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 projects income estimates from a variety of sources and sets forth the organization's anticipated expenditures.

Staff members are responsible for determining which items are included in the budget and for the initial drafting and presentation of the budget to the finance committee and later to the board for deliberation and approval. 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?

An organization's budget indicates its priorities. 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 in business to make a profit, profits must be retained to support the mission. Building a surplus allows a nonprofit to reinvest earnings in programs and operations and reserve for financially challenging years.

Accumulating nonprofit operating reserves allows the organization to be financially prepared for the loss of a major revenue source, a recession, or an unexpected investment opportunity. Conversely, deficit budgets are not ideal. However, they are occasionally necessary as long as the organization has adequate reserves to draw on.

Should you be fortunate to have a budget with a surplus, prepare answers to why you are seeking additional funds while you are projecting a surplus. It's a reasonable decision but one that may require an explanation.

3. Where are revenues projected to come from?

A diversified income base allows an organization to stay flexible, stable, and more insulated from environmental and economic fluctuations. Still, the reliability and competitiveness of revenue streams will dictate an individual organization's degree of diversification. Many nonprofits earn revenue through fees for service, product sales, membership programs, endowments, operational reserves, and social enterprises, as well as contributed income from, fundraising, from individuals, grants from foundations, board member contributions, corporate support, in-kind donations, the United Way or other Federated organizations, and contracts or grants from federal, state, or local government.

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. 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 relies on the budget to determine if deviations are occurring and adjustments are needed. Do your policies allow the senior management to make and approve these adjustments or do revisions require board approval? Requiring board approval on significant revisions 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 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, and average program or product costs.

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.

BoardSource-201 Resource | Last updated: September 28, 2023

Resources: Financial Responsibilities of Nonprofit Boards, The Nonprofit Policy Sampler, The Nonprofit Dashboard: Using Metrics to Drive Mission Success