

Basic Financial Oversight and Management for Nonprofit Organizations

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The NPML Program at UMSL and My Background...

- The NPML Program at UMSL:
<http://www.umsl.edu/npml/>
- My background...
 - The point is, if I can stay on top of financial information, anyone can stay on top of financial information!!

AGENDA

- I. General/Overview**
- II. Where to Start – Your fiscal Year**
- III. Your Finance Committee and Your Treasurer**
- IV. The Budget**
- V. Bank Statements, Credit Card Statements, etc.**
- VI. Financial Statements 101** (definition and reading them)
- VII. The Importance of Forecasting**
- VIII. Tips for spotting trouble, unusual activity and how to ask questions**
- IX. A few words about the audit**

Why is Good Financial Management Important? Why are financial statements important? Why do members of management need to understand and control finances?

- It's **required** (See information from former Assistant Attorney General Bob Carlson, for example.)
- Leadership has **fiduciary oversight responsibility**.
- Financial Statements are the **primary tool** for monitoring the organization's financial position, condition, and its ability to deliver services.
- They **provide critical information** to evaluate, decide, and set goals and strategies for the organization.
- They act as a **report card** on how well the organization is managed.
- Outsiders receive them and you have to respond to **public scrutiny**.
- They allow you to **benchmark** to other organizations.

I believe that good financial oversight and management starts with an appreciation of your fiscal year, and the things that have to happen every fiscal year

- Do you know the end date of your organization's fiscal year?

The following are the things that should happen during, or in relation to, your fiscal year every year

- Fiscal year starts:
- Monthly monitoring of approved budget vs. actual budget – EVERY BOARD MEETING
- Employee/CEO reviews and proposed salary adjustments accordingly
- Preparation of a proposed budget, and initial review of that proposed budget by ALL staff
- Presentation of the proposed budget to the Finance Committee of the Board of Directors (if you have one – more on this below).
- Presentation of the proposed budget to the full Board of Directors for review
 - Leave time in your schedule for this to take two board meetings to finalize...
 - This could be a good time for your Board to think about what you do, how you do it, changes you need to make, etc.
- Approval of the budget by your Board prior to start of the new fiscal year
- Fiscal year ends... then:
- Selection of an auditor (multiple bids??)
- Work with the auditor to audit your previous year's financial statements and help you prepare your 990 (does everyone know what the 990 is?)
- Presentation of your previous year's audited financial statements to the Board of Directors
- Review of your 990 by the Board of Directors
- Filing the 990 with the IRS
 - Could involve an extension or two...

A visual depiction of your organization's fiscal year and related activities

January 1, 20XX _____ December 31, 20XX _____ May 15th (??), 20XX

- This Assumes your fiscal year ends 12/31/20XX
- Obviously need to modify this if your fiscal year ends on a different date...
- The key is to remember that these things happen EVERY YEAR – so, for example, you know that every year you will look at a first draft of your proposed budget for the next year in your October board meeting (again, just as an example)...

Your Finance Committee and Your Treasurer

- Good financial management is not the sole responsibility of your Treasurer and your bookkeeper or financial manager – it is EVERYONE's responsibility
 - Cultivate a culture of vigilance and risk management
- You should have a finance committee of the Board of Directors
 - The Committee is led by the Board Treasurer
 - Should have one or two other board members on it – EVEN (or especially?) those that do not have a financial background...
 - Should have additional useful volunteers from the community on it that want to help but don't have time/interest to serve on the Board of Directors
 - All relevant staff should be part of this committee, too
 - This committee should meet monthly, if possible. Or at least 9 out of 12 months a year...
 - This committee should have members with financial/accounting experience, but **other kinds of people should be on this committee, too**, and they should be able to understand what's going on, the information shared, etc. Because if they can understand it...

What should the finance committee look at in each meeting?

