# Non-Profit Boards Made Easy:
# Dealing With Funding & Budgets

## Wenatchee Valley College

## April 20, 2005    11:30 AM – 1:30 PM

**Presented by:**

**ACCG:avenue2possibilities LLP**

*Our mission is to provide an avenue to possibilities for people and organizations.*
*An avenue is a way of access or a conduit for pursuing a desired objective.*
*Possibilities are potential or prospective values; one's greatest or highest degree of ability, capacity or power.*

| Form 12-1 Controls Self-Assessment | | |
|---|---|---|
| | **Yes** | **No** |
| *Do you have the following policies, and have they been updated within the past 24 months:* | | |
| *Bylaws* | **3** | **–3** |
| *Conflict of Interest* | **2** | **–2** |
| *Financial Policies* | **2** | **–3** |
| *Personnel Policies* | **2** | **–3** |
| *Media Policies* | **2** | **–1** |
| *Quality Assurance Policies* | **2** | **0** |
| *Do you train staff and board annually on key policies?* | **2** | **0** |
| *Do you enforce your policies consistently?* | **3** | **–2** |
| **Total of column score** Add each column up and put the answer here ➔ | | |
| **TOTAL SCORE** Add total scores from Yes and No columns and put the answer here ➔ | | |

**SCORING ANALYSIS:**

**39-32 Excellent**
**31-23 Very Good**
**22-14 Adequate**
**Less than 14 – You Need Help Now**

## BYLAWS COME FIRST

Before you nominate a single person to your company's board of directors, you must determine your board's institutional structure and document that structure in a set of written bylaws. Bylaws should answer questions such as:

- **How many members will your board have?** Try to determine the best size, or number of board members, to help your company achieve its mission. Count in terms of the roles you need board members to fill.
- **How and when will board members be elected? How long should they serve?** Board members usually serve two to four years. Terms generally expire on a staggered basis so that new members are not all elected at the same time.
- **What officers and committee structure will form the backbone of your board?** Standing and sometimes temporary committees are charged with keeping certain subjects under review, focusing the board on those things that need board attention, and making constructive recommendations for board decisions. One of the first committees to establish is the nominating committee, which selects candidates for board vacancies. The nominating committee should be a permanent, ongoing committee, with its responsibilities clearly spelled out in the bylaws or in a board resolution. Other standing committees may include finance or budget, audit, personnel policy, executive evaluation, and a building or facilities committee.
- **How often will your bylaws be reviewed and updated?**
- **How will your board assess its own performance?**

**Board Resolutions (single acts of approval for, eg, contracts, dues, etc.)**
Articles, charters, constitutions, etc., and bylaws are ongoing rules. A resolution is a single act by the Board to approve or adopt a change to a set of rules, new program, new contract, etc. Resolutions are included in the minutes for the Board meeting.

## Form 5-1 Board of Directors Self-Assessment

| | Yes | No |
|---|---|---|
| *Does the board have a mandated policy of turnover? (Are there set terms for board members? A limit on the number of consecutive terms?)* | **3** | **–3** |
| *Is there an annual assessment of the skills of board members?* | **2** | **0** |
| *Is that list compared annually to a list of skills needed on the board this year and within the next three years?* | **2** | **0** |
| *Does the board have these skills represented?* | | |
| *Legal* | **1** | **0** |
| *Business* | **1** | **0** |
| *Financial* | **1** | **0** |
| *Marketing* | **1** | **0** |
| *Fund-Raising* | **1** | **0** |
| *Human Resources* | **1** | **0** |
| *Does the organization carry director's and officers insurance?* | **2** | **0** |
| *Does the board have a written list of its responsibilities?* | **2** | **–2** |
| *Have more than 75% of board meetings had a quorum over the past 24 months?* | **3** | **–4** |
| *Is there a current, written board manual?* | **1** | **–1** |
| *Does the board have standing committees that function regularly?* | **2** | **0** |
| *Do board members receive their meeting information at least three days before each meeting?* | **2** | **0** |
| *Does the board have and enforce a conflict of interest policy?* | **3** | **0** |
| *Are board members actively involved in fund raising?* | **3** | **0** |
| *Do all board members contribute to the organization annually?* | **3** | **–2** |
| *Does the board annually evaluate the head staff person, in person and in writing?* | **3** | **–3** |
| *Is the board involved in strategic planning on a consistent and regular basis?* | **2** | **0** |
| *Is time set aside at each board meeting for ongoing orientation about the organization's work?* | **2** | **0** |
| *Does the board annually approve the budget and then monitor it on a regular basis?* | **3** | **–5** |
| **Total of column score** Add each column up and put the answer here ➔ | | |
| **TOTAL SCORE—BOARD OF DIRECTORS** Add total scores from Yes and No columns and put the answer here ➔ | | |

**SCORING ANALYSIS:**
**44-34 Excellent**
**33-22 Very Good**
**21-13 Adequate**
**Less than 13 – You need help now!**

## Board Of Directors Code of Conduct

Board members must represent the interests of the organization above personal interests, and must not allow membership on other boards or groups to supersede the role of a board member of this organization.

Individual board members should act only as a full board and not unilaterally unless instructed by the full board to do so.

Individual board members should only speak for the full board when the full board has sanctioned their doing so. Typically the board president and the executive director are authorized to speak for the organization. It is not appropriate to speak to the media independently.

Individual board members must support the decisions of the full board in public, even if they disagreed when those directions are made. Should they feel strongly about an issue that they feel they must speak out publicly, they must leave the board and work change from the outside.

Individual board members will keep their hands on the organization, but not in it. This is done through appropriate performance monitoring the board.

Individual board members will recognize the board's continuing need for ongoing leadership development and play an active role in the process of identifying potential new board members.

Board members must avoid conflict-of-interest situations. Should they or a family member be considered for employment by the organization, they will withdraw from deliberating and voting on that issue. They will also reveal other relationships, interests and holdings which could potentially result in a conflict of interest.

## Board Attendance Policy (Sample)

*This policy is a sample that should be modified to suit the nature and needs of the corporation.*

**Purpose**

This policy is intended to support full contribution of all board members. All board members receive a copy of this official policy. The policy is reviewed once a year and maintained in each member's Board Manual. The policy has been reviewed and authorized by the board (see signature and date below).

