



Budgeting, Variance Analysis, and Forecasting

This guide provides a high-level overview of building, managing, and analyzing budgets. It includes key definitions of budgeting components; guidance on identifying the people, processes, and technology needed for effective budgeting; instructions for performing a variance analysis; and steps for creating a basic forecast. Additionally, the guide offers starter resources for budget creation and variance analysis. This guide will:

- Help leaders to right-size their budgeting process to fit their organization’s maturity level and needs
- Provide guidance on engaging team members in budget design and clarify methods for establishing accountability in the budgeting process
- Support ESE finance leads in understanding and communicating planned or unplanned changes in financial position to key stakeholders

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Introduction

Budgets are essentially a plan – they demonstrate which programs, teams, and departments an organization will prioritize for investment in a given period. Budgets play an essential role in aligning key stakeholders, including executive directors, leadership teams, staff, and the board of directors. They outline clear revenue and expense targets, empowering teams to work independently within defined guardrails. Additionally, budgets help the board of directors thoughtfully oversee annual planning, ensuring any growth or reductions align with the organization's overall objectives. Budgets should be developed annually and – for nonprofits, at least – approved by the board before the start of each new fiscal year.

Key Definitions for this Guide

- **Chart of Accounts (COA)** – Categories used by your accounting software to classify financial transactions. These can be organized in countless ways, usually employing a numbering system. The COA is a critical tool for budgeting and should remain as simple as possible while providing the necessary detail for reporting to the team, the board, and donors.¹
- **Budget** – A financial plan outlining expected revenue for the current or upcoming fiscal year. Budgets should align closely with an organization's Chart of Accounts and can range from simple to complex based on the organization's needs. Some budgets are segmented by program, location, or other essential categories. They are also vital components of grant applications, demonstrating financial stability and supporting philanthropic fundraising efforts.
- **Variance Analysis** – This is a key process for understanding financial performance as it helps to identify what happened over a given period of time (i.e., did we vary from the plan?), why any variance occurred, and what to do next. Variance analysis compares what is budgeted (planned spend or income) against actual results (what really happened). It helps identify trends and necessary adjustments. Variance analyses can be conducted monthly, quarterly, or annually, and enable timely identification of deviations from the budget, facilitating quick decision-making and mid-year adjustment.
- **Forecasting** – The practice of making informed predictions about future financial outcomes using historical data and key assumptions (the distinction from a budget is that a forecast is not a *formal plan* in the way a budget is). Forecasting falls into two buckets: **long-term forecasts (12–18 months or more)** help organizations anticipate future cash flow needs and plan for different scenarios, while **mid-year forecast updates (or mid-year reforecasts)** provide refreshed guidance during the current fiscal year when actual results diverge from the budget. Importantly, mid-year forecast updates are not changes to the approved budget as the budget remains the baseline for accountability and variance analysis regardless of updated forecasts. Instead, mid-year reforecasts provide updated expectations to guide operational decisions, resource allocation, and financial planning for the remainder of the year. For the purposes of this guide, when the term “forecast” is used, it's referring to mid-year reforecasts unless otherwise specified.

Each of these core financial management tools and activities requires effort to build and maintain, but the process can be streamlined with clearly defined steps, assigned roles, and thoughtful & disciplined use of

¹ There are a number of web-based resources that can help with designing and building your COA:

<https://www.nonprofitaccountingbasics.org/about-us/chart-accounts>
<https://thecharitycfo.com/how-to-set-up-a-nonprofit-chart-of-accounts>
<https://www.gsquaredcfo.com/blog/chart-of-accounts-for-nonprofit>



technology. When these tools and activities function smoothly, the budget is aligned with the COA, accounting software systems can be used to easily develop budget to actual reports, and forecasts can be quickly updated based on variance.

Components of a Budget

Organizational budgets typically mirror the layout of the Income Statement (IS) (also called the Profit & Loss Statement in for-profits) or Statements of Activities (SOA) (typical for nonprofits). Budgets contain the plan for revenue and expenses for a defined period (usually the fiscal year) in the same or similar categories contained in the IS or SOA.

The level of detail in a budget depends on your organization's maturity, complexity, and financial reporting needs. Earlier stage ESEs may find it helpful to keep budgets simple and high-level, while more mature organizations often create detailed budgets by program, department, or location.

