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Financial Responsibilities of Nonprofit Boards

Presented by

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Not-for-profit Services Group



Individual Board Member Responsibilities

The first step to effective Board service is to reduce the many ambiguities that inevitably accompany it.

Introduction

- ▶ Board members are ultimately responsible for the very survival, financial viability, and program success of the organization.
- ▶ Fiduciary responsibility is a concept in evidence from ancient Athens, to the American frontier to today.
- ▶ Individuals in the community have been selected to protect the common good.
- ▶ When you understand the issues important to financial integrity, solvency, safeguards, signs of financial trouble, you will be able to protect and enhance the organization's ability to serve the community.

Agenda

1. Financial Issues Board Members Should Address.
2. Systems that Protect Nonprofit Organizations.
3. Major Financial Roles in Nonprofits
4. Understanding the Financial Condition
5. Dealing with the Outside World.

Financial Issues Board Members Should Address

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1. Financial Planning
2. Sufficient Available Cash
3. Satisfactory Reserves
4. The Relationship between Revenue and Expenses
5. Meeting the Budget

Financial Issues Board Members Should Address

6. Propriety of Expenditures
7. Insuring Against Risks
8. Meeting Guidelines and Requirements Set by Resource Providers
9. Avoiding Conflicts of Interest

Financial Issues Board Members Should Address

- 1. Financial Planning***

2. Sufficient Available Cash
3. Satisfactory Reserves
4. The Relationship between Revenue and Expenses
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Financial Planning

- ▶ A sound strategic plan...
- ▶ Linked to a realistic financial plan...
- ▶ Results in an organization using its resources effectively.
- ▶ Define the mission...
- ▶ Develop a strategic plan to fulfill the mission...
- ▶ Identify and implement programs to achieve goals and objectives.
- ▶ Define the mission...

Financial Planning

The Planning Process should include:

1. Evaluation of existing and potential financial resources.
2. Examination of internal and external environmental forces affecting the organization and its funding.
3. Review of the cost effectiveness of existing programs.
4. Examination of alternatives and their financial implications.

Financial Planning

Once the planning process is completed:

- ▶ Staff should be assigned the task of developing budgets needed to implement the plan.
- ▶ Budgets should cover at least one year, but preferable two or more years.

This process could take six months or more.

Financial Issues Board Members Should Address

1. Financial Planning
2. ***Sufficient Available Cash***
3. Satisfactory Reserves
4. The Relationship between Revenue and Expenses
5. Meeting the Budget

Sufficient Available Cash

- ▶ Cash is critical...it is the fuel on which the economic engine runs.
- ▶ If you do not have cash in the bank to operate for at least one month, you should have available very liquid investments or a reliable source of funding (donor or bank line of credit).

Sufficient Available Cash

Cash flow projections:

	<u>January</u>	<u>February</u>
Cash beginning	\$ 35,000	31,500
Receipts	\$ 15,000	10,000
Disbursements	\$ 18,500	22,900
Cash ending	\$ 31,500	18,600

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Satisfactory Reserves

- ▶ **The Goal:**

Have the financial strength to continue to perform your important services no matter what problems the organization faces or what happens to the economy as a whole.

- ▶ The level of reserves is one gauge of financial strength.

Satisfactory Reserves

What do we mean by reserves?

Net Assets – assets minus liabilities

NO!

Unrestricted assets that are reasonably liquid,
minus liabilities that must be paid off fairly
soon.

Satisfactory Reserves

How do you build reserves?

By running a surplus from normal operations

or

By special fundraising efforts.

Satisfactory Reserves

How much reserve is appropriate?

- ▶ Most experts agree that one year's operating expenses in reserve would be a strong financial position.
- ▶ What is more practical is 35% to 40% of one year's expenses.
- ▶ Build to this level over a 5 to 10 year period.
- ▶ Make funding reserves a line item in the budget.

Satisfactory Reserves

Remember...

Restricted resources and endowments are not to be counted as part of the reserves.

Financial Issues Board Members Should Address

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- 4. *The Relationship between Revenue and Expenses***
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Relationship Between Revenue and Expenses

- ▶ Expenses that are rising at the same rate as revenue are said to be “in line”.
- ▶ Expenses that are rising ahead of revenues will result in deficits.
- ▶ There is no non-profit magic – deficits have to be made up someplace !!

Relationship Between Revenue and Expenses

- ▶ Compare expenses with the related revenue source.
- ▶ Every program and activity should take care of itself unless it is the organization's intention to subsidize it.
Programmatic analysis.
- ▶ Natural account (salaries, utilities, etc.) analysis.

Financial Issues Board Members Should Address

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5. ***Meeting the Budget***

Meeting the Budget

- ▶ Fulfilling the mission is the bottom line.
- ▶ Meeting the budget makes it possible.
- ▶ Tracking actual results against budget is more important than tracking against prior years.
- ▶ Variances must be investigated and the appropriate response initiated.