- What should the finance committee look at (and discuss) in EACH meeting:
 - Proposed budget vs. actual budget
 - Financial statements (more on these below):
 - Statement of Financial Position – which used to be called the Balance Sheet
 - Statement of Financial Activities – which used to be called the Profit & Loss (P&L)
 - ACTUAL BANK STATEMENTS for all accounts at all banks (and other financial accounts, too)
 - Screen shots from bank and financial accounts that day (overkill?)
 - Credit card statements, if you have any
 - For checking accounts, scrutinize the statement from the bank that covers the checking account – and all funds going in AND out. Do you recognize all the vendors, do you know what each item is? This takes time, but, eventually you will get familiar with what's regular, and what's not...
 - Bank reconciliations... (need help here to describe these...)
 - Payroll report (this is where you will catch fraud if someone is paying themselves too much...)
 - Either review an actual cash flow projection document, or at least discuss upcoming cash flow issues
 - Do you need a single audit this year... Depends on government funds...
 - Any of your financial policies need updating or review – or altogether new ones needed?
 - Future planning needed? I.e. time to start the budget, looking for auditor, 990 prep, etc...
 - Probably a good idea to have some kind of report from development/fundraising staff... everything going ok?
 - Any concerns about things like fraud, embezzlement, lack of internal controls, etc.
 - More on “internal controls” below (slide 27)

Then the finance committee info/minutes/report goes to the full Board at each board meeting

- If you don't have a finance committee, then the Board should be doing some or all of this at each meeting – should have meaningful amount of time on the agenda for board meetings for this
 - Or the “Executive Board” could have separate meetings to do this, too
- If you do have a finance committee, allow time for Treasurer to present the committee report at EVERY board meeting, and allow time for meaningful discussion...

The Ongoing Struggle: How much info is too much?

- Realistically, what are people going to look at and comprehend?
 - Everyone is busy... You are dealing with and using volunteers...
- Different standards for Finance Committee vs. the Board of Directors
 - Finance Committee should be committed to getting a lot and reviewing a lot – that's all they have to do...
 - Board of Directors...?
 - My personal thought/standard = 3 sheets of paper, or, at most, 3 reports:
 - Statement of Financial Position – which used to be called the Balance Sheet
 - » Rolled up into one page?
 - Statement of Financial Activities – which used to be called the Profit & Loss (P&L)
 - » Rolled up into one page?
 - Budget summary/info (see below)

The Budget

- I personally think the budget is key because EVERYONE – not just financial people – gets the concept of a budget, and the importance of a budget...
 - Think about all of this – all of what we are talking about today – in the context of your own life, and that can be applied to your nonprofit management, too...
 - Makes the idea of nonprofit finances less scary...
 - Our everyday budget and financial management:
 - How much money do you make? (income)
 - What are your monthly expenses?
 - How much do you have in savings?
 - How big is your credit card bill, or your credit card debt
 - » This is a “line of credit”, by the way...
 - What big expenses do you have coming up?
 - What financial changes are coming to you and your family in the future?
 - Does something seem to be missing or out of whack in a way that indicates a problem?
 - Etc.
 - Accounting terms, principles, procedures, practices, etc. matter a great deal, but just because you aren’t familiar with them should not keep you from applying all of the above to your oversight of your nonprofit finances...

Tips for reviewing AND preparing the budget

Ask or ascertain the following:

- Does the budget include all the organizational goals, strategies, and approved projects?
- What new initiatives are included in the budget?
- What major capital purchases or repair projects are included (or excluded)?
- How was the budget calculated? (“Bottom up”, historical trends, variable methods, etc.)
Flush out the major estimates and learn the assumptions behind them so you have a comfort level that they are based on reasonable data or assumptions.
- Compare to historical periods to test the trends assumed in the budget.
- Determine if the organization has the financial resources to meet the budget goals.
- Understand the key sources of revenue and expenditures and keep an eye on those throughout the year. (Top down review.)
- Is the budget revised during the year (could be a red flag as budgets are rarely revised)?
- If a significant change occurs during the year, ask how it impacts the budget.
- Who provided input for the budget (inclusive or a one-person job)?
- Be prepared to share your organization’s budget...