**Definition of a Board Attendance Problem**

A board-attendance problem occurs if any of the following conditions exist in regard to a board member's attendance to board meetings:

1. The member has two un-notified absences in a row ("un-notified" means the member did not call ahead to a reasonable contact in the organization before the upcoming meeting to indicate they would be gone from the upcoming meeting).
2. The member has three notified absences in a row.
3. The member misses one third of the total number of board meetings in a twelve-month period.

**Suggested Response to a Board-Attendance Problem**

If a board-attendance problem exists regarding a member, the Board Chair will promptly contact the member to discuss the problem. The member's response will promptly be shared by the Chair with the entire board at the next board meeting. In that meeting, the board will decide what actions to take regarding the board member's future membership on the board. If the board decides to terminate the board member's membership, termination will be conducted per this policy (or the process may specified in the organization's bylaws). The board will promptly initiate a process to begin recruiting a new board member.

(For example, the termination process might include that the Board Chair will call the member with the board-attendance problem and notify him or her of the board's decision to terminate the member's membership per the terms of the Board Attendance Policy. The Chair will request a letter of resignation from the member to be received within the next two weeks. The Chair will also request the member to return their board manual back to the agency by dropping it off at a specified location over the next two weeks. The board will vote regarding acceptance of the member's resignation letter in the next board meeting.)

Board Chair's Signature Indicating Board Authorization _____________
Date _________
(Board Policy Last Revised: [insert date]

## What is a conflict of interest?

Conflict of interest is difficult to define, yet many people think they know it when they see it. The legal definition of conflict of interest, usually set out in state laws governing nonprofit corporations, is very specific and covers relatively few situations. Most conflicts fall into a gray area where ethics and public perception are more relevant than statutes or precedents.

Conflict of interest arises whenever the personal or professional interests of a board member are potentially at odds with the best interests of the nonprofit. Such conflicts are common: A board member performs professional services for an organization, or proposes that a relative or friend be considered for a staff position. Such transactions are perfectly acceptable if they benefit the organization and if the board made the decisions in an objective and informed manner. Even if they do not meet these standards, such transactions are usually not illegal. They are, however, vulnerable to legal challenges and public misunderstanding.

Loss of public confidence and a damaged reputation are the most likely results of a poorly managed conflict of interest. Because public confidence is important to most nonprofits, boards should take steps to avoid even the appearance of impropriety.

## Conflict of Interest Policy

First, the organization can establish a policy related to conflict of interest, which is signed by all board members at the time they join the board and perhaps renewed annually. The statement may be a simple declaration or it may require detailed information about the board members' financial interests.

Second, establish disclosure as a normal habit or practice. Board members should find it customary for someone to say, for example, "This next agenda item relates to joining a collaboration with other mental health agencies that receive county funds. Because I am on the staff of one of the agencies involved, I have a potential conflict of interest and I am going to excuse myself from the room for this discussion." In another situation a board member might say, "I have started to date the Clinic Director and as a result feel that I must resign from the board. I would like to continue as a member of the Fundraising Committee, but not as a board member." Disclosures and excusal from voting should be recorded in the meeting's minutes.

Third, if major purchases are involved, competitive written bids should be obtained to ensure that prices and product are comparable if there will be a financial benefit to a board member.

Perhaps even more than written policies, board and staff leadership must establish by example and attitude an atmosphere of personal integrity. Some situations may need only a brief informal comment to maintain that climate. In other situations a decision may be delayed because of the need to ensure that the decision has been made truly in the best interests of the organization. Each of us, by our words and actions every day, contributes towards a culture of integrity and responsibility.

## Sample conflict of interest policy

The standard of behavior at the _________ Nonprofit is that all staff, volunteers, and board members scrupulously avoid any conflict of interest between the interests of the _________Organization on one hand, and personal, professional, and business interests on the other. This includes avoiding actual conflicts of interest as well as perceptions of conflicts of interest.

I understand that the purposes of this policy are: to protect the integrity of the _________ Organization's decision making process, to enable our constituencies to have confidence in our integrity, and to protect the integrity and reputation of volunteers, staff and board members.

Upon or before election, hiring or appointment, I will make a full, written disclosure of interests, relationships, and holdings that could potentially result in a conflict of interest. This written disclosure will be kept on file and I will update it as appropriate.

In the course of meetings or activities, I will disclose any interests in a transaction or decision where I (including my business or other nonprofit affiliation), my family and/or my significant other, employer, or close associates will receive a benefit or gain. After disclosure, I understand that I will be asked to leave the room for the discussion and will not be permitted to vote on the question.

I understand that this policy is meant to be a supplement to good judgment, and I will respect its spirit as well as its wording.

Signed: Date: ______________________

## SARBANES OXLEY AND NONPROFITS

BY THOMAS SILK; This article is in digest form; the full text and other articles can be found at http://www.silklaw.com.

The ten principles of governance are derived primarily from four sources: the Sarbanes-Oxley Act and three corporate governance codes published after the Act became effective – the Report of the Task Force on Corporate Responsibility of the American Bar Association; the Findings and Recommendations of the Commission on Public Trust and Private Enterprise of The Conference Board, and Principles of Corporate Governance of The Business Roundtable.