In terms of structure, the most effective budgets are structured to align with the accounting system's master list of categories: the Chart of Accounts (COA). This alignment ensures that what you budget can be easily compared to what actually happens, simplifying reporting and variance analysis.

Note that for nonprofits following Generally Accepted Accounting Principles (GAAP), they must track expenses by both natural category (what an expense actually *is*) and functional category (what an expense *supported* — program services, management & general, or fundraising). Designing your budgeting and expense-tracking systems to reflect both the natural and functional categories can streamline financial reporting and grant compliance.²

Estimating Revenue

Revenue projections form the first major portion of the budget. This section outlines how much income your ESE expects to bring in during the fiscal year. For most ESEs, this includes both contributed revenue (grants, donations) and earned revenue (revenue from business activities). These projections help set expectations, define strategic goals, and inform spending plans.

- **Contributed Revenue:** This includes revenue from foundations, donors, government contracts, and other philanthropic sources. In this area, it's important to distinguish between:
 - **Restricted funding:** Funding which must be used for a specific purpose or program
 - **Unrestricted funding:** Funding which can be applied toward general operations

Your budget should reflect both types and should be aligned to the COA as well as any grant reporting requirements. Consider including specific grants or donor segments if helpful for planning or board reporting.

- **Earned Revenue:** This is the revenue resulting from business activities of the ESE. Each business line should have clear revenue targets. You can build projections relatively quickly by using key drivers as a basis for your assumptions. For example, a carry-out restaurant ESE may estimate its annual revenue using the following:

² For more on GAAP and its relevance to ESEs, see the guide "Reading Financial Statements."



$(\text{Number of orders per day}) \times (\text{Days open per month}) \times (\text{Average order size}) \times 12 = \text{Annual Revenue}$

Set targets that balance realism and ambition. Your revenue budget should motivate performance while staying grounded in historical trends and market assumptions.

Planning Expenses

The second major portion of the budget includes all planned spending for the fiscal year. Expenses generally fall into three broad areas: Cost of Goods Sold (COGS) or Cost of Sales (COS), Operating Expenses, and Nonoperating or Other Expenses. These areas are meant to provide a helpful framework (but not a prescription) for how to structure your ESE's budget. Your organization's COA, funding requirements, and mission-driven activities may call for a different approach. Note that the below broad areas can be considered *natural* expense categories. Keep in mind that nonprofits following GAAP must also track and report expenses by *functional* categories as well. Therefore, included in each of the below is a note on how the natural expense category may relate to the functional expense category for a nonprofit ESE.

- **Cost of Goods Sold (COGS) or Cost of Sales (COS)**³: These are direct costs tied to producing goods or delivering services. They're variable and rise or fall with business activity. Examples include raw materials, packaging, shipping, and direct labor. A simple method for setting COGS budgets (which ESEs may use) is calculating it as a percentage of revenue. For example, if an ESE expects \$100k in annual sales and estimates COGS to be 30% of sales, the annual COGS budget is \$30k. For nonprofits following GAAP, the COGS would most likely be considered a part of the **program services** functional expense category, as they are costs and expenses for activities that are directly related to mission delivery.
- **Operating Expenses**: These are indirect costs necessary to run the organization, such as rent, salaries, software, marketing, and professional services. These expenses may be fixed or variable, and should be aligned with your COA. For nonprofits following GAAP, operating expenses would likely intersect with all functional expense categories - **program services, management & general, and fundraising**.
- **Nonoperating or Other Expenses**: These are costs not directly tied to delivering or operating the core enterprise but that still affect the overall financial picture. Examples include interest expense, bank fees, investment losses, or other unusual one-time costs. These expenses are generally considered "below the line" and may not recur regularly. For nonprofits following GAAP, nonoperating expenses would most likely be categorized under the **management & general** functional category, since they relate to financing or organizational sustainability rather than to mission delivery or fundraising.

Building a Budget: People, Process, Technology

Budgets take time, care, and input from stakeholders. Depending on organizational complexity and maturity, budget preparation could begin as early as halfway through the fiscal year. Remember: your first budget (or first several budgets!) won't be perfect. As you're establishing a budgeting process, focus on iterative learning and establishing a culture of regular financial reflection instead of getting it perfect.

