Treasurer's Notes for 2021 KDA Budget Discussion with

Finance Committee
And
Executive Committee, Executive Board
May 2020

2019 Budget versus Actual Revenues & Expenditures Commentary

The Finance Committee, Executive Board and House of Delegates approved a balanced budget in the amount of $738,580. Year-end actual balanced revenues and expenditures were $822,682, a difference of $84,102. A large portion of this differential was composed of additional revenue with balanced expenditures of $50,304 from an ADA Grant to increase association membership via recruiting and hiring a Membership Concierge. Other than the ADA Grant, notable positive deviations from budget in the Budgeted Revenue Category of the budget included: $15,612 in net profit over budgeted amount from the KDA Annual Session, higher than budgeted revenue from "Association Gloves" (which is now becoming TDSC), and income from endorsement of Commonwealth Solutions. However, in the Non-Budgeted Revenue, contributions from the Journal Fund of $7080 (budgeted) and the Reserve Fund of $17,904 (unbudgeted and necessary to balance the budget) were also important "revenue" sources. Therefore, a total of $24,984 was taken from other designated KDA Funds in order to acquire resources to sustain the Operating Budget.

Net Expenditures in excess of original budgeted amounts were $33,798, exclusive of the ADA Grant, for a total of 4.6% excess of expenses over the original budget. Following is a breakdown of expense by category to demonstrate in which areas of the budget these overruns occurred. (See also Five-Year Budget Trend Chart)

Category A Expenses (Utilities, Maintenance, Professional Services, Postage, Insurance) of $17,237 over budget, primarily related to $13,901 in Miscellaneous Expenses of which $13,000 were unbudgeted campaign contributions for ADA offices being sought by members of other states in the Sixth District of the ADA, and $8276 was higher than budgeted rent after a loan modification to the mortgage loan on the building held by the KDA. In the future, the KDA needs to carefully consider whether it is financially feasible to make such generous campaign donations despite historical donations to candidates from KDA. It is suggested that "passing the hat" among members might be a better way to support these candidates and still keep the KDA on solid financial footing.

Category B Expenses (Equipment Rental, Tech Support, Officers Expenses, ADA Delegates Expenses, Executive Board Expense, Councils and Work Groups and Student Support) of $5423 in excess of budgeted amount, primarily due to higher than anticipated expenditures on Equipment Rental and

Maintenance, contribution to Student Support and Council support expenses. The line item for "Auto Expenses" was also overrun, however this appears to be related to categorization of automobile insurance into this line item that was previously included under the "Insurance" line item. Tracking this expense here gives us a more accurate idea how much it costs to maintain an automobile. Expenditures in this category were positively mitigated by lack of expenditures on the part of the Presidents (Bill Lee and Mark Moats) and 1st Vice Presidents (Mark Moats and Darren Greenwell) who spent only a total of $519 of a budgeted $8000. (Note: Had the approved, unbudgeted contribution to the UK Student Success Banquet been made, there would have been an additional deficit in this category.) The largest expense in this category is ADA Delegates expenses of $35,000. At some point, the KDA may have to decrease or eliminate the amount of travel subsidization to the ADA Delegates based on actual availability of funds.

Category C Expenses (Staff Salaries, Benefits, Retirement Contributions, Payroll Taxes, Executive Director Expense Account) were in excess of budget by $25,566, with the majority of the overage in the Staff Salaries line item ($28,688, which was mitigated by lower than budgeted expenses for retirement contributions and personal payroll tax). This was caused by a bonus given to the Executive Director that was not included in the 2019 Budget at the time that it was developed. In the future, such bonuses **must** be budgeted and must come from budgeted AND available amounts in the Operating Budget and not be taken from the Reserve Fund. Bonuses need to be tied to overall budget performance in addition to specific growth metrics. Aggregated revenues from all sources must be available to cover all expenses, including any bonus, and bonuses should NOT be taken from the Reserve Fund or the Journal Fund. This occurred in 2019 due to an oversight by the Executive Committee. Further, there should be a separate line item for "Bonus" given that this is a non-recurring expense and has no retirement contribution associated with it as regular salary does. Also, "Treasurer's Expenses" as a line item needs to be moved from Category C to Category B now that the Treasurer's position is not a paid one.

