Part One

Understanding Budgeting Basics

Chapter 1

Why Budgets and Budgeting Are Important to Nonprofits

MERRIAM-WEBSTER'S Collegiate Dictionary defines *budget* as

1. "A statement of the financial position of an administration for a definite period of time based on estimates of expenses during the period and proposals for financing them"
2. "A plan for the coordination of resources and expenses"
3. "The amount of money that is available for, required for, or assigned to a particular purpose"

These are pretty long-winded definitions. In plain language, they mean:

- An effective budget is a plan
- For receiving and spending specific amounts of money
- In specific cost categories
- To get specific things done
- Within a set period of time
- With monitoring mechanisms built into the process.

There is an even shorter way of saying this:

A budget is a plan for getting and spending money
to reach specific goals by a certain time.

A budget is a plan. The word *plan* in this sentence sounds solid and reassuring. In reality, however, most plans are only as good as the work and information that go into preparing them. Basically, a plan is

- A well thought-out idea of future actions
- Needed to achieve specific goals
- Within a set period of time,
- Based on past experience,

- Accurate current information,
- And assumptions about the future (based on the best research possible).

This means that people who prepare budgets and plans must

- Set specific goals,
- Examine the past, present, and future,
- And identify the specific actions and costs
- Needed to reach the goals they set in the first place.

Four basic rules about budgets and plans are

Rule 1. A budget is a plan for spending money to reach specific goals within a certain time period.

Rule 2. Any budget or plan is only as good as the time, effort, and information people put into it. Good budget practices should foster collaboration and exchange of information among the budget team participants.

Rule 3. No budget or plan is perfect because none of us can totally predict the future.

Rule 4. In order to reach the goals, all budgets and plans must be monitored and changed as time goes on.

A. The Importance of Budgets and Budgeting

Many nonprofits need budgets to get money in the first place. Government funders and foundations will generally not accept a grant application without a properly prepared budget. But even if a funding source or a donor is willing to provide funds when no budget exists, a well-managed nonprofit will still prepare a detailed budget for spending the money. Simply stated, the top economic priority of any nonprofit should be staying solvent, and budgeting is the optimum tool for promoting this goal. Finally, the more clear, accurate, and well thought out budgets are in the beginning, the more likely a nonprofit is to be able to

- Adjust plans, activities, and spending as needed.
- Spend money cost effectively.
- Reach the specific goals it has set.
- Receive “clean” audits.
- Avoid incurring questioned or disallowed costs or cost overruns that it may have to pay for from other funds.

Well-prepared budgets have many other important benefits too. They let everyone in the organization know

- The goals to be achieved
- The work to be done to reach the goals
- The resources (people and things) needed to get the work done

- The resources available for getting the work done
- The timetable and deadlines for getting specific work done
- The individuals responsible and accountable for doing the required work

Budgets serve these additional functions for well-managed nonprofits:

- Budgets provide the financial and operational guidance management and staff need to implement board policies and directives.
- Budgets allow management to measure and guide current and long-term financial health and operational effectiveness.
- Budgets guide the acquisition and use of resources.
- Budgets anticipate operational expenses and identify income to pay for such expenses.
- Budgets are tools for controlling spending and avoiding deficits.
- Budgets help integrate administrative, staff, and operating activities.
- Budgets allow management to monitor actual income and expenses, comparing them to the amounts budgeted, assessing the nonprofit's overall financial situation, and altering plans as needed.
- Budgets can serve as the basis for performance reviews and, in some cases, compensation criteria.

B. The Basic Characteristics of Budgeting

Effective budgeting is thoughtful and deliberate. It involves carefully setting goals and developing plans and also creating a logical and informed process for allocating resources.

Budgeting is inclusive. It brings together the perspectives and interests of a wide variety of stakeholders: the board, clients, management, staff, volunteers, prospective donors and income sources, and the general public. At the outset of the budget process, input from all relevant parties is sought. Dissemination of the approved budget should clearly and effectively communicate priorities, goals, and operational plans to the entire organization as well as to other stakeholders.

Finally, budgeting is an ongoing process. It does not occur in a vacuum or for a limited period, producing a document that gathers dust on a shelf. Ongoing monitoring, data gathering, analysis, revision of projections and assumptions, and consideration of alternatives are needed.

Over time, careful attention to the budgeting process will lead to greater financial stability, operational effectiveness and efficiency, and responsiveness to organizational needs and priorities.