1. The board of directors of a nonprofit corporation must engage in active, independent, and informed oversight of the activities of the corporation, particularly those of senior management.
2. Directors with information and analysis relevant to the board's decision making and oversight responsibilities are obligated to disclose that information and analysis to the board and not sit passively. Senior management should recognize and fulfill an obligation to disclose – to a supervising officer, to a committee of the board, or to the board of directors – information and analysis relevant to such person's decision making and oversight responsibilities.
3. Every nonprofit corporation should have a nominating/governance committee composed entirely of directors who are not part of the (staff) management team. The committee is responsible for nominating qualified candidates to the board, monitoring all

matters involving corporate governance, overseeing compliance with ethical standards, and making recommendations to the full board for action in governance matters.
4. Every nonprofit corporation with substantial assets or annual revenues should develop and implement a three tier annual evaluation process whereby the performance of the board as a whole, each board committee, and each board member are evaluated annually. The board should also develop and implement a process for review and evaluation of the chief executive officer on an annual basis.
5. The Sarbanes Oxley Act, enacted on July 30, 2002, imposes on publicly traded companies and their accountants and lawyers new requirements designed to improve corporate governance and thereby rebuild public trust in the corporate sector.
6. In January 2003, Attorney General Eliot Spitzer of New York announced the introduction of legislation on nonprofits similar to those enacted by Sarbanes-Oxley. Attorney General's Legislative Program Bill # 02-03. In California, Attorney General Lockyer's staff developed a legislative proposal which emerged as SB 1262, introduced by Senator Sher on February 13, 2004.
7. The four documents are available at the following websites – http://www.findlaw.com; http://www.abanet.org; http://www.conference-board.org; and http://www.brt.org. tier annual board evaluation process whereby the performance of the board as a whole, each board committee, and each board member are evaluated annually. The board should also develop and implement a process for review and evaluation of the chief executive officer on an annual basis.
8. Each board of directors is responsible for overseeing corporate ethics, and consider the following actions: a) communicate to all personnel a strong, ethical tone from the top, b) adopt a Conflicts of Interest policy; c) include ethics-related criteria in employee qualification standards and in employees' annual performance reviews.
9. Every nonprofit corporation with substantial assets or annual revenue should be audited annually by an independent auditing firm.
10. The chief executive officer and the chief financial officer of every nonprofit corporation should review Form 990 or Form 990-PF and other annual information returns filed with federal and state agencies.
11. Any attorney providing legal services to a nonprofit corporation who learns of evidence that indicates a material breach of fiduciary duty or similar violation shall report that evidence to the chief executive officer of the nonprofit corporation and, if warranted by the seriousness of the matter, to the board of directors.
12. Every nonprofit corporation should adopt a written policy setting forth standards for document integrity, retention, and destruction. Section 1102 of the Sarbanes-Oxley Act provides that whoever alters or destroys any document with the intent to obstruct the investigation or proper administration of any matter within the jurisdiction of any federal agency or department is guilty of a felony. This provision applies to individuals within nonprofit corporations as well as business corporations.
13. Every nonprofit corporation should adopt a written policy to permit and encourage employees to alert management and the board to ethical issues and potential violations of law without fear of retribution. This is based on Section 1107 of the Sarbanes-Oxley Act which treats as a felony any discharge, demotion, or harassment of any employee who provides to a law enforcement official true information about the potential commission of a federal offense. This provision also applies to individuals within nonprofit corporations as well as business corporations.

## Learning from Sarbanes-Oxley A Checklist for Nonprofits and Foundations

Created to rebuild public trust in the corporate community in the wake of corporate and accounting scandals, the American Competitiveness and Corporate Accountability Act, or Sarbanes-Oxley Act, requires that publicly traded companies conform to new standards in governance, financial transactions, and audit procedures. BoardSource and INDEPENDENT SECTOR have made recommendations on how nonprofits and foundations can voluntarily incorporate certain provisions of the Act into their operations in their publication, *The Sarbanes-Oxley Act and Implications for Nonprofits*, www.IndependentSector.org.

A checklist for nonprofits and foundations includes:

**1. Insider Transactions and Conflicts of Interest**

- Understand and fully comply with all laws regarding compensation and benefits provided to directors and executives (including "intermediate sanctions" and "self-dealing" laws).
- Do not provide personal loans to directors and executives.
- In cases in which the board feels it is necessary to provide a loan, however, all terms should be disclosed and formally approved by the board, the process should be documented, and the terms and the value of the loan should be publicly disclosed.
- Establish a conflict of interest policy and a regular and rigorous means of enforcing it.

**2. Independent and Competent Audit Committee**

- Conduct an annual external financial audit (the boards of very small organizations, for whom the cost of an external audit may be too burdensome, should at least evaluate carefully whether an audit would be valuable).
- Establish a separate audit committee of the board.
- Board members on the audit committee should be free from conflicts of interest and should not receive any compensation for their service on the committee.
- Include at least one "financial expert" on the audit committee.
- The audit committee should select and oversee the auditing company and review the audit.
- Require full board to approve audit results.
- Provide financial literacy training to all board members.

**3. Responsibilities of Auditors**

- Rotate auditor or lead partner at least every five years.
- Avoid any conflict of interest in staff exchange between audit firm and organization.
- Do not use auditing firm for non-auditing services except tax form preparation with pre-approval from audit committee.
- Require disclosure to audit committee of critical accounting policies and practices.
- Use audit committee to oversee and enforce conflict-of-interest policy.

**4. Certified Financial Statements**

- CEO and CFO should sign off on all financial statements (either formally or in practice), including Form 990 tax returns, to ensure they are accurate, complete, and filed on time.

- The board should review and approve financial statements and Form 990 tax returns for completeness and accuracy.

**5. Disclosure**

- Disclose Form 990 and 990-PF in a current and easily accessible way (also required of all nonprofit organizations by IRS law).
- File 990 and 990-PF Forms in a timely manner, without use of extensions unless required by unusual circumstances.
- Disclose audited financial statements.
- Move to electronic filing of Form 990 and 990-PF.

**6. Whistle-Blower Protection**

- Develop, adopt, and disclose a formal process to deal with complaints and prevent retaliation.
- Investigate employee complaints and correct any problems or explain why corrections are not necessary.

**7. Document Destruction**

- Have a written, mandatory document retention and periodic destruction policy, which includes guidelines for electronic files and voicemail.
- If an official investigation is underway or even suspected, stop any document purging in order to avoid criminal obstruction.

**Note:** This is an abbreviated list. For a discussion of the law and recommendations for nonprofits and foundations, see the BoardSource-INDEPENDENT SECTOR publication, *The Sarbanes-Oxley Act and Implications for Nonprofit Organizations*, www.IndependentSector.org/Issues/SarbanesOxley.html.

## Removing a Board Member

Occasionally, a board member needs to be removed from the board. In some cases, a conflict of interest or unethical behavior may be grounds to remove an individual from the board. In other cases, the behavior of a board member may become so obstructive that the board is prevented from functioning effectively.

