Budget Development

Whether drafting your organization’s first budget or a subsequent one, there are basic principles to follow. While budgeting is a staff function, your board must ultimately approve the final document. It is therefore important to keep the board informed and involved at the right points in the budgeting process.

Starting up

Part of filing for your organization to have [tax-exempt status](https://boardsource.org/resources/applying-tax-exemption/) requires you to submit projections for your first three budgets. It is not wise to ask an outsider to prepare these budgets! Projecting is a very useful exercise because it forces you to face reality and allows you to practice budgeting. You also should involve your new board members in the process as they most likely will be wearing several hats during the start­up phase and will be participating in day-to-day activities before you hire staff.

Foundation for other plans

Before you can draft your budget, you must know what your organization plans to accomplish in the future and specifically in the coming year. One of your board’s primary functions is to set the direction for the organization. Your [strategic plan](https://boardsource.org/product/shaping-future-organization-strategic-planning-guide-nonprofit-leaders/) drives all other planning you do. It could be helpful, as the next step, to create a business plan. A [business plan](https://blog.boardsource.org/blog/how-to-produce-a-world-class-investment-grade-business-plan-for-your-nonprofit), in a way, is the strategic plan with numbers attached to all activities. Because your business plan must calculate both internal and external threats and opportunities in dollars, it provides a firm base for the next set of supporting documents: operational plans. Your annual operational plan is the staff’s detailed guide for the coming year. In the end, your annual budget must align with your operational plan.

Goals

Within the above framework, you must be realistic about your goals when developing a budget. In addition to reflecting your program needs, it must resonate with revenue expectations. If you build your budget on wishes rather than hard facts, you will be sadly disappointed when you and the board study your[financial statements](https://boardsource.org/product/financial-statements-primer/). It’s important to create a truthful base for your finances.

Options

When calculating a rough, preliminary budget, you have at least two options. The first involves computing your present available liquid assets, estimating the amount of money you will both be able to raise and earn from your services, and then adding these figures. This will be the amount of money that you can play with when defining the scope of your activities beyond your fixed expenses. With this scenario, you work strictly within the expected income.

A second approach: Look at your goals, determine your priorities, calculate the necessary expenses, and estimate how much money you can raise. Your objective is to at least balance the budget. If you do not tie your expenses to realistic income, you will quickly run out of money while trying to keep your programs viable. If you feel that your funds raised may not cover all your annual costs, go back to the drawing board and reassess your goals. Learn to prioritize.

Expenses vs. revenue

Calculate realistically your fixed expenses. These are the expenses that you must take care of whether or not you run any programs. They may include rent, utilities, equipment, basic fees for phones and postage, and other costs that relate to keeping an office viable. After your fixed expenses are assessed, you can determine how much money is left for programs and services. Consider activities that will enable you to bring in some earned income; that helps you build for the future. It is perfectly normal for nonprofits to charge reasonable fees for services. Only if you have outside contracts, adequate donations, or you manage to subsidize one activity with the income from another can you retain programs that do not cover their own expenses.

When developing your fundraising proposals and plans and calculating your fundraising income, make sure that you include all the costs in your project budget. Don’t underestimate the expenses that are needed to run a program. Your objective is to cut down overhead and administrative costs by allocating appropriate portions to each activity.

Although a board occasionally might [approve a budget](https://boardsource.org/resources/7-questions-ask-reviewing-annual-budget/) in the red, it must be an exceptional situation and well justified and documented. Without strong evidence and semi-certainty that the missing money will appear in the very near future, it is not wise to have bigger plans than what you can deliver. Most nonprofits start small and, with smart financial planning, grow to their potential. This takes patience, but it is the only viable way to ensure that you will be there year after year. Your board has a key role in making sure that your organization lives within its means.

Monitoring results

The budget is also a planning tool and a guide to use throughout the year when making decisions. It provides monetary guidance as you implement the planned activities — or say no to some unplanned ones. Your financial statements serve as the means for the board to monitor how well the budget is being followed. Your board must request and receive regular financial statements that allow it to ascertain that you are heading in the right direction. “Well planned is half done” should be your board’s motto — but it is also perfectly normal to do a mid-year forecast and adjust your budget accordingly. Once the board approves the budget or its adjustments, it should make sure that the budget is respected during the course of daily operations.