



Finance

The Association of People to Solve Community Problems is 9 months into the fiscal year. The CFO, Hafiza, has created the budget projections for the end of the year. She was going to present it to the Finance Committee, but that committee has not really been meeting, and the Treasurer does not know much about Finance anyway, so she just brought it straight to the full board.

“I am confused by something,” said Malcolm. “If our projected budget shows us ending the year with a \$28k surplus, then why are we planning on dipping into the credit line to make payroll?”

“Oh, that is ok,” said Hafiza. “We have enough money coming in, it’s just not in the bank.”

“But, Hafiza,” said Malcolm. “It shows that we *currently* have a surplus.”

“Don’t forget, Malcolm, we’re doing this on an accrual basis. It will be fine.”

As Malcolm gets ready to ask what accrual means, Rosa jumps in, “If we have \$109,000 in reserves, why are we dipping into the credit line? We will have to pay fees on that.”

Hafiza answered: “Remember last year when Cherise agreed to invest our money? We used our reserves to buy CD’s; now we have no cash on hand. But don’t worry. We can certainly afford the fees.”

Board members are not expected to be financial experts. No one expects that every board member will come in with an inherent understanding of finances, with an MBA or as a CPA, or owning their own accounting firm. What is expected is that board members will take responsibility for the financial viability of their organization, and will gain enough understanding of finances and accounting to be able to responsibly oversee the organization.

What should a board member be able to do?

A board member has several very important responsibilities. He or she should understand financial integrity and solvency, the procedures of the organization, and how to spot financial trouble. Much of this comes from being able to understand the financial statements, developing a sense of comfort with the presenters and users of funds, providing guidelines for what you expect and making decisions based on that information.

Perhaps the most important thing board members should be able to do is ask questions when they do not understand something and challenge an answer that does not make sense. You do not need to know

the answers but you do need to know the right questions to ask. If a person is not comfortable with probing for more information, they may not be able to uphold their fiduciary responsibilities.

What are my financial oversight responsibilities as a board member?

Your responsibilities are three-fold:

1. Approve an annual budget
2. Periodically assess the organization's financial performance in relation to the budget
3. Ensure the organization has and adheres to appropriate written financial policies

Why does the budget matter?

As you learned in prior modules, a nonprofit is guided by its mission. And each year, a nonprofit creates an operating plan, accompanied by a budget, that directs the work of the organization. Essentially, the work of the organization comes down to what the organization can afford to do. If there is no money for the mission, why should the organization continue to exist?

The board is responsible for approving the budget. The board should also periodically assess the organization's financial performance in relation to the budget. If this happens regularly, the board can measure the use of the organization's resources in meeting the mission and approve any necessary mid-term corrections.

What should I look for in the budget and financial projections?

This one is quite simple. A board member should be looking at revenues and expenditures. Generally, revenues should be higher than expenditures. Sometimes, a nonprofit may have a year where it is investing time or resources into a new program, a new fundraising process, or capital expenditures. In those years, it may be that the organization runs a deficit. As long as there are reserves to fall back on, this may be acceptable. On the other hand, perhaps expenses were very low and revenue came in higher than expected. In this case, the organization may have a larger surplus than was expected.

In these cases, the board member should be looking at the *variances*. A variance analysis is simply a comparison of the budgeted amount (year to date) and the current actual amount (year to date), in both revenue and expenses. Many variance analyses also include comparisons to the same period last year, which helps the board develop the strategic guidance for the financial plan. Understanding what the variance analysis shows will enable a board member to understand what areas are performing at, above, or below expected levels.

What is accrual accounting?

Accrual accounting is an accounting method that recognizes revenues and expenses when they are earned or accrued, regardless of when the actual cash is sent or received. On the other hand, cash accounting only counts money when it is sent or received. The Generally Accepted Accounting Principles (GAAP) used by accountants only recognizes accrual accounting.

This module is not meant to make you an expert in accounting. What you should recognize is that you have a fiduciary responsibility to ask these types of questions of your organization's CFO or Finance Director, and to do some independent research so you can understand the budget discussions that occur.

My program does not make money; is this an issue?

Nonprofits have a unique situation; they must meet the *double bottom-line*. This bottom line is the measurement of both budget and mission. It is clear that a nonprofit must make money; running in the red is fiscally irresponsible, and will eventually bankrupt the organization. But at the same time, a nonprofit must be meeting their mission.

Nonprofits often use a type of accounting that is quite different than for-profit businesses: fund accounting. Fund accounting is a way of splitting financial reporting into various funds. Income and expenses are reported for each fund to allow the board and staff to understand the fiscal health of the individual funds. For instance, if a nonprofit received a grant that was restricted to a specific program, they may create a fund to track that grant. All expenses incurred in that program would be included in that account, so a proper reconciliation of that money can occur. Common funds include those for a program, capital project, debt service, or endowment.