Sample of a Budget Report I like

- See sample from the St. Louis Jefferson Solid Waste Management District

Account ID	Account Description	2015 Approved Budget	Dec-15	YTD	Balance	Percent (%) Expended
1111	SALARIES PERMANENT	290,000	25,016.86	277,874.57	12,125.43	95.82%
1121	PART-TIME EMPLOYEE	Included Above	-	0.00	Included Above	
1211	SOCIAL SECURITY	22,000	1,968.20	19,528.51	2,471.49	88.77%
1221	RETIREMENT PLAN (COST)	-	-	0.00	0.00	
1222	RETIREMENT PLAN (403 PLAN)	15,000	1,402.76	14,269.55	730.45	95.13%
1231	UNEMPLOYMENT COMPENSATION	-	-	0.00	0.00	
1241	WORKER'S COMP	1,500	855.64	855.64	644.36	57.04%
1251	MEDICAL INSURANCE	2,000	2,606.49	30,318.63	1,681.37	94.73%
1261	O. PAYROLL COSTS	20,000	1,699.00	17,331.58	2,668.42	86.66%
1281	LONG TERM DISABILITY	-	-	0.00	0.00	
1283	SHORT TERM DISABILITY	-	-	0.00	0.00	
2521	LIFE INSURANCE/DISABILITY	2,000	153.99	1,808.54	191.46	90.43%
	S-Total	382,500	33,702.94	361,987.02	20,512.98	94.64%
1311	POSTAGE & OTHER DELIVERIES	1,000	105.94	657.52	342.48	65.75%
1321	OFFICE MAT & SUPPLIES	4,000	848.90	3,514.51	485.49	87.86%
1741	COMPUTER SOFTWARE	1,000	-	887.88	112.12	88.79%
1821	MINOR OFFICE FURNITX & EQUIP	-	-	0.00	0.00	
2011	PROF SRVC - AUDIT SRVCS	18,000	-	18,046.25	-46.25	100.26%
2011	PROF SRVC - LEGAL	5,000	-	2,112.00	2,888.00	42.24%
2011	PROF SRVC - COMPUTER	7,000	2,541.66	7,864.32	-864.32	112.35%
2011	PROF SRVC - OTHER	5,000	150.00	1,997.31	3,002.69	39.95%
2111	TELEPHONE	10,000	574.71	7,578.20	2,421.80	75.78%
2221	LOCAL & OUT-OF-TOWN TRAVEL	8,000	36.28	3,678.88	4,321.12	45.99%
2241	AUTOMOBILE ALLOWANCES	1,500	75.99	978.46	521.54	65.23%
2251	TRAINING	5,000	-	2,825.49	2,174.51	56.51%
2261	PARKING CHARGE/ALLOWANCE	100	-	40.00	60.00	40.00%
2270	AUTO LEASE/RENTAL	500	-	291.81	208.19	58.36%
2311	ADVERTISING & PUBL NOTIC	3,000	1,100.00	3,936.97	-936.97	131.23%
2411	PRINTING & BINDING	1,000	-	185.00	815.00	18.50%
2630	INSURANCE	3,500	1,025.00	3,694.17	-194.17	105.55%
3011	RENT & LEASES REAL PROP	30,000	2,319.00	27,828.00	2,172.00	92.76%
3021	RENTAL OF EQUIPMENT	-	-	0.00	0.00	
3551	MEMBERSHIPS	1,500	-	1,635.00	-135.00	109.00%
3561	SUBSCRIPTIONS & PUBLICATIONS	500	-	446.83	53.17	89.37%
3581	OTHER EXPENSES	3,000	195.70	1,527.79	1,472.21	50.93%
3582	MEETING SUPPORT	2,000	33.47	907.64	1,092.36	45.38%
3590	COMMUNITY OUTRACH	5,000	2,812.67	5,000.00	0.00	100.00%
4811	OFFICE FURNITURE & EQUIP.	1,500	1,280.00	5,279.00	-3,779.00	351.93%
	S-Total	117,300	13,099.32	100,913.03	16,186.97	86.18%
	Total Operating	499,800	46,802.26	462,900.05	36,699.95	92.65%
	TRAINING-PROF DEVELOP - LOCAL	6,132	0.80	569.11	5,562.70	9.28%
	PROFESSIONAL SERVICES - LOCAL	10,500	0.00	10,500.00	0.00	
	Total Operating/Admin	516,232	46,803.06	473,969.16	42,262.65	91.81%
	P. I. (Tech. Assist)	0	-	-	0.00	
	T1 Budgeted*	516,232	46,803.06	473,969.16	42,262.65	91.81%
	Total (-) Legal Expenses	46,803.06	-	473,969.16	-	
	(-) Direct Payments	-	(65.69)	(13,495.70)	-	
	(-) Accrued Salaries/Op'r Pmts	-	4,552.26	(180.47)	201,520.11	PL EXP
	(-) Accrued-Reimb. To-Date	-	(4,552.26)	180.47	-	Tech Asst Reimb - P.I.
	Tech Asst. Total	-	46,737.37	460,473.46	460,473.46	
	(-) P.I. RFPs (Tech Asst Grants)	-	-	-	-	Tech Asst Reimb
	Tech Asst Reimb	-	46,737.37	460,473.46	460,473.46	