³ For product-based ESEs, "COGS" is the norm. For service-based ESEs, "COS" may be used instead.



People: Bringing the Right Team to the Table

Budgeting is a team sport. Every dollar spent and every hour worked contributes to the financial health and mission of the enterprise, which means involving the right people leads to better accuracy, transparency, and buy-in. While the level of involvement varies depending on your ESE's size and maturity, here are the typical people you'll find at the budgeting table and their roles:

- **Executive Director (ED) or CEO:** Provides overall vision and ensures the budget aligns with both mission and strategy. In earlier stage ESEs, the ED often leads budgeting directly.
- **Strategic Finance Lead (CFO, Finance Director, or fractional/part-time equivalent):** Guides the budgeting process, ensures alignment with financial strategy, and translates budgets into actionable financial plans. In more mature ESEs, this person leads the process instead of the ED.
- **Budget & Financial Analyst:** Supports budget creation by analyzing historical data, building projections, and preparing scenario plans. May be contracted, part-time, or in-house depending on organizational maturity.
- **Grants Manager:** For nonprofit ESEs with significant grant funding, ensures restricted vs. unrestricted funds are budgeted accurately and grant compliance is built into the plan.
- **Program or Department Leads:** Build sub-budgets for their areas (program costs, staffing, etc.), contributing frontline insights into revenue and expenses.
- **Controller, Staff Accountant, and Bookkeeper:** Work collaboratively to provide accurate financial records, helps ensure the budget aligns with the chart of accounts, and supports realistic expense assumptions.
- **Board of Directors:** Reviews, challenges, and approves the budget to ensure it is mission-aligned, realistic, and financially responsible.

Process: Making it Happen

As ESEs mature, the budgeting process evolves. Earlier stage ESEs often rely on a streamlined approach where the Executive Director or finance lead builds the budget by adjusting prior year numbers, with board approval as the final step. This keeps things simple and agile. More mature ESEs, however, benefit from (and often require) a more collaborative process. Program leads, finance staff, and leadership all contribute sub-budgets that roll up into an overall organizational plan, increasing transparency, accountability, and accuracy.

Regardless of your stage, budgeting is an ongoing, iterative process that strengthens with practice. Below is a step-by-step framework for designing a budget, with notes on how the process might look different for earlier stage ESEs versus more mature ESEs.



Table: Budget Development Process

Step	Suggested Timeline	Process Activities	Notes and tips
Step 1: Define Organizational Priorities	This begins about 6 months before new fiscal year	Earlier stage ESEs: The ED or finance lead sets high-level goals with some input from staff or board. More mature ESEs: Leadership team collaborates with department leads to define cross-organizational priorities.	- Consider any commitments related to expanding impact. - Organizational priorities can include goals related to internal factors: operations, culture, etc.
Step 2: Gather Supporting Historical Data	5 months before new fiscal year	Earlier stage ESEs: Use prior year actuals as a baseline, adjusted for known changes. More mature ESEs: Review multiple years of historical data, external benchmarks, and peer comparisons.	Data quality is crucial. As your ESE grows and matures, invest time in making sure it's accurate and consistent.
Step 3: Estimate Revenue	4.5 months before new fiscal year	Earlier stage ESEs: ED or finance lead projects revenue using simple drivers (e.g., customer count × order size). More mature ESEs: Department or program leads submit detailed revenue projections (earned revenue & contributed revenue). Projections consolidated by finance team.	- Set revenue goals that motivate the team but remain achievable. - Be sure to document assumptions. This helps with reviews of budget performance and future budgeting cycles. - If relevant, make adjustments based on seasonality (e.g., revenues that may change monthly or quarterly due to weather, customer demand, etc.)



