

# 7 Questions to Ask When REVIEWING THE ANNUAL BUDGET

**The annual operating budget outlines the organization's goals and activities for the year and attaches numbers to them.** It estimates income from a variety of sources and sets forth the organization's anticipated expenditures. Staff members have the responsibility for determining which items are covered in the budget and for drafting the overall document. The board is responsible for reviewing and approving the budget.

Here are seven questions the board should keep in mind as it reviews and approves the budget:

## 1. DOES THE BUDGET REFLECT THE ORGANIZATION'S MISSION ACCURATELY?

The budget can send signals that an organization may be veering from its mission. Look for them by asking the above question.

## 2. DOES IT CALL FOR A SURPLUS?

Although nonprofits are not primarily in business to make a profit, building a surplus constitutes a wise business practice. It provides an opportunity for a nonprofit to reinvest profits in programs and operations and/or invest for those years when the balance sheet tips the other way. Accumulating large reserves is not inherently bad, provided the organization has a sound reason for having them, such as being financially prepared for the loss of a major revenue source or for an unexpected investment opportunity. And remember, while deficit budgets are not ideal, they also are not a sin now and then — as long as the organization has adequate reserves to draw on.

## 3. WHERE ARE REVENUES PROJECTED TO COME FROM?

A diversified base for creating income allows an organization to stay flexible, stable, and more insulated from environmental and economic fluctuations, but the reliability and competitiveness of your revenue streams dictate the degree of diversification that you need. Many nonprofits earn income through fees for service, product sales, membership programs, endowments, operational reserves, for-profit subsidiaries, fundraising, grants from foundations, federal grants, board member contributions, corporate support, inkind donations, and the United Way.

## 4. WHAT ARE THE OPERATING RATIOS FOR KEY AREAS?

Determine what percentage of total budgeted expenditures goes to such areas as salaries and benefits, fundraising, and so forth. Some donors may request this information to determine, for example, how much of every dollar raised goes directly to support programs or services. Keep in mind, however, that administrative costs are crucial to supporting an organization and its mission — a program cannot function without its infrastructure, adequate space, staff, and supplies. The board must take time to assess the organization's needs and ensure that the budget is not "starving" the organization — underinvesting in administrative costs is consistently linked with poor organizational performance and sustainability.

## 5. WHAT POLICIES APPLY TO BUDGET REVISIONS?

How much flexibility does the staff have to adjust the budget as the fiscal year unfolds? Mid-course adjustments are common and considered normal in many organizations. Many nonprofits use forecast modeling that incorporates the budget to determine if deviations are occurring and adjustments are needed. Do your policies allow the senior

# 7 Questions to Ask When REVIEWING THE ANNUAL BUDGET

management to make and approve these adjustments or do significant revisions require board approval? Requiring board approval on any significant revision to the budget can be an effective internal control, decreasing the opportunity for fraudulent activity or misuse of funds.

## 6. HOW DO REVENUES AND EXPENDITURES STACK UP AGAINST THOSE OF OTHER NONPROFITS?

To make well-informed financial decisions, board members also need to remain abreast of trends within the community and the nonprofit sector as a whole. Helpful benchmarks may include member or donor retention rates, the cost to acquire a new donor or member, average program or product costs, and the percentage of each dollar raised that goes to program delivery versus administrative costs (keeping in mind, of course, that administrative costs are crucial to supporting an organization and its mission).

## 7. DOES THE BOARD REGULARLY RECEIVE FINANCIAL STATEMENTS THAT INCLUDE BUDGET INFORMATION?

It is helpful for board members to compare actual to budgeted expenses and revenues, including the percentage of variance. These statements should be reviewed regularly during board meetings so that all board members remain aware of profit-and-loss performance.

### Resources:

[The Overhead Myth: Moving Toward an Overhead Solution](#)

[Financial Responsibilities of Nonprofit Boards](#)

[Understanding Nonprofit Financial Statements](#)

[The Nonprofit Policy Sampler](#)

[The Nonprofit Dashboard: Using Metrics to Drive Mission Success](#)