Financial Issues Board Members Should Address

6. *Propriety of Expenditures*

- 7. Insuring Against Risks
- 8. Meeting Guidelines and Requirements Set by Resource Providers
- 9. Avoiding Conflicts of Interest

Propriety of Expenditures

- ▶ The appearance of propriety extends not only to fulfilling the mission, but also to how efficiently it is perceived to be achieving its ends.
- ▶ Do operating and fundraising costs appear reasonable in comparison to other organizations?

Propriety of Expenditures

- ▶ Compensation and fringe benefits are other areas of special concern to the public.
- ▶ Avoid conflicts of interest – more on this later.

Propriety of Expenditures

- ▶ Better Business Bureau Wise Giving Alliance has set standards:
- ▶ Spend at least 65% of its total expenses on program activities.
- ▶ Spend no more than 35% of related contributions on fund raising.

Financial Issues Board Members Should Address

6. Propriety of Expenditures
7. ***Insuring Against Risks***
8. Meeting Guidelines and Requirements Set by Resource Providers
9. Avoiding Conflicts of Interest

Insuring Against Risks

- ▶ Even with the greatest vigilance.... problems may arise.
- ▶ Manage risks with insurance.
- ▶ Everyone handling cash should be bonded.
- ▶ Ask the auditors for a formal or informal opinion on the adequacy of insurance.

Financial Issues Board Members Should Address

6. Propriety of Expenditures
7. Insuring Against Risks
8. ***Meeting Guidelines and Requirements Set by Resource Providers***
9. Avoiding Conflicts of Interest

Meeting Guidelines and Requirements Set by Resource Providers

- ▶ Funding received for restricted purposes must be spent for their designated purpose.
- ▶ The organization must account for this carefully so it can prove their use for restricted purposes.
- ▶ Restricted funding may come from the Federal or state government, foundations, other entities, or individuals.

Financial Issues Board Members Should Address

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Avoiding Conflicts of Interest

- ▶ Avoid conflicts of interest – real or perceived.
- ▶ Private inurement – when a staff or volunteer receives inappropriate financial gain

Avoiding Conflicts of Interest

- ▶ Avoid conflicts of interest – real or perceived.
- ▶ Private inurement – when a staff or volunteer receives inappropriate financial gain.
- ▶ Board members involved in competing or potentially competing organization – either nonprofit or for-profit.

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2. ***Systems that Protect Nonprofit Organizations.***
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Systems that Protect Nonprofit Organizations

- ▶ Internal Controls
- ▶ Accounting Policies and Procedures
- ▶ External audits

Systems that Protect Nonprofit Organizations

▶ *Internal Controls*

- ▶ Accounting Policies and Procedures
- ▶ External audits

Internal Controls

- ▶ The processes and procedures that both protect the assets of an organization and promote its efficient operation.
- ▶ The key to good internal controls is segregation of duties.
- ▶ Correct procedures should be documented in an up-to-date accounting manual.

Systems that Protect Nonprofit Organizations

- ▶ Internal Controls
- ▶ ***Accounting Policies and Procedures***
- ▶ External audits

Accounting Policies and Procedures

- ▶ Every nonprofit should have written policies and procedures governing how it does business.
- ▶ Two specific documents are most important:
 1. Accounting Manual
 2. Investment Policies

Accounting Policies and Procedures

Accounting Manual:

Contains guidelines for processing transactions and maintaining good internal controls.

Accounting Policies and Procedures

Investment Policies:

Organizations should have procedures for safeguarding cash, for ensuring liquidity, and for keeping cash productively employed at all times.

Systems that Protect Nonprofit Organizations

- ▶ Internal Controls
- ▶ Accounting Policies and Procedures
- ▶ *External audits*

External Audits

- ▶ The key role of the external auditor is to attest to the accuracy of the financial statements.
- ▶ The principal purpose of an external audit is to keep the Board and other key constituents apprised of the organization's financial position.
- ▶ Secondary purposes include regulatory requirements.

External Audits

- ▶ The auditor must be absolutely independent of management.

Auditor rotation?

- ▶ A truly professional firm will maintain its perspective and independence year after year.
- ▶ If the Board is satisfied with the audit firm's competence, independence, and perspective, it need not replace it.
- ▶ In-depth understanding of an organization gained over a number of years can be exceedingly valuable.

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Major Financial Roles in Nonprofits

- ▶ Board committees and task forces
- ▶ Treasurer
- ▶ Chief Executive
- ▶ Bookkeeper, Controller, Director of Finance

Major Financial Roles in Nonprofits

- ▶ *Board committees and task forces*
- ▶ Treasurer
- ▶ Chief Executive
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Board Committees and Task Forces

- ▶ A finance committee to oversee financial operations.
- ▶ Oversight of the budget process.
- ▶ Regular in-depth review of financial activity.
- ▶ Oversight of fundraising, employment practices, the audit and investment performance.