Step	Suggested Timeline	Process Activities	Notes and tips
Step 4: Estimate Expenses	4 months before new fiscal year	Earlier stage ESEs: ED or finance lead estimates expenses. Certain variable costs can be estimated as % of revenue, based on prior year trends. More mature ESEs: Department leads build detailed expense budgets (staffing, programs, operations). Budgets reviewed and consolidated by finance team.	• Include a buffer (or error factor) for unforeseen expenses. • Make sure that restricted funding is budgeted properly. • If relevant, make adjustments based on seasonality (e.g., expenses that may change monthly or quarterly due to external factors)
Step 5: Review Full Budget & Make Necessary Adjustments	3 months before new fiscal year	Earlier stage ESEs: ED or finance lead reviews consolidated budget with board chair or finance committee. More mature ESEs: Finance lead consolidates departmental budgets. ESE leadership reviews consolidated budget and board committee examines draft before full board presentation.	• Confirm that cash flows cover obligations. • Make adjustments to revenue or expense estimates if new information becomes available or if assumptions seem unrealistic.
Step 7: Receive Budget Approval	1 month before new fiscal year	Earlier stage ESEs: Board reviews and approves a single draft presented by the ED. More mature ESEs: Board reviews consolidated budget. If necessary, there may be further iterations to address board questions.	• Engage your board's finance committee early in the process so they can flag issues before final approval. This often speeds up full board approval and reduces last-minute surprises.
Step 8: Roll Out Budget to Organization	Following board approval	Earlier stage ESEs: The ED or finance lead shares the approved budget with staff at a high level, focusing on overall revenue targets and spending limits. More mature ESEs: Department or program leads receive their sub-budgets and are responsible for managing them, with finance team providing training and ongoing variance reports.	• Frame the budget as a tool to guide decision-making, not just a compliance document. • Visual tools or summaries (e.g., graphs and charts) can help staff see how their work connects to the bigger financial picture.



Technology: Choosing your Systems

Your budgeting technology should support your people and processes. The right tools depend on your ESE's size, maturity, and complexity. Earlier stage ESEs often rely on simple, flexible tools like Excel or Google Sheets to build budgets. These allow for quick adjustments and don't require specialized training. As your organization grows, more robust tools like CloudBudget, Jirav, or the budgeting modules within your accounting software can provide greater automation, integration, and reporting power.

For ESEs using a collaborative budgeting process, consider investing time in creating user-friendly templates to collect budget input. This makes it easier for program and department leads to participate in the process regardless of their financial management expertise or background.

No matter the system you choose for building your budget, be sure to load it into your accounting system once it's approved. This greatly facilitates the process of comparing actuals to budget and generating variance reports.

Variance Analysis: Learning from Budget vs. Actuals

Recall that variance analysis is the process of reviewing and evaluating how the organization performed against the budget (or plan) in order to inform adjustments moving forward. Performing a variance analysis on a regular basis (ideally monthly, but at least quarterly) is essential to keeping your ESE financially healthy. This practice ensures that your budget becomes a living management tool rather than a static document.

Ideally, a budget-to-actuals report (the foundation of a variance analysis) can be pulled directly from your accounting system, either for the entire organization or segmented by program, team, or department. Keep the report simple and easy to read, using rounded numbers where possible (e.g., \$123,000 instead of \$122,998.78) and highlighting meaningful differences in order to make it easier to reach useful conclusions. Transaction-level reports can be used if needed to pinpoint the drivers of specific variances.

Keep in mind that finding variances is normal (no budget is perfect). The important part of the process is investigating the most impactful variances and acting accordingly. Here are the core activities involved in a strong variance analysis process:

- **Review the Budget-to-Actuals Report:** Start with the big picture (total income and total expenses) and then drill down into categories and line items as needed. Focus on significant differences (more than +/-10% variance is a good benchmark) or any expenses that appear to be on track to exceed critical thresholds.
- **Investigate the Causes:** Ask "why" behind the numbers. Was there an unusual purchase this month? A timing difference in grant revenue? An area or activity where there is overspending or underperformance in terms of output? Understanding whether a variance is one-time or recurring is crucial.
- **Document Findings:** Keep concise written notes that explain major variances. Be specific about the driver (program, team, external factor) and note whether it's a minor issue to monitor or a significant concern that requires immediate action.
- **Take Corrective Action (If Needed):** If variances point to a significant issue (such as underperforming revenue streams, critical cost overruns, or assumptions that have proven far off base) create an adjustment plan. This may involve reducing expenses, revising revenue goals, or updating the forecast for the remainder of the period in the fiscal year.



- **Communicate Results and Next Steps:** Share findings with leadership, the board, and relevant staff. Celebrate when performance exceeds expectations and clearly explain when adjustments are necessary. Transparency builds accountability and keeps the budget relevant throughout the year.