Strongly felt disagreements and passionate arguments are often elements of the most effective boards (and genuine debate); and arguing for an unpopular viewpoint is not grounds for board dismissal. But if a board member *consistently* disrupts meetings or prevents the organization from working well, it may be appropriate to consider removing the individual from the board.

Although board member removal is rare, organizations should provide for such removal in their by-laws. The following three strategies can be used to remove troublesome board members:

• *Personal Intervention:*
One-to-one intervention by the board president or other board leadership is a less formal solution to managing problem board members. If a board member has failed to attend several meetings in a row, or has become an impediment to the board's work, board presidents can meet informally with the board member in question. In person or on the telephone, the board president can request a resignation. Examples: "I respect your strong opinion that we have made the wrong hiring decision. But we can't continue debating the

issue. If you don't feel you can wholeheartedly help us try to make the decision a success, I'd like you to consider leaving the board." "I'm having a hard time managing board meetings with your frequent interruptions and I am worried about losing board members due to the kinds of criticisms you make of them in meetings. I think it would be best if you would take a break from the board . . . you could resign now, and later, when there's a different board president, talk with him or her about your re-joining the board."

• *Leave of absence:*
Make it possible for individuals to take a leave of absence from the board if they have health, work, or other reasons why they cannot participate fully during the current term. A board member can maintain formal membership (but not, for example, be included for purposes of determining a quorum) if he or she is "on disability leave" or "taking a six months leave." Suggesting a leave of absence to a board member who is, for example, failing to do tasks he or she agreed to do, offers a gracious exit and allows the board to assign tasks elsewhere.

• *Term Limits*:
Many boards establish not only board *terms* but also *term limits,* such as two-year terms with a limit of three consecutive terms. In such a situation, a board member cannot serve more than six consecutive years without a "break" from the board. After a year off the board, an individual can once again be elected to the board. Proponents feel that term limits provide a non-confrontational way to ease ineffective board members off the board. Opponents of term limits believe that, *with proper board leadership,* errant board members can be guided toward either improving their behavior or quietly resigning from the board.

• *Impeachment*:
Organizational by-laws should describe a process by which a board member can be removed by vote, if necessary. For example, in some organizations a board member can be removed by a two-thirds vote of the board at a regularly scheduled board meeting.

## Alligators in the sewer: myths and urban legends about nonprofits

*It is worth noting that some common assumptions about nonprofits are actually more like urban legends. Like the legendary alligators in New York sewers, these stories have been passed along through so many people they've gained a measure of credibility just by their longevity.*

- "Nonprofits can't make a profit." The IRS guidelines clearly state that any profits can't be simply distributed to board members (as corporate profits are to shareholders), but they *don't* say that nonprofits can't have profits. In fact, surpluses ("profits") are needed by nonprofits to even out their cash flows, to provide reserves for emergencies, and to allow them to pay for equipment, research, staff development, building renovations, and other necessary investments.
- "Nonprofits can't charge for their services." In fact, many nonprofits exist solely or mostly on fees charged, such as nonprofit preschools that charge tuition, or community choirs that sell tickets to their concerts.
- "Nonprofits are poorly managed compared to businesses." It depends which business! Compared to Enron, Montgomery Ward, Webvan? In fact, nonprofits often achieve growth rates well above for-profit companies of comparable size, and do so while undercapitalized, highly regulated, and still with the highest of ethical standards.

- "Nonprofits can't lobby." Nonprofits cannot engage in any *electoral* activity—they can't support or oppose candidates. However, they *can* support or oppose ballot measures (such as *for* public school bonds or *against* new immigration laws). In addition, nonprofits *can* encourage legislators to support or oppose various pieces of legislation—as long as such lobbying activities are an "insubstantial" part of their activities. (More good info at http://www.independentsector.org/clpi/index.html, Charity Lobbying in the Public Interest.)
- "A nonprofit budget has to be balanced." In fact, in some years a nonprofit will want to budget for surpluses, such as to create a cash reserve, or to save up for new equipment. In other years the same nonprofit might budget a deficit, for example, to do one-time programs with windfall money, or to invest in a new fundraising director, or a publicity strategy. Over time, the financial goal of a for-profit is to *maximize profits;* the financial goal of a nonprofit is to *sustain sufficient working capital for program continuance andstrategic choices.*
- "Nonprofits aren't important economically." Surprisingly, nonprofits generate 6% of the US GDP (gross domestic product), and employ 1 in every 14 American workers. Nonprofits mobilize the efforts of an army: 83.9 million adults volunteer 15.5 BILLION hours each year for the community and public benefit. This is equivalent of 7.7 million full time staff. In comparison to this 7.7 million staff, the total active military personnel in all services (Army, Navy, Marines, Air Force) is 1.4 million!



## The Board Should Raise Money: True or False?

The all-too-common scenario: the executive director is frustrated because she thinks it's the duty of the board to raise money—but they aren't. A few board members agree and they say (or bring in a consultant to say) something like: "Every member must give, get, or get out." As board members we typically have three reactions simultaneously. First, we resent being required to do something when we were not told of this requirement when we were invited to join the board. Second, we feel guilty anyway. Third, we doubt we could succeed at raising money, even if we were to try. It's as if we were invited to a potluck, arrived with a dish, and then scolded for not having brought the right dish.

To untangle this knot, it's helpful to think of the board as having two roles: a Governance role where the board acts as a body to ensure accountability, and a support role where board members support the organization, acting as individuals, through volunteering and donating. Ensuring that the organization has a realistic strategy for raising funds *is* a critical governance responsibility of the board of directors. But that strategy may or may not include individual fundraising by board members. The strategy for raising funds will probably include a combination of efforts: fees-for-service (such as tuitions, service fees, registration fees, tickets), special events, mail fundraising campaigns, government contracts, and individual major donor gifts.

There are four crucial rules to fundraising on the board:
1. As a body, the board is responsible for approving and monitoring performance of a revenue strategy that will sustain the organization's work.
2. In the context of that plan, as individuals, each board member must do something to help implement that strategy.
3. No one has to do everything, and
4. Expectations must be clearly and fairly communicated to new board members during the recruitment process. In other words, there should be methods that take advantage of each of the individual strengths that board members have and are willing to contribute.

