **Occupancy**

Our current lease expires in the Summer of 2016, and I am actively seeking new office space, as our current space is inadequate to our needs. I plan to remain in the western suburbs of Chicago, but am looking at adjacent towns with lower real estate costs than Naperville; ideally I would like to get us more, better space (to include bringing items stored in an offsite storage unit into our office home) at a comparable price by moving to a more affordable area. (Naperville is one of the more expensive communities in the region). I have increased the occupancy, equipment, and office expense lines of the budget to reflect a move in 2016.

### **Other Expense Elements**

Changes in other expense elements from 2015 to 2016 include:

- I have increased the Board and Liaison expense line to reflect a larger Board performing at full capacity.
- I have increased the Technology expense line to support a new website in 2016.
- I have reduced Tour expenses reflecting cost of living/renting between South Florida and the Central Carolinas.

- I have reduced Auction expenses reflecting simplification of the event, which reduces shipping, storage, and staff travel costs, e.g. we will need and bring fewer people.
- I have kept the Travel and Meetings line the same at a macro level, but changed what's in it: in 2015, we had budgeted for planned giving visits that did not happen. In 2016, I will use that available funding to visit the ISA chapters, and will consider planned giving visits as part of those trips.

### **Conclusion**

I look forward to our discussions on the budget as proposed. I will be traveling in the next week to TCIA EXPO in Pittsburgh and then to Partners in Community Forestry Conference in Denver, but will be back in office Wednesday, November 18<sup>th</sup> if you need any supplemental information provided before our December 1<sup>st</sup> meeting. I will obviously have my cell phone and be checking e-mail as I able during my travels, but my ability to access files and provide additional materials will be limited until my return.