Note 1: The Operating Total includes direct payments that are not reflected from Technical Assistance (Client Credit Funds). Grant payments are not recorded from
Admins Associate: The Client Credit Funds (CFF002), Local Funds (L0002), and General Revenue (L0001) are not included in the Operating Total.
Note 2: The Operating Development and Training for (LAWD) DISTRICT (the member District) is funded from Local Funds pursuant to Resolution of the District Board, dated
January 21, 2003 and Personnel Agreement dated May 15, 2012. Dependent on Item: \$1,668.19.

Bank Statements – and other statements

- The importance of reviewing the ACTUAL statements from your:
 - Bank
 - Credit card provider
 - Investment manager/account (if have one)
 - Others
- Get familiar with:
 - Usual payroll amounts...
 - Usual vendors/contractors/bills/etc.
 - After a few months you should be able to spot unusual activity

What are these things called “financial statements?”

They are a group of reports that summarize an organization's financial standing. They tell the story of the organization in dollars and cents.

A quick side note: Nonprofit Accounting

- The way your financial statements are prepared and kept = “Cash” accounting vs. “Accrual” accounting...
- Has to do with how you “book” expenses, donations, etc.
 - From: <http://www.nonprofitaccountingbasics.org/accounting-bookkeeping/cash-vs-accrual>
 - Generally, there are two methods under which you can do your accounting; the cash method and the accrual method. The **cash method of accounting** is focused on the inflows and outflows of cash. Much like your personal finances, organizations have revenue when we make a deposit and incur an expense when we cut a check. There is little regard to when the revenue was actually earned or the expense was actually incurred, we just worry about the cash flows.
 - The **accrual method of accounting** doesn't worry about cash flow and instead focuses on when revenue was actually earned and when expenses were actually incurred. For example, let's say you purchase office supplies in the month of April on your credit card and pay for the purchase in May when you receive the credit card bill. Under the accrual method of accounting we would record the expense for supplies in April.
 - other main difference between the two methods is the ability to budget accurately. Accrual method of accounting allows for better budgeting and planning because it looks at when liabilities are incurred and revenue earned and not when cash is paid. This method puts on the books liabilities that might otherwise be forgotten, like accrued vacation. The cash method doesn't worry about accrued vacation until it is required to be paid. This could create a very painful situation for a nonprofit that hasn't planned to pay out an accrued vacation balance and is now faced with cutting expenses in other areas to have enough cash to pay the outstanding balance.

Cash vs. Accrual Accounting: which method to use?