The board's Governance responsibility is to ensure that a suitable financial or revenue strategy is in place. This strategy must have three characteristics: a) it will result in funding needed by the organization for its work; b) it will provide funding for emergency reserve, evening out cash flow and organizational investments (such as in new computers or carpeting, or a publicity campaign); and c) it is in line with the organization's ethics and values (for example, whether or not a community center should accept donations from beer companies).

For a breast cancer awareness center, the board may consider several funding strategies, such as a) a combination of foundation grants and an annual dinner/dance; b) a combination of participating in a combined breast cancer walk-a-thon and publication sales; c) mail appeals combined with major individual gifts; d) government contracts combined with foundation grants, etc. This board may decide to adopt a strategy of participating in the walk-a-thon, selling publications, and soliciting major individual donations. This decision is based on what is realistic for their current board and staff as well as the opportunities most open to them.

As a result, board members in their Support responsibilities agree that each board member will participate in one or more activities. One board member agrees to bring 10 volunteers to help at the walk-a-thon. Another will send out email publicity about publications to book editors and bookstores. A third agrees to hold a party at her house and ask her friends to attend for $1,500 each. Each board member is, in a way comfortable to her, supporting either the contributions component or the earned-income component of the revenue strategy.

In short, the board's Governance responsibility is fulfilled by its choosing and monitoring a revenue plan, while individuals support the organization by participating in the plan's implementation. Clarifying this distinction, as well as the expectations of board members, will go a long way towards calmer, less charged, more productive discussions about fundraising.

*Related Board Café articles (archived at* http://www.boardcafe.org*):*
Five Things One Board Member Can Do to Raise $100 to $5,000 (May 99)
Easy Ways to Communicate Expectations about Money (Feb 1998)
Board Member Agreement (March 01)

## Ten Tips for Staying Sane about Your Board

1. Let go of any written or unwritten rules you may have about the "right" way for board members to participate in fundraising.
2. Above all, let go of the notion that all board members must ask others for money.
3. Accept the 20-60-20 rule when it comes to fundraising and your board. That is, 20% of the board will enjoy being involved in fundraising, 60% will be neutral about it, and the remaining 20% will want nothing to do with it.
4. Stop thinking that every other nonprofit organization's board members do more fundraising than your board members do. It's irrelevant (and highly improbable, anyway).
5. Recognize that your board members are volunteers who are giving you the gifts of their time and attention. In today's world, those gifts are more precious than money. They are not paid staff nor, in most cases, do they wish to become paid staff.
6. Know that your board members are looking to you to steer the fundraising process and to make requests of them as needed. Do not assume that anyone on your board wakes up each morning worrying about the fundraising needs of your organization.
7. Treat each board member with the care and respect that you would treat each major donor or potential major donor. If, over time, you consistently shower your board members with that level of personal attention and respect, many of them will naturally become significant donors.
8. Thank your board members sincerely and promptly for every little thing they do. A quick e-mail or voicemail "thank you" tells them that what they did mattered to you. Whether they have served on your board for ten months or ten years, make certain they know you do not take them for granted.
9. Meet with each board member individually once a year to be sure you understand what interests them most about your organization. Find out why they got involved on your board in the first place and what keeps them involved. When interacting with each board member, keep these interests and self-interests foremost in your mind. Let go of any expectations or illusions that these will ever change. Do your very best to fulfill these interests.
10. Make two lists and have them available as you meet or talk with each board member. (See suggested lists below.)

**List #1: Ten easy and meaningful things for board members to do to advance your organization's individual giving program**

1. Speak positively about your organization with the people in their day-to-day lives. Talk about the good work you are doing and share their genuine passion for your work.
2. Attend a Point of Entry Event at least once a year to update their knowledge of your program and get re-inspired. Give you their honest feedback afterwards.
3. Invite friends to attend Point of Entry Events, after the board member has become comfortable with the process. Within one week after the event, call these friends to thank them for attending.
4. Be the official board host at one of your generic, pre-scheduled Point of Entry Events once or twice a year.
5. Host a private Point of Entry for their friends or colleagues (or book club, etc.) in their home or office.

6. Attend one-on-one or small-group Point of Entry lunches with the Executive Director as necessary. Be prepared to tell why they got involved with the organization.
7. Attend Point of Entry Conversion Events (golf tournaments, galas, etc.) wearing a special board-member ribbon or nametag and be "on duty" as a proud representative of your organization throughout the event, ever alert to guests who might want more information.
8. Attend Free Feel-Good Cultivation Events in their official capacity as a board member. Genuinely thank and appreciate the guests for all they have given to your organization.
9. Make brief thank-you calls to recent donors. (Leaving a message is acceptable.)
10. Make a personal financial gift to your organization annually, of any amount they would like.

**List #2: Five valuable and useful roles for development committee members**

1. Be involved in planning the entire individual giving fundraising system for your organization.
2. Regularly review the lists of people who have attended Point of Entry Events and offer strategic advice and guidance about additional ways to involve or connect these potential donors.
3. Conduct open-ended telephone interviews with prior donors to gather feedback about what your organization could be doing better.
4. Ask selected donors or potential donors for financial contributions after the donors have been sufficiently educated, inspired, and involved.
5. Host additional private meetings or group cultivation events with major donors as needed.

## Basic Guide to Non-Profit Financial Management

Nonprofit leaders and managers have to develop at least basic skills in financial management. Expecting others in the organization to manage finances is clearly asking for trouble. Basic skills in financial management start in the critical areas of cash management and bookkeeping, which should be done according to certain financial controls to ensure integrity in the bookkeeping process. Non-profit leaders and managers should soon go on to learn how to generate financial statements (from bookkeeping journals) and analyze those statements to really understand the financial condition of the organization. Financial analysis shows the "reality" of the situation -- seen as such, financial management is one of the most important practices in management. This topic will help you understand basic practices in financial management, and build the basic systems and practices needed in a healthy non-profit organization.

**Your Board Treasurer -- A Critical Resource**
An active board treasurer can be the most important resource in the long-term financial health of your nonprofit. As a nonprofit organization, you must get accounting expertise somehow, if you don't have strong skills in this area yourself. You (or, ideally your board chair) should get someone on your board with accounting skills to be your treasurer.