To meet the double bottom-line, many nonprofits must subsidize some of their programs. For instance, a nonprofit that provides technical assistance to health service providers may make money from consulting contracts and lose money on their training programs. If they believe the training programs are an integral part of their mission that will never be a profit center, they may continue to subsidize the programs with money from other areas

That being said, a nonprofit must be fiscally solvent. It is the responsibility of the board to keep the nonprofit's finances strong, and also to recognize when there are issues that must be fixed.

What financial policies should I be looking for?

Nonprofits should have in place policies addressing four major areas:

Investment policies

Once an organization begins to hold cash, an investment policy should be created. Smaller organizations will focus on short-term cash investments, while larger organizations can discuss retaining an investment advisor to manage an account. Regardless of size, a nonprofit should adopt an investment policy to protect both the organization and its board members from investment risks.

These policies may also cover endowment funds and board restricted funds. Endowment funds are given by donors specifically to be invested to produce income. In a typical endowment fund, only the income--and never the principal--can be spent. On the other hand, a board restricted fund is a fund the board has chosen to restrict, either to spend on a certain purpose or to invest for income purposes. These funds are restricted by board action, and can be unrestricted if necessary.

Internal controls policies

An organization will never get a clean audit--see below--without internal controls in place. According to the American Institute of Certified Public Accountants, internal controls are used for an organization to:

- Safeguard its assets;
- Check the accuracy and reliability of accounting data;
- Promote operational efficiency; and
- Encourage adherence to prescribed managerial policies.

As a board member, you should ask to see the internal controls policies, and the organization's accounting manual. The types of topics typically covered in the accounting manual include:

- Processing revenue and cash receipts;
- Processing purchasing, payments, and payroll;
- Maintaining the general ledger;
- Preparing financial statements; and
- Budget process.

If you have any expertise in accounting, you should review this document to ensure it is strong. If not, you may want to make sure it has been reviewed by an external auditor in the recent past. Generally, it is reviewed as part of the organization's annual audit.

Purchasing policies

Purchasing policies typically cover researching vendors, sending out RFPs, using consultants, separation of responsibilities for the various steps in purchasing, etc. Purchasing policies are often separate from accounting manuals because they should be easy for the entire staff to understand. While an accounting manual can be more technical, purchasing policies should be able to be used on a regular basis by any staff member who makes purchases or signs contracts.

Unrestricted current net assets policies

This used to be known as a reserve fund. Many nonprofits accumulate unrestricted net assets by having excess revenue year after year. A board should have a policy for this. Does your organization want a 90-day cushion for operating expenses, so if no revenue came in over 90 days, they would still be able to run? Or do they want a 180-day cushion? And what happens when your organization gets to that 180-day cushion? Are excess funds reinvested into new programs?

There is no right answer to these questions. After a discussion with the board, however, policies can be made so everyone is on the same page when looking at what to do with unrestricted net assets.

So we are getting audited? That cannot be good.

An organizational audit is actually a very useful thing to do. An audit is simply an evaluation of your organization's finances. Larger organizations should be audited annually by an objective outside source; other organizations choose to just be reviewed.

An audit provides a certified opinion, independently verified, on not only the finances of the organization but also the financial processes. The audit process is quite intense, and typically quite expensive. A smaller organization, however, can get a review instead of an audit. A review does not require any independent verification. In an audit, the auditor forms an opinion on the financial records of the organization; in case of lawsuit or challenge, the organization has a certain amount of protection regarding misstatements and errors. In a review, there is no legal protection.

At the end of an audit, your organization will receive one of four "opinions" regarding the accuracy of financial reporting:

- **Unqualified (clean):** This is the highest level of assurance from an auditor. Typically, the letter from the auditor will have three paragraphs.

- **Qualified opinion:** The auditor expresses reservations on a specific issue. There will typically be four paragraphs in this letter. The board should immediately seek to rectify the areas of reservation.
- **Adverse opinion:** The financial statements are misleading, and the organization will not correct them. This rarely happens, but there is great cause for concern when it does.
- **Disclaimed opinion:** The auditor cannot form an opinion. The board should investigate the cause of the disclaimer.

The organization will also receive a management letter. This letter will provide the auditor's observations on process or procedural deficiencies, or material weaknesses. The board and staff should discuss any issues raised by the management letter, and how they can work to fix them.

Review of the basics:

Can you now answer the following questions?

1. What are the responsibilities of a board member in the financial planning and budgeting processes?
2. If a board member does not understand the budget given to her, what should she do?
3. Why is an annual audit a good thing for a nonprofit?
4. What financial policies should your organization have in place?

Quick Links to More Resources about Finance

Managementhelp.org offers a resource center for nonprofit financial management.

NonprofitExpert.com has created a [Budget Basics area](#).

Check out The Nonprofit Times article: [Your Balance Sheet Tells All](#).

The [Delaware Association of Nonprofit Agencies](#) maintains a library of information in their InfoCentral. In addition, members of DANA can get sample policies and procedures for free.

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[Finance Training Module Survey](#)