Forecasting: From Mid-Year Reforecasting to Long-Term Planning

Forecasting is about looking ahead and using data to make informed decisions. It comes in two forms, each serving a different purpose:

- **Mid-Year Reforecasting:** These updates follow variance analysis when actual results differ significantly from the budget. A reforecast does not mean changing the approved budget as the budget remains the benchmark for accountability and reporting. Instead, mid-year reforecasts provide updated guidance for decision-making, helping leaders adjust operations in real time. For example, if revenue is consistently under target, a reforecast may guide expense reductions, tighter controls (such as additional approvals on spending), revised fundraising priorities, or cash flow adjustments.
- **Long-Term Forecasting:** Beyond the current fiscal year, forecasts can extend 12–18 months or more to inform longer-term strategic planning. These forecasts connect directly to cash flow projections (as described in the Liquidity & Cash Flow guide). They help answer bigger questions like: When will reserves be sufficient to expand capacity? Do we have enough liquidity to weather seasonal fluctuations or invest in growth?

Together, these two practices make forecasting a bridge between the budget you set at the start of the fiscal year and the cash and growth strategies you need for the future. In practice (and for the purposes and scope of this guide), **mid-year reforecasting** helps ESE teams to use the outputs of the variance analysis process to answer questions such as:

- Do we need to adjust spending now to stay within available resources if revenue is falling critically below the budget target?
- Will our current cash position cover upcoming obligations like payroll, rent, or debt service without disruption?
- Should we revise fundraising or sales goals to reflect a more realistic target for the remainder of the year?
- Are there programs or initiatives that require more resources than planned this year, and can those needs be met given our current state and updated revenue outlook?
- How should we update our forecast for the rest of the year so leadership, staff, and the board have clear guidance on expected results?



Appendix: Guidance on Process Maturity for Budgeting, Variance Analysis, and Forecasting

Review the following table for examples of how budgeting, variance analysis, and forecasting practices may evolve as an ESE grows and matures. These are not prescriptions, but rather guidance to help you right-size the approach for your ESE.

Function	1 - Fundamentals	2 - Early	3 - Foundational	4 - Growth	5 - Mature
Budgeting Planning for next fiscal year	Budget development primarily led by ED based on prior year with simple adjustments. Budget approved by the board.	Budget development may still be primarily led by ED. Budget incorporates some staff input. Budget approved by the board.	Budget development led by ED or strategic finance lead with structured staff input. Budgets are submitted by program or department to roll up into organization-wide budget.	Collaborative budget development involving department leads. Finance team consolidates department-level budgets. Board reviews and approves consolidated budget.	Collaborative budget development is fully integrated across programs or departments and supported by finance team. Board finance committee reviews before full board approval.
Variance Analysis Understanding performance in the current fiscal year	ED reviews budget-to-actuals at least quarterly, focusing on major variances.	ED conducts monthly or quarterly reviews of budget-to-actuals. Board reviews reports periodically.	ED and finance lead conduct monthly variance analyses. Board finance committee reviews regularly.	Variance analysis conducted at program/department level with finance team consolidation. ED and board review report.	Regular, detailed variance analysis conducted across departments and consolidated by finance team. Reports inform decision-making by ED, leadership, and board.
Forecasting Projecting the near- and long-term future based on constraints and goals	Mid-Year Reforecasting: Conducted once, usually mid-year, to assess whether spending aligns with available cash and revenue trends. Long-Term Forecasting: May not be applicable at this stage. Focus instead on short-term cash visibility.	Mid-Year Reforecasting: May occur once or twice a year, using variance results to revise expectations for revenue, expenses, and cash. Long-Term Forecasting: May be limited or informal. Simple projections (e.g., 6–12 months) developed to anticipate funding needs or shortfalls.	Mid-Year Reforecasting: Conducted quarterly to update expectations and support decision-making for the remainder of the year. Long-Term Forecasting: 12-month projections produced on an annual basis. Rolling projections may also be developed.	Mid-Year Reforecasting: Integrated with variance analysis, allowing leadership to update forecasts quarterly and adjust operations or resource allocations as needed. Long-Term Forecasting: Rolling 12-month cash flow projection updated monthly.	Mid-Year Reforecasting: Continuous, dynamic forecasting linked directly to variance reports and operational dashboards used to adjust strategy in real time. Long-Term Forecasting: Formalized process using robust tools and models to project 3 to 5 years ahead.