**Board Treasurer Job Description**
The following description was adapted from materials from the National Center for Nonprofit Boards.

1. Is a member of the Board
2. Manages finances of the organization
3. Administrates fiscal matters of the organization
4. Provides annual budget to the board for members' approval
5. Ensures development and board review of financial policies and procedures

**Accounting Software**
Note that an accounting software package can greatly reduce the time to enter and manage accounting transactions, and generate financial statements. However, you still should have at least a basic understanding of the accounting process for your organization, including what journals are used and what general accounts exist. You must have good understanding of financial statements and how to analyze them -- an accounting package cannot do this for you!

## Getting and Using Accounting Services

**Ways In Which An Accountant Can Help**
The majority of non-profit organizations will need the services of an accountant. Even board members with accounting backgrounds will need help from time to time. It’s challenging enough to run the organization, much less keep up with tax or benefit law changes.

Here are some of the ways in which an accountant can assist your organization:

1. Prepare periodic financial statements and annual audit reports.
2. Assist you in analyzing your financial statements, looking for problems or opportunities for improvement.
3. Determine working capital and cash flow requirements.
4. Help you develop a budget and setup system for your monthly review of budget vs actual results.
5. Prepare tax returns and assist with tax planning.
6. Establish tax calendar for you and set up system to help you comply with the myriad filing requirements.
7. Help set up your accounting systems, including computer based systems.
8. Assist with determining loan or capital requirements.
9. Act as your advisor and sounding board in financial and administrative matters.
10. Perform operational reviews and help you find ways to run more efficiently.
11. Determine service costs analysis and breakeven analysis.

**Keep Accounting Costs Down**

Accountants have various ways that they bill their time, depending on the type of service performed. An hourly rate is commonly used, although flat fees are often used as minimums and for types of services performed on a regular (monthly or quarterly) basis. Familiarize yourself with the type of billing used for the services that you are requesting assistance with.

**Hourly rate**

Find out what the rate is for the services that are in fact billed this way, and if you will be billed in 10 or 15 minute increments, and when the clock starts. Similar to attorneys, accountants will sometimes provide the initial consulting session (first 1/2 hour) for estimating services, etc. Ask first, though, because if you go in with a problem that needs immediate attention, you can expect to be on the clock.

**Flat fee**

This is commonly used with payroll services, sometimes monthly reports and tax returns, depending on the accounting organization, when the amount of time is similar each month.

**Tax returns billed by form**

This is a common practice among tax preparers, and often is adopted by accounting offices as a way to simplify billing for tax return preparation. You can often get an estimate based on this type of billing practice if the accountant can see a prior year return, and knows what the changes have been for the current year.

**How You Can Keep Costs Down**

1. Any time you are being billed on an hourly basis, the easier it is for the accountant to read and understand the information that you bring in, the quicker the requested service will be performed. Find out what you can prepare first to make the work easier, and if it will make a difference on your total bill, e.g., if you are being billed by form for tax preparation, there isn't much you can do to decrease costs. You may want to find an accountant that does not bill this way so you can impact the bottom line of your bill.

2. Choose an accounting system, either manual or computerized, that you can understand and that enables you to do as much of the bookkeeping work as you have time for. You will need less work done outside of your office, and you may be able to contract for technical assistance as needed. Finding an accountant that will return your phone calls or e-mail will obviously be critical for this to work well.
3. Talk to your accountant or tax professional prior to making major decision so you will know the tax implications ahead of time, and make sure that you set up the deal appropriately for your tax situation; it will save your professional time later if all of the documents are in proper order.
4. Write down as many of your questions that you can think of to keep your visit organized and flowing smoothly, and don't get into an argument with your organization at the accountant's office; they are not usually paid for mediation unless you have arranged it ahead of time. Taking time to prepare for your visit can save money and time. And write down the answers so you will not have to ask the same question again on a subsequent visit.
5. Ask for a detailed bill that specifies what you are being billed for each type of service that you receive, including time and billing rate. This will help to give some clues about what you can do to help save money. Remember that contracting out services that take you a lot of time to learn about can actually save you money.

## Bookkeeping and Accounting - From Start to Finish

**REVIEW CHECKLIST**
Even if you hire someone to do your accounting and bookkeeping, there are a number of items that that *you as the organization* should do periodically. Many organizations have suffered serious losses when the board lost track of the numbers and the trusted bookkeeper "borrowed money" and left for an extended cruise. The following checklist will keep you in touch with your organization, and perhaps even prevent you from serious losses.

- **Compare actual results to budget.** ***Each and every month*** you need to compare your income and expenses to your budget. This review is perhaps one of the most important tools for a non-profit organization. It's a great way to learn what's working and what's not working with your organization. The goal is not to have an accurate budget... but for you to have a thorough knowledge of what is happening **and** to know if anything unexpected is happening so that you can adjust your actions in a timely manner.

- **Scan the check register.** Periodically (say every 3-4 months) you should take a look at the check register just to make sure all the payees are familiar to you. Multiple checks written around the same time to the same vendor could be an indication that funds are being diverted. (You also might want to reduce the time spent writing and posting multiple checks.)

- **Review the bank reconciliation.** This should be done on a monthly basis (or if you skip a month take a look at all the reconciliations since your last review.) This step is important, particularly if you have one person doing all the bookkeeping: writing checks, posting entries, preparing financials, etc. Look at any adjustments to the bank accounts, stale items, etc.

- **Look at canceled checks.** Occasionally (say 1-2 times a year) pull out a bank statement and flip through the canceled checks making sure that all those signatures are yours, that you recognize the vendors and scan the endorsements on the back. Obviously, this can't be done if you don't get your canceled checks back from the bank. In this case you might want to spend a little extra time with the check register.

- **Review statements from vendors.** Every now and then (say 3-4 times per year) take the time to open the mail and look at statements from vendors (many vendors have stopped sending statements, but they will send late notices). Here you want to make sure that your organization is in good standing with vendors -- long overdue invoices might be an indication that a check you thought was going to a vendor actually went in someone else's pocket, or that an invoice has been overlooked.