Beginning with the 2020 Budget, staff salaries, other than the Executive Director, are to be recommended as a lump sum by the Finance Committee and approved in a similar manner by the Executive Board. Total Staff Compensation for 2020 is budgeted at $505,850 as compared to total actual expenditures in this category for 2019 of $494,865 versus a budgeted amount of $470,750, which did not include the Executive Director's bonus. This means that in 2020, a pool of <u>$10,985</u> is potentially available, based on budget performance, for salary raises or bonuses for all staff, including the Executive Director. For 2021, per the proposed budget, only <u>$3800</u> is potentially available, based on budget performance, in excess of the 2020 budgeted amount. If we do not live within these limits, we will be facing additional budget overruns in this category of expenses. The budgeted amount for 2020 appears to be budgeted as though the 2019 Executive Director bonus were recurring salary level, but this should be verified with

Todd. The Finance Committee should recommend to the Executive Board a set dollar amount for staff raises other than the Executive Director for 2021 and make clear the amount available for Executive Director for any metrics driven bonus.

Todd has indicated that the budgeted amount in this category for 2020 was due to an overestimation of payroll taxes. However, the issue of identification of a specified dollar amount available for raises for staff and bonuses for the Executive Director still needs to be determined.

Category D Expenses (Fund Contributions) returned $8000 to the budget for other uses, because no contributions could be made to the Reserve Fund or the Capital Expenditure Fund due to significant budget overruns in other areas. This inability to deposit funds in these accounts is not conducive to good investment in the future of the KDA.

Category E Expenses (ADA Grant Expenses, Investment Fees) were balanced with no net gain or loss over budgeted amounts. Although the percentage looks large on the chart (see below), the same amount has been budgeted for this expense category since 2017.

The balance in the Reserve Fund as of December 31, 2019 was $270,675. Our By-laws require that this fund retain a balance of 35% of the annual Operating Budget. The proposed Operating Budget for 2021 is $783,805. In order to meet the mandate of the By-laws, at the proposed budget amount for 2021, the Reserve Fund would need a balance of $274,332. Contributions totaling $38,216 were made from the Reserve Fund to the Operating Budget in 2018 and 2019, while a contribution of 20,312 in 2017 has been the only contribution to this fund in three years.

The last year that we were able to make a contribution to the Reserve Fund was 2017. Factors leading to that were a $10,000 over realization of dues revenue, ADA Delegate expenses were less than budgeted, there were NO unbudgeted expenditures, and we adhered to budgeted amounts for expenditures. This needs to be our status in the future!

2020 Budget versus Actual Revenues and Expenditures
Commentary/Possible Confounding Factors

Revenue from dues realized so far in 2020 is $408,432 or 89% of budgeted revenue from this source, whereas revenue from assessment is only at 76% of the budgeted amount. Revenue from these sources generally comes in during the months of January, February, and March, but this year there seems to be some lag due to the COVID-19 situation. There are 175 non-renewals from 2019 as of May 7. We are significantly ahead of budgeted amount in the category of

Association Gloves, which is now actually revenue from TDSC. Given that this is a new relationship and source of revenue for KDA, it is hard to predict how this revenue stream will play out over the next several months, but it should continue to increase. Overall, at the end of the first quarter we have realized 67% of our budgeted revenue.

Given the corona virus crisis, the big question for us with respect to 2020 revenue is the status of the KDA Annual Session. If we are unable to hold this meeting, we will have to do some serious expense cutting to compensate for the lack of revenue. Rick is already thinking of areas where he can make cuts. It is entirely possible that KDA may not be able to fund ADA Delegates this year, if in fact the ADA does hold an annual meeting.

Expenses through the first quarter of 2020 were 26% of the annual budgeted amount. However, on the Expense side of the equation, early trends indicated that we might experience some overrun of budgeted amounts for utilities, excluding telephone, rent and maintenance. The rent issue deserves a serious discussion, as our annual rent amount has increased after loan modification our mortgage loan in 2018. Our rent has increased from $84,630 to $92,906, for a total increase of $8276 over last year. (See the section below on Mortgage)

Other Areas of Consideration/Concern:

Investment in the Future

KDA had not budgeted for or held a Leadership Conference in several years, and yet this is important for the future sustainability of the organization. Nor have we contributed to the Reserve Fund or the Capital Improvement Fund. Expense overruns last year were significant and resulted in further depletion of the Reserve Fund. Although some of the overrun would be considered “nonrecurring” expenditures such as campaign contributions, the large overrun in Staff Compensation is a recurring expense and it will compound annually.

The amount budgeted for support of the Executive Board does not include funding for a sorely needed retreat to shore up strategic planning.

Status of the Membership Concierge Position after the ADA Grant

Jena resigned her position on May 6, 2020, which has in a sense solved a problem, because after talking with Todd, it is clear that there is NO funding to replace this position. The number of dues paying members did not increase sufficiently to fund this position on a recurring basis.

