Budgets and forecasting

What is a budget?

A budget sets out your organisation's planned activities in financial terms. By expressing your plans in money terms a budget can help you to make good decisions and keep control of your organisation's finances.

A budget can be for the operation of the whole organisation, which would usually cover a 12 month period, or be created for a specific project that you are running. A basic budget is an estimate of income and expenditures set out in a table format.

You will need a budget if you are applying for a grant as the funder will want to know how the project is being paid for, and where the money will be spent.

When you set your budget at the start of the year, or start of the project, you will be predicting (forecasting) the likely income and spending that you will need to deliver your activities. These figures may change, or you may need to alter your plans and change the budget. This process of monitoring the budgets against the actual situation and checking how your financial situation varies is an important part of managing your organisation's finances to make sure that you remain on track to deliver your plans.

How to prepare a budget?

The process of setting a budget for your organisation, or for a specific project that you are carrying out, should be done alongside the planning of your activities as the two processes go hand in hand.

You will need to develop a list of the items of expenditure that are relevant to your activities and cost them all. If you are creating a budget for a project then make sure that you include the appropriate contribution to overheads (See our section on Project budgets and full cost recovery). You then need to work out where the income to pay for these activities will come from, and whether the activities are affordable.

It won't be possible for you to know all the costs exactly but you can estimate them as accurately as you can based on evidence and research. You should also talk to the people in your organisation who will be carrying out the activities as they should have good knowledge of what is needed.

You can use a budget from the previous year as a basis for your calculations but you should scrutinise the figures carefully and do not assume that you are carrying out the same activities, for the same cost. You will also need to take into account increased costs due to inflation. It is also wise to factor in a 'contingency' line in the budget to cover any emergency payments should something unexpected happen.

The budget will also need to show the income that you expect to receive. It is likely that some sources of income will be uncertain so you should estimate these figures as accurately as possible.

If you are applying for a grant but do not know yet if your application will be successful then you should mark this income entry as 'unconfirmed'.

You should keep notes of how you have arrived at the figures for any uncertain income or expenditure. This will help during the monitoring process to check whether you are on track, and whether the assumptions that you have made were correct.

You should also make a note of the timings of key items of expenditure and large receipts as this will be relevant to your cash flow. We will look at this in the Cash flow forecast section.

Once you have all your income and expenditure figures you can set them out in a table format to create your budget.

For further guidance and some practical examples on how to create your budget have a look at our free e-learning course Creating a budget from scratch

Other sources of information

NCVO have a flow chart showing the key questions in the budget setting process

Charity Finance Group have created a range of resources for small organisations which covers things like budgeting. You can find this information here.

Approval of the budget

The board or management committee are ultimately responsible for the finances of the organisation and for agreeing the budget.

A key decision for the board in approving the budget is whether the income / expenditure on the budget needs to balance. A balanced budget, also called a break even budget, is one that creates no surplus or loss (deficit). A surplus on the budget would mean that income exceeds expenditure, whereas a deficit budget means that the income is not enough to cover the expenditure. This decision needs to be agreed by the board as it has an impact on the financial situation of the organisation.

The board should be clear about their budget requirements and communicate this to the people preparing the budget before they begin their planning, so that everyone is working to the same aim.

The final budget must be approved by the board in advance of it being implemented.

Monitoring the budget

Once your budget has been created and approved you should use it to monitor how your organisation is performing. Once the budgeted activities start you can record the actual income received and expenditure incurred to make sure that you are on track and understand how much money you have left to spend.

Any significant variations in the budget lines could be a warning sign that something is wrong, so it’s important that this monitoring is undertaken regularly and systematically. Problems in sticking to the budget may mean that plans need to be changed and sometimes organisations will create a revised budget, or a projection based on the new circumstances. If you create a revised budget then you should make sure that it is labelled as this, as you need to have clear and accurate records of your organisation’s financial decision making.

While responsibility for monitoring the budget may sit with one person, such as the Treasurer or a finance clerk if you have one, the board will retain the ultimate responsibility for the organisation’s finances. It is important that the board receive regular updates on how the organisation is performing against the budget. The board might want to see a document setting out the actual figures compared to the budget, or the variance between the budget and the actual figures. There are no fixed rules on the information that the board should receive, but it must provide an accurate picture of the organisation’s finances and be what they need to support good decision making.

Project budgets and full cost recovery

Full cost recovery is a method of budgeting projects or services that allows organisations to recover all costs associated with the delivery of the project or service when applying to funders or submitting tenders.

When you are working out the cost of a project you need to take into account the direct costs relating to the project itself and the share of general support costs from the rest of the organisation that are needed to deliver the project. Support costs may also be called indirect costs or overheads and include things like rent, insurance and management time.

When allocating support costs to a project budget you need to use a calculation method that is consistent, logical and clear. Common allocation methods are based on headcount and floor space. You need to be methodical in your calculations and be able to justify how you are arrived at your figures.

Our information sheet Full Cost Recovery contains more information about this.

Other sources of information

CAPlus have useful spreadsheets for allocating overheads to projects.

National Lottery Community Fund have guidance about full cost recovery.

Cash flow forecast

To have a true picture of the financial performance of your organisation you should monitor your cashflow, alongside your budgets.

Understanding your cash flow will help you manage your organisation and ensure that you have enough funds available to pay your bills at the right time. A cash flow forecast or statement sets out the movement of cash in and out of the organisation over a period of time and can be very helpful in indicating when you may need to take action, for example in adjusting payment schedules or chasing money that is due to you.

Failure to manage cash flow effectively can lead to serious difficulties, even the closure of an organisation, so it is important that this is done routinely and accurately as part of your financial reporting to your board.

An example of how to approach this is set out in our Basic Bookkeeping information sheet.

Longer term financial forecasting

Much of your organisation's financial management will be focused on dealing with the current financial period, but it also has a role to play in preparing your organisation for the longer term. In our section on Strategy, planning and impact we talk about the need to develop a business plan for your organisation which sets out the longer term aims and objectives that you are working towards. This includes creating a financial forecast which predicts your income and expenditure over the relevant time period.

You can use your budget template for this work, but your predictions about income and expenditure will be in more general terms.

This kind of financial planning is important to inform decision making relating to the longer term direction of the organisation. It also helps identify financial risks that the organisation may face in the future.

You can find more information about how to manage risk in our Risk Management section.

Other information The Charity Finance Group have a range of templates and a recording of a webinar that will help small organisations with budgets and cash flow.