  1. **Review your Accounts Receivable and aging.** This needs to be done on a regular basis. Of course you need to know if you have any slow paying receivables or overdue pledge payments and a periodic review would also disclose any scheme of "misapplying" payments.
  2. **Take a physical inventory.** Many small organizations have very poor inventory records, so if you have a large amount of inventory, you probably will want to work with your accountant and get some type of perpetual inventory system set up. Again, there are some excellent software packages available for non-profits that will make this process relatively painless. Once you have a system in place, you should take a physical inventory at least once a year and compare the actual goods on hand to the inventory records.

## No Matter Who Does Your Finances, YOU Should Know Basic Accounting Principles

**Description**
The following basic overview will give you some overall perspective on the basic processes involved in nonprofit financial management. Key terms to learn are bolded .

The following activities described on this page occur regularly as part of the yearly **accounting cycle**. The accounting cycle includes bookkeeping, generating financial statements and analyzing information from the statements.

**Basic Bookkeeping Activities**
Bookkeeping is basically recording various financial transactions. Bookkeeping activities can often be done by someone who's doing basic clerical work in the organization. Often, the board treasurer can help you develop and carry out your bookkeeping system.

***Fiscal Policies and Procedures Manual (or Accounting Procedures Manual)***
The board develops and authorizes a set of procedures for how the organization manages its finances, including how the following activities are carried out by your organization. The board treasurer usually coordinates the board's responsibility for the manual, including its regular review and update. The board and chief executive should make every effort to ensure compliance to the procedures in the manual.

***Type of Accounting System and Recording of Financial Transactions***
Accounting starts with basic **record keeping (or bookkeeping)**. When your organization is just getting started, your bookkeeping system will probably be based on what's called a **cash-basis accounting system**, rather than **accrual-basis system**. Many organizations, when starting out, use the cash-basis system and a checkbook to track transactions. In the "memo" portion of the checkbook, they note if the amount depicted on the check is an expense or revenue, and where the amount came from or is going to. As your organization grows, you'll begin using ledgers to track transactions, for example, you'll **post** cash receipts to a **cash receipts journal** and checks you write to a **cash disbursements** journal.

As your nonprofit grows and as you begin using the accrual method, you'll likely need more types of journals, for example, a Cash Receipts Journal, Cash Disbursements Journal, Payroll Journal, Accounts Receivable Ledger, Accounts Payable Ledger, Sales Journal, Purchases Journal and General Ledger.

(In an accrual-basis system, you post entries when you earn the money and when you owe it. Small organizations usually do not have the resources to use an accrual-based system. However, financial statements are prepared on an accrual basis. As a compromise, many organizations use the cash-based basis to record entries in journals, but get help to convert to an accrual-based basis to generate financial statements.)

You can do postings using a **single-entry** or **double-entry method**. Double-entry works from a basic accounting equation "assets = liabilities + capital". The double-entry method makes sure that your books are always in balance. Every transaction has two journals entries, a **debit** and a **credit**. Each transaction effects both sides of the equation.

Each posting might refer to accompanying documents that you keep in a file somewhere. For example, postings about cash receipts might refer to invoices that you sent to a clients which prompted them to write checks to your organization (checks which you posted as cash receipts). For example, postings about cash disbursements might refer to invoices that were sent to your organization which prompted you to write checks (checks which you posted as cash disbursements.) When you make a deposit to the bank, you'll file the bank's deposit receipt in a file.

***Manual or Automated Accounting System***
Your record keeping system will be based on a manual system (where you make entries and total them by hand) or a computer system. You might even choose to outsource your record keeping system to another business that manages your bookkeeping activities (along with other financial management activities) for you.

Soon you may evolve to using a computer-based system, which greatly automates entry of transactions, updating of ledgers, generation of financial statements and financial analysis (more on these later), and generation of reports needed for filing taxes, etc. The only drawback to using a computer is that you might underestimate the importance of knowing how your accounting processes really work -- that's an advantage of doing the bookkeeping yourself, if only for a few months. You should also generate your own financial statements and financial analysis at least for a couple of months. Having this knowledge and experience helps you develop an instinct for getting the most out of your financial resources.

***Accounts and Chart of Accounts***
You'll post each entry according to the category, or **account**, of the transaction. Each account will be associated with an **account number**. These numbers are referenced when developing your financial statements (more on those later). You'll refer to a **chart of accounts** which will tell you what account number to use when you post an entry. You can design your own chart of accounts, including coming up with your own account numbers. The chart usually have five areas, including assets, liabilities, net assets (or fund balances), revenues, and expenses. The account numbers you come up with should depend on the particular kinds of revenues and expenses you expect to have most frequently.

However, nonprofits have to report account activity according to the classifications functional (or **programs**) and natural (or **supporting**). Program transactions are those directly related to providing services to clients, members, etc. Supporting transactions are those in common to all programs, for example, general management costs, etc. It's not always easy to know which transactions belong to which category!

***Budgets (Financial Forecasting)***
You'll have a an **operating budget** (or **annual budget**)**,** which shows planned revenue and expenses, usually for the coming year. Budget amounts are usually divided into major categories, for example, salaries, benefits, computer equipment, office supplies, etc. You might also have **cash budgets**, which depicts the cash you expect to receive and pay over the near term, for example a month. You also might have **capital budgets**, which depict expenses to obtain or develop, and operate or maintain major pieces of equipment, for example, buildings, automobiles, computers, furniture, etc. Development of the budgets is usually driven by the chief executive. In the case of corporations, the board treasurer can take a strong role in developing and presenting the budget to the rest of the board. The board is responsible to authorize the yearly budgets.

You should develop a **program budget**, that is, a budget for each major service you provide to clients. For example, a transportation program, a child-care program. Many nonprofits have more than one program. It's critical to plan and track financial costs for each program. As much as possible, nonprofits should strive to minimize **overhead or administrative costs**, that is, costs to support the resources that support the entire organization and all programs, rather than just one program. Examples of administrative costs are rent for a building, office supplies, labor costs for personnel who support the central office or more than one program, insurance, etc. It's wise to develop a program budget that allocates indirect costs to programs.

Usually, each month (during trial balancing), you'll update your budget report to include actual revenue and expenses. Then you can compare your planned revenue and expenses to your actual revenue and expenses. This will give you a good idea whether your operating according to plan or not, including where you need to cut down on expenses and build up on revenue.