Structural Deficit Represented by Legislative Fund Balance

The Legislative Fund continues to run a deficit created or at least magnified by the decision to hire a professional lobbying firm to advocate for the KDA. This firm has resulted in much closer relationships with Kentucky legislators and helped the KDA influence the outcome of legislation. But the amount of dues earmarked for this fund is woefully inadequate and thus offsets for this expense have been coming from other funds within KDA. Last year the amount of dues revenue dedicated to the Legislative Fund was $24,273 but expenses were $75,667. The expenses are mostly for payment to McCarthy Strategic Solutions, the professional lobbying firm KDA has employed. Travel funds for those attending the Washington Leadership Conference are also charged against this fund. It is time that the KDA determine how to balance this situation. This can be done by dues increases earmarked to this fund over a period of three or more years, or a decrease in expenses. Persons going to the Washington Leadership Conference may need to pay their own travel expenses, and we may need to determine if we can decrease the service level at McCarthy Strategic Solutions to something more in line with what we can afford. I am aware that there was a suggestion at the February 2020 Executive Board Meeting to add a line for voluntary contributions to this fund to our dues statements, but I doubt seriously that this will help close a deficit of over $50,000 per year given our experience with requesting voluntary contributions to the KDF on our dues statements.

I also believe that there is a lot of confusion between the KD-PAC and the Legislative Fund. The KD-PAC is a separate organization and all contributions to it are voluntary. The vast majority of contributions to KD-PAC are used to make cash donations to candidates running for office in the Commonwealth of Kentucky. These donations help provide access to candidates when we have state legislative issues that we either want sponsored or defeated. The Legislative Fund is intended to be purely for the purpose of supporting political advocacy to convince both state and federal legislators that they should sponsor ADA/KDA supported legislation or help defeat legislation unfavorable to our organizations. The Legislative Fund was intended to be fully dues supported. In the past, KDA did not even hire professional lobbyists. I am not suggesting that we return to that level, but I think we need to live within our means. I see this like the Kentucky Teachers' Retirement System- systematically underfunded and with a time clock ticking before the piper has to be paid.

Dues Increases/Membership Numbers

We have discussed previously whether we should raise dues by a modest amount annually as opposed to waiting several years and imposing a larger increase that runs the risk of decreasing membership. A review of the history of the amount and timing of dues increases would be helpful. Todd has projected Dues Revenue and Assessment Revue for 2021 based on the following projections: 800 Active Members, 200 Life Members, 150 New & Retired Members. He has projected that all Active and Life members will be "full dues paying" level based upon the assumption that the House of Delegates passes a Resolution from the Executive Board requesting this change, which is consistent with the same change passed by the ADA HOD last October. Consideration should be given to institution of a small dues increase for 2021 for general

Operating Budget as well as for an additional earmarked portion to go to the Legislative Fund.

As we have discussed on multiple occasions, the biggest concern for the future of the KDA is the decreasing number of dues paying members. Currently, Retired Life Member dentists pay no dues, Retired Active Members pay 25% of full dues, Active Life members pay 75% of full dues. Currently, new dentists are afforded membership for 25% of full dues the year that they complete their educational program, whether a DMD degree or a specialty degree/certificate. The following year they pay 50% of dues and the year following that, the third year they pay 75% of full dues. No members except Active Members are paying assessments. This dues discount structure was changed at the 2019 ADA House of Delegates to eliminate the 25% discount the first year and the 75% discount the third year and allow no dues the year of completion of the training program and 50% discount the second year, and then full dues paying status the third year. KDA intends to adopt these same changes.

As of May 7, 2020, we still have 175 dues paying members from 2019 that have not renewed membership. In 2019 we had 787 dues paying members Active Members (full dues paying) with a total of 1149 members. As of May 7, 2020, we have 722 Active Members, 17 half price members (Special ADA promotion for those with lapsed memberships) 20 retired members, 93 New Dentists, 175 Active Life, and 357 Retired Life. Thus, many of our members pay no dues or reduced dues despite the increase in membership numbers. The total decline in membership numbers and the increasing percentage of Life Members paying discounted dues and no assessments has been a multiyear trend.

Assessment Status

Assessments were added to the KDA Dues statement when the association moved to the new building and took out a mortgage. The amount of the assessment was set based on membership numbers at that time and was calculated to produce revenue to directly offset the amount of the rent (AKA mortgage, but KDF owns the building for tax purposes). As membership numbers dropped over the years and more members aged into the category of Life Members with discounted dues and no assessment, AND as the rent increased with the loan modification on the building, the revenue from Assessments has not been adequate to cover the rent. Todd has budgeted an amount that will do so for 2021, if the number of members is actually achieved that he used to make this projection. The existence of the Assessment has made it hard to also add dues increases. Additionally, members were assured that once the building was paid for, this assessment would be discontinued. The loan is currently scheduled to be paid off in June of 2030. If the purpose of the assessment is simply to offset the rent (mortgage) payments, then eliminating Assessments once the mortgage is paid should not be a problem. The discontinuance of assessments would allow more leeway to increase dues. But we cannot wait 10 years to have dues increases.

