Here are the steps to consider in creating a functional budget. These don’t answer all the details for every group, but they do provide the general approach to the project.

1. **Clarify the strategic direction and multi-year plan.** Developing a functional budget is difficult if you don’t have a plan from which to draw the details and priorities. Functional budgeting is essentially an extension of the planning process, and that’s where all budgeting processes need to start. Absent a strategic and/or operating plan, the budgeting process is less informed and more difficult to quantify.

2. **Identify the functional areas for the budget.** These usually can be taken from the goal areas of the strategic plan. Sometimes it makes more sense to budget according to the strategies of the plan. It’s essential to remember that budgeting can only take place at the level of detail that the organization can track expenses. Small things like the size of a staff time card may be a determining factor in the level of detail the organization will attempt to track and budget its expenses.

For reporting purposes on the IRS 990 form, groups are required to list three categories of expenses: Program, Management and Fundraising. For the functional budget of a fundraising plan, three or four program areas make more sense, along with management (or administration) and fundraising. Revenue areas differ considerably from group to group, but often include categories such as membership, major gifts, grants, and fee-for-service.

3. **Develop a detailed one-year functional budget.** Develop the detailed budget for year one based on the activities and regular expenses for year one of the three (or five) year plan. The numbers will be allocated among the functional areas defined above. This detail is important as a management tool, and also will help with the development for second- and third-year budgets in the plan as well.

Add the revenue sources that will be required to meet the expense needs of the budget. Starting first with existing revenue realities, this first year can begin to add new options and opportunities. However, these changes will need to be measured since the first year will not yet have the advantage of all improvements to the fundraising program identified in the plan.

4. **Develop a more simplified first year budget with summaries of both revenues and expense.** This initial budget is pretty simple and condensed. It should balance – any left over revenue should be included in a “reserve” expense area. It should never have a negative balance. (Drawing from reserve is another option to reflect spending money raised in previous years.)
CREATING A FUNCTIONAL BUDGET (CONTINUED)

5. **Extend the budget to the out years of the plan.** This involves estimating the expense of implementation for the activities in the second and third (and more, if necessary) of the strategic plan. If the details have been worked through in the first year, summarizing the expenses for the following years is much easier.

Once you’ve got some sense of the expense, you can make estimates for the revenue. This is challenging since it forces assumptions about growth of revenue to cover the expenses. Remember that this is only an initial estimate about possible revenues. The full fundraising plan will delve more deeply into the appropriate revenue streams to meet the expense needs of the strategic plan.

For this part of the process, it’s very important to keep track of all the assumptions made in the development of the numbers. Many, many assumptions will be made that will become the basis of the details of the fundraising plan (program descriptions, outcomes, strategies, etc.) Tracking them from the very beginning will help analyze and understand this information as it is folded into the plan document.

6. **Allocate revenues to cover all of the expense areas.** This step creates the second spreadsheet, which begins to ask questions beyond total revenues to determine if the organization has the right revenues needed to meet your budget. By allocating your revenues to specific expense areas, you make sure that you have adequate unrestricted money, or in the case of a highly restricted budget, the right restricted money.

This process is done by first allocating the revenues that have specific restrictions to the expenses outlined in the plan. Once this is all allocated, then the more subjective process of allocating the revenues from the areas where donor intent will affect results. For example, if donors are more likely to support land acquisition than educational outreach, you should allocate your donor funds to acquisition expenses first. After the restricted and intended funds are designated, then the allocation of totally unrestricted (legally and philosophically) funds can fill in the various holes. In some cases (like fundraising) most or all of the revenue for a certain expense area may need to come from unrestricted sources (like fee-for-services or membership renewals).