Board Committees and Task Forces

- ▶ As the organization grows larger, subcommittees of the finance committee could be created for investments, personnel, budget and fundraising.
- ▶ Separating the business side of the organization from its mission can be most productive.
- ▶ Not every committee member need be a Board member.

Major Financial Roles in Nonprofits

- ▶ Board committees and task forces
- ▶ ***Treasurer***
- ▶ Chief Executive
- ▶ Bookkeeper, Controller, Director of Finance

Treasurer

- ▶ Responsible for overseeing financial operations to make certain that things are done in an appropriate fashion.
- ▶ In most nonprofits, the Treasurer has the legal responsibility for custody of the organization's funds and securities.

Major Financial Roles in Nonprofits

- ▶ Board committees and task forces
- ▶ Treasurer
- ▶ ***Chief Executive***
- ▶ Bookkeeper, Controller, Director of Finance

Chief Executive

- ▶ Principal role is implementing and coordinating programs...
- ▶ But CEO also has basic responsibility for the financial records of the organization.

Major Financial Roles in Nonprofits

- ▶ Board committees and task forces
- ▶ Treasurer
- ▶ Chief Executive
- ▶ ***Bookkeeper, Controller, Director of Finance***

Bookkeeper, Controller, Director of Finance

- ▶ The size and complexity of the organization will dictate which of the above are needed to run the fiscal office.
- ▶ Avoid promoting someone beyond their capabilities.

Salary and title will not turn a bookkeeper into a Finance Director

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Understanding the Financial Condition

- ▶ Financial insight is essential to making wise decisions on the vast majority of board matters – even those that may not appear to deal specifically with finances.
- ▶ Ask questions.
- ▶ Don't agree to anything that does not make sense to you.

Understanding the Financial Condition

- ▶ The Board should receive internally prepared financial reports on a monthly basis.
- ▶ These should be explained by either management or the head of the finance committee (usually the Treasurer).

Understanding the Financial Condition

- ▶ The Board should receive annual audited financial statements.
- ▶ The Board or the finance committee should meet with the auditors.
- ▶ Part of the meeting should be without management present.
- ▶ All Board members should be free to contact the auditors directly.

Understanding the Financial Condition

- ▶ The Board may wish to receive a copy of the IRS Form 990 and other regulatory reports.
- ▶ Documents should be mailed to Board members prior to the meeting at which they will be discussed.

Understanding the Financial Condition

Signs of financial distress:

- ▶ Critical income sources declining
- ▶ Certain expenses increasing
- ▶ Private inurement
- ▶ Unplanned auditor turnover
- ▶ Board micromanagement

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Dealing with the Outside Financial World

- ▶ Choosing a Bank
- ▶ Obtaining Insurance
- ▶ Making Investments
- ▶ Contracts with Outside Advisors

Dealing with the Outside Financial World

- ▶ *Choosing a Bank*

- ▶ Obtaining Insurance
- ▶ Making Investments
- ▶ Contracts with Outside Advisors

Choosing a Bank

- ▶ Select a sound financial institution... with experience and comfort in dealing with nonprofit organizations.
- ▶ Identify the organization's needs and select a bank based on the bank's ability to meet those needs.

Dealing with the Outside Financial World

- ▶ Choosing a Bank
- ▶ ***Obtaining Insurance***
- ▶ Making Investments
- ▶ Contracts with Outside Advisors

Obtaining Insurance

- ▶ Seek insurance providers who are familiar with nonprofit organizations.

Coverage needed:

- ▶ Property including property belonging to others.
- ▶ General liability.
- ▶ Bonding for employees and volunteers who handle cash.

Obtaining Insurance

Coverage needed:

- ▶ Loss of papers and records (including electronic media).
- ▶ Auto insurance if you own vehicles.
- ▶ Directors & Officers liability insurance.

Obtaining Insurance

Health Insurance:

- ▶ As with all insurance, premiums are lowered as deductibles are increased.
- ▶ Consider using an independent broker.
- ▶ Get employees involved.

Dealing with the Outside Financial World

- ▶ Choosing a Bank
- ▶ Obtaining Insurance
- ▶ ***Making Investments***
- ▶ Contracts with Outside Advisors

Making Investments

- ▶ Only invest after being sure there is sufficient cash to operate.
- ▶ First excess cash should be placed in an interest-bearing savings account.
- ▶ U.S. Treasury securities.
- ▶ Long-term investments – seek professional assistance.

Dealing with the Outside Financial World

- ▶ Choosing a Bank
- ▶ Obtaining Insurance
- ▶ Making Investments
- ▶ ***Contracts with Outside Advisors***

Contracts with Outside Advisors

- ▶ The selection of capable outside advisors or consultants is vital to the success of many activities.
- ▶ Seek those who are familiar with nonprofit organizations.
- ▶ Create an engagement letter of understanding for most arrangements.

Thank you

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