Impact of Other Budgets on Overall Financial Position

While the Finance Committee has been asked to review and recommend an Operating Budget for 2021, there are other budgets within the KDA. For example, the Annual Session Expenditure Budget for 2020 is $142,525 and for 2021 is $164,825. Only the net of profits after expenses is built into the KDA Operating Budget. Booth rentals, patronships, and sponsorships of specific events (non dues revenue) all help fund the Annual Session, as well as CE payments, and fees for event attendance at some events.

Similarly, there is a Journal Fund Budget and there is a Legislative Fund Budget. (See comment above) A specified but inadequate percentage of dues become revenue for this Legislative Fund on an annual basis. However, given that the Legislative Fund consistently runs a significant deficit, presumably cash from other nonrestricted accounts is used to pay ongoing accounts payable budgeted to these accounts over the course of business of the association. This has a negative impact on the overall financial wellbeing of the KDA and is a major reason why I believe that we must set up a long-term solution to the deficit in the Legislative Fund. At some point, cash flow could become a real problem for the KDA, especially as the balance of the Reserve Fund continues to dwindle. This problem reminds me of the underfunded Kentucky Teachers Pension Fund! In 2019 the Legislative Fund had revenue from dues, its only source of revenue, of $24,237, and expenses for legislative advocacy of $75,667 leaving the year-end deficit at -$51,430.

The Journal Fund generates revenue from advertisements, and has been generating enough excess revenue that it has become a “go to” source for balancing the Operating Budget, with $17,577 nonbudgeted revenue from this fund slated for 2020 and $18,805 in 2021. A total of $62,515 has been expended from or budgeted to the Journal Fund from 2017 through 2021. In 2019, the Journal Fund had an excess of $15,629 revenue over expenses, leaving the year-end balance at an amount less than the budgeted amount to come from this fund for the both the 2020 and 2021 operating budgets. While revenue will continue to accrue from ongoing operations, our current practice will keep this fund balance from growing to be invested in the future of the KDA.

Impact of 2018 Mortgage Loan Modification

In 2018 KDF modified the mortgage on the KDA headquarters building. The immediate result of this loan modification was an annual increase in rent due from the KDA to the KBD of $8275 per year as indicated above. The current loan has a variable interest rate of 4.85% for the first five years, which will be until

June of 2023. However, the interest rate on the mortgage is to be adjusted in June of 2023 to a Five Year Swap Rate plus 2.7% at which time the distribution of the payment directed towards interest will increase and that directed toward principle will decrease unless we modify the loan again to prevent the escalation of interest rate. If no loan modification is made until the end of the loan, additional balance related to increased interest increases is due and payable at that time. However, it is our intention to modify the loan again to avoid increase in interest percentage on or before June of 2023. This type of variable interest rate mortgage is pretty much all that is available for commercial loans. Modifying the loan in 2018 did increase our rent payment because the term of the loan was shortened to save money on interest payments. The balance on the mortgage loan at the end of 2019 was $703,921.

KDA has a lease agreement with KDF, which is currently scheduled to end in 2026. KDA will have to sign a new lease agreement until the building is paid off, and if for any reason interest rates do increase, our rent payments to KDF will be increased.

Need for a Process for Mid-Year Budget Corrections

Because the Executive Board often approves expenditures after the budget is approved by the Board and the House of Delegates, it seems that it would be prudent to establish a way to conduct budget revisions quarterly or semiannually to reduce the budget overruns that we have been experiencing. We should seriously consider making certain that there are unexpended budget dollars available before approving any additional expenditures and then immediately revising the budget to reflect the new expenditure guidelines unless there is additional revenue to cover these added expenditures. Additionally, there should be a “trip figure” such that when any expense is more than a defined percentage over budget, would require notification of and possible action of the Executive Board. The Board should be well acquainted with the budget as well to decrease these well meaning unbudgeted expenditures.

Drawbacks of an Incremental Budgeting Process

The process that we have been using to develop the budget is what is called incremental budgeting. We take the budget from the year before and the actual expenditures from the year just ended and “tweak” each line item based on history. But the problem with that is it doesn’t allow us to address any reprioritization that we might need or want to make (such as investment in the future of the organization), and it pretty much blinds us to long-term trends unless we start looking for them. Expenses can get out of balance with priorities and with what we can actually afford over time. There comes a time when it is best to forget the line items from the past and do de novo budgeting to realign our overall financial picture. I believe that KDA has reached that point.