Which Method to Use

- The **cash method of accounting** is the easiest method, but not necessarily the most accurate. If you have paid staff you should not use the cash method of accounting. Be sure to check your state regulations. Some states require the accrual method of accounting to be used. The cash method of accounting is best used by very small nonprofits with no paid staff, no set programs, and little to no plans for expansion.
- The **accrual method of accounting** should be used by organizations starting out with larger amounts of funding, paid staff, and plans to raise additional funds from larger donors such as foundations or government entities. Generally accepted accounting principles (GAAP) also require the use of the accrual method of accounting. If you wish to have an audit done under generally accepted accounting principles you should use the accrual method of accounting.
- Quiz: I pledge \$10,000 to your organization... When do you “book” this pledge?

And, what do Financial Statements tell us?

They:

- describe “**who**” the organization is
- portray the current **financial position**
- report how **cash** is generated and how it is used and liquidity
- give **historical perspective**
- provide clues about management and **internal controls**
- disclose if **revenue** was received with **restrictions** or not
 - which is unique to nonprofit organizations

Definitions

- Balance Sheet (or Statement of Financial Position):
<https://www.nonprofitaccountingbasics.org/reporting-operations/statement-financial-position>
 - Balance Sheet has “Assets and Liabilities”
 - Nonprofits need to keep track of things that have value (assets) but aren’t “liquid”. Also need to keep track of “possible costs” (liabilities) that could become a real cost
- Profit & Loss (P&L) Statement (or Statement of Financial Activities):
<https://www.nonprofitaccountingbasics.org/reporting-operations/statement-financial-activities>
 - P&L has “Income and Expenses”

A few *TIPS* on reading financial reports and what you should look for...

- **COMPARE**, compare, compare – to the budget, to prior periods and maybe even to other organizations. Look for unusual trends and unexplained fluctuations.
- Always **READ** the **NOTES**.
- **WATCH CASH**.
- Items in parenthesis (\$\$\$)
- Be familiar with the largest assets and liabilities.
- Are there major swings from one time period to another, or one set of reports to another?

Some more thoughts on financial reports:

- All reports – Statement of Financial Position, Statement of Financial Activities, Budget Actual vs. Approved, etc. – should be no more than 30 days old
 - If you can't get timely reports, that's a problem...
 - Exception are annual audited financial records/report that look all the way back at the last, closed fiscal year...
- Importance of AP and AR – what are they and why do they matter?
- From a non-accountant, operations standpoint, income and cash are key
 - Valuable assets are great, but can you use them to make payroll and pay the bills?
 - What's "liquid", and what isn't?
- Do your financial statements make you look "too wealthy"?
 - Might have to be ready to explain to donors and funders...

The Importance of Forecasting

- Just a General Point here... Someone, at least the Finance Committee... Should be forecasting cash flow, income, and expense likelihoods into the future...
 - Someone should be thinking about this... Good staff will do it, but they are often already bogged-down with the day to day management. It's really the Board's job to be thinking ahead. Or at least a Committee of the Board, or the Treasurer should be thinking about this.
 - The E.D. and/or CFO should be thinking about this a lot, too – how to make payroll?
 - History as a guide
 - Changes or additions to your program/services/mission that you did not have to cover before?
 - If the cash runs out, what will you do?
 - Line of credit?
 - Ask nonprofits in Illinois about this...

Your organization may be financially healthy – but if it wasn't – how would you know?

???

Tips for spotting trouble or unusual activity on financial reports

In no particular order...

- Check cash on hand - is cash being invested timely and excess cash being used efficiently? Generally if <5% of revenue is in cash and short term investments, the organization may be cash starved.
- Are proper reserves established for Assets?
- Are liabilities building? If payments to outsiders are slowing down there is a possible cash crunch. Can current assets cover current liabilities?
- Control of expenses – how do they compare with budget? Are key expenses under control? Does the trend (up or down) make sense?
- Are revenue categories ahead or behind? Are key sources of donations rising or falling?

- Are financial reports issued on time and are they accurate? Delayed financials can be a warning sign.
- Are there uncollected pledge receivables?
- Look at professional services expenses with an eye towards legal fees. Excessive legal fees may indicate potential negative legal actions or settlements.
- Consider changes in other key expenses like insurance or bad debts.
- Benchmark the financial statements against other similar organizations.
- Do the Balance Sheet and Investment Policies support the organization needs?
- Can someone explain the reports, and the information in the reports in “plain English”?