### *Petty Cash*

You'll have a lot of small, recurring expenses that you'll need to pay right away, for example, to buy a computer power cord, stamps, etc. You'll probably work from a **petty cash** fund. You might establish this fund by writing a check to your organization, and noting on the check that it goes to the "petty cash" fund. You'll withdraw from the fund by filling out a voucher that describes who took the money, how much, for what and on what date.

### *Trial Balances*

Usually, once a month, you'll do **trial balancing.** Often, the board treasurer can help with this activity. This activity usually starts by totaling the entries from the journal(s) into a **general ledger**. (As your business grows, you may use other types of ledgers, too, for example for equipment, payroll, etc.) When using double-entry accounting, you'll add up totals on both sides of the ledger to make sure that total debits equal total credits.

You'll make sure that the individual postings and totals are correct by comparing each to its accompanying documentation. For example, your recording of cash disbursements will be compared to your bank's monthly checking statement that indicates what checks you wrote over the month. Your recording of cash disbursements will also be compared to accompanying invoices and other forms of billing to your organization, to verify there was a need for each check that was written to pay bills.

### *Internal Controls*

You will have various forms of **internal controls** to ensure the business is following its plans, minimize the likelihood of mistakes, avoid employee thefts, etc. There are a wide range of internal controls. For example, you'll be careful about whom you hire. You might have authorization lists about who can access which areas of the building, types of information, etc.

As mentioned above, you'll carry over totals to various financial reports, including your budget, to see if your financial activities are according to plan or not. To minimize employee theft, the business's mail will be opened by one person who logs in each check that is received. This person will be someone other than the person who deposits the checks to the bank. Disbursements of large amounts, for example, over $500, may require a secondary signature, for example, from the board treasurer.

Another form of financial control is an **audit.** An audit is a comprehensive analysis, by a professional from outside the organization, of your financial management procedures and activities. The auditor produces a report, with a variety of supplements, that indicates how well your organization is managing its resources. Some nonprofits are required to have audits. It's usually good practice to have an audit, whether you're required to or not.

## Financial Statements

In order to know how your organization is doing, you'll do some ongoing financial planning and analysis. In this planning and analysis, you'll likely use your bookkeeping information to produce various financial statements, including a cash flow statement, statement of activities and a statement of financial position.

Your **cash flow statement** depicts changes in your cash during the year. Your **statement of activities** (known as the income statement before) depicts the changes in your assets over the past year. This statement is particularly useful to tell you if you are operating with extra money or at a deficit. This gives you a pretty good impression of your rate of revenues and spending. It signals areas of concern, as well. Your **statement of financial position** depicts the overall value of your organization at a given time (usually at the end of the year), including by reporting your total assets, subtracting your total liabilities and reporting the resulting net assets. Net assets are reported in terms of **unrestricted**, **temporarily restricted** and **permanently restricted assets**. Funders often want to see the statement of financial position.

**Financial Analysis**
By themselves, numbers usually don't mean much. But when you compare them to certain other numbers, you can learn a lot about how your organization is doing. For example, you can compare the planned expenses depicted on your budget to your actual expenses in order to see if your spending is on track.

Another form of comparison is by using ratios. A ratio is a comparison made by mathematically dividing one number by the other. For example, nonprofits are expected to keep administrative costs down in order to make more money available for programs. Dividing a program's expenses by your total expenses indicates the amount of administrative overhead to run your program.

The interpretation of results from various types of comparisons depends on the nature of the nonprofit. For example, an association might expect to spend far less on administrative overhead than would a social services agency during their first year.

**Financial Reporting**
The types and frequency of reports depend on the nature of the nonprofit and its situation. For example, if the nonprofit is in some sort of crisis, the board may require frequent reports.

Your board should require regular financial reports at each board meeting. When your organization is just getting started, the chief executive will prepare and present financial reports to the board. However, as the organization develops, a board treasurer will likely take a strong role in helping the chief executive to present financial information to the board. The finance committee, led by the board treasurer, ensures that financial reports are complete and helps present them to other members of the board.

The board may require a statement of financial position and statement of activities at each meeting. They also may request descriptions of finances for each program or of affordability for upcoming, major initiatives. They may request information prior to filing taxes. They will certainly need to see any results from financial audits.

## How do we prepare a budget?

**Timing of Budget Activity**
At least two or three months before the beginning of your fiscal year you will want to start thinking about the budget for the upcoming year. The budget ordinarily corresponds to your fiscal year, which should be selected to reflect your organization's operating cycle. For example, a theater company might have a fiscal year beginning September 1st to correspond to the beginning of its performance schedule. A nonprofit relying on government funding might choose a fiscal year ending June 30th so that the budget corresponds to the major funding cycle.

**Who Should Be Involved in the Budget Process?**
Staff and board members must participate in each phase of the budgeting process that affects the line items for which they will later be responsible. For too many nonprofit organizations, planning and financial management are activities that divide rather than unite the organization.

Program planning is often viewed as the domain of the executive director, program directors, and the board. Fiscal management is assigned to the bookkeeper, accounting, finance director, and, perhaps, the board treasurer. Program planners and fiscal managers speak different languages and often have different priorities, and may or may not be aware of the importance of the other's approach to the budget process. Program planning decisions often are viewed as failing to reflect economic realities, while fiscal management decisions are often viewed as insensitive to the programmatic mission of the organization. For this reason, both program staff and financial staff should work with the executive director and board to develop budgets which truly reflect organizational priorities and act as a guide for spending and decision making.

**What Are the Steps in the Budget Process?**
The first step in the budget process is a review of program and management achievements and fiscal performance over the year just ending. This includes, but is not limited to, reviewing objectives achieved, comparing budget to actual figures, and looking at the number of people served in each program. By dividing the true cost of each program by the number of people served, you can also analyze the cost per unit of service. Based on this review, new goals and objectives should be discussed and agreed upon in a preliminary way. These goals and objectives should fit into your strategic, long-range plan, and help you make progress towards your mission.

Then, estimate the costs required to achieve your objectives, including staff, supplies, and other resources. Include both program and financial staff in discussions of programmatic costs to make sure that all resources required