The Importance of Internal Controls

The quality of INTERNAL CONTROLS is the most important predictor of accuracy and exposure of risk in an organization.

Definition of “Internal Controls”: Policies and procedures designed to minimize errors and surprises, ensure the reliability of financial statements and management information, prevent and detect fraud and achieve compliance with laws, regulations and established policies.

Breaking it down...

Examples of general controls that should be in place in any size organization:

- The **Bylaws** of the organization should include authorization policies for finance activities and a strict conflict of interest policy.
- **Financial Statements** should be prepared and distributed to the board on a monthly basis. The financial information reported to the board should include comparative periods and budgets and major discrepancies should be investigated and discussed.
- The **books and records should be kept up-to-date** and balanced and reconciled timely. **If bank statements are not reconciled**, there is no guarantee that all activity is recorded. The “chart of accounts” should be detailed enough to give adequate management information.
- **“Separation of duties”** is important to be in place to enhance internal controls. Practices such as appropriately routing unopened mail and separating the processing versus reconciliation of checks, payments and data reduces the risk of fraud. Reconciling systems and paperwork to make sure everything is recorded and recorded accurately is important to ensuring good management information. **No one person should be doing too many things!!**

- Other, written and board approved **financial policies**.
- **Computer software and hardware** should be monitored and maintained by professionals. Business data should be backed up off-site. Virus protection and firewalls need to be in place to prevent unauthorized intrusion.
- **Passwords or locks** should restrict access to records, systems and assets. Payroll files, blank checks, cash and gift certificates should be locked or in a combination safe. Building keys and alarm codes should be furnished to office employees in accordance with responsibility level and identity.
- Exposure to risk is reduced by adequate **insurance coverage**. Employees should be bonded. Insurance coverage should be reviewed periodically by the board. Background checks should be conducted on staff members and volunteers. Make sure the organization's charter or articles of incorporation conform to state statutes limiting liability of board members.
- **Management influence** and creating a CLIMATE of observing policies and procedures is vital.

These practices are difficult to implement in smaller organizations. Employees sometimes view these procedures as a “lack of trust”. However, they are as much a protection for employees and ensuring accuracy of information as preventing theft and fraud.

A few words about the Audit (audited financial statements)

- When you hear about an “audit” it means an accountant/firm audits your financial statements and checks to make sure they are “ok” (prepared properly, in accordance with standards). They usually then produce a set of your audited financial statements for a given fiscal year – and some people will want to see those (i.e. funders, foundations, and grant providers)
- You do not HAVE TO have an annual audit... But you should... clearly a best practice... Usually happens as part of the preparation of your 990
- Note that audits are not designed to catch fraud, embezzlement, etc. They might, but they are not designed to do that.
 - Rather, they are meant to show that your organization has good records and is complying with generally accepted accounting procedures (GAAP) when it comes to the preparation and maintenance of your financial statements.
- If you are worried about fraud/embezzlement, need a “forensic audit”

Other audit “lingo” to understand

- See example of audit report...
- Ideally, you want a “clean opinion”
 - An unqualified opinion is also known as a clean opinion. The auditor reports an unqualified opinion **if the financial statements are presumed to be free from material misstatements.**
- No “material weaknesses”
 - A material weakness is **a deficiency**, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis.
- No “significant deficiencies”
 - A significant deficiency is a deficiency, or a combination of deficiencies, in internal control over financial reporting that **is less severe than a material weakness**, yet important enough to merit attention by those responsible for oversight of the company's financial reporting.

Other Resources to Consider

- VLAA Guide
- IRS web site and publications
 - See: <https://www.irs.gov/charities-and-nonprofits>
- Free seminars/presentations from accounting firms
- St. Louis and St. Charles Library Grants & Foundation Center

Summary...

- ★ Compare, compare, compare
 - ★ Ask questions (NEVER assume)
 - ★ Read
 - ★ Be aware
 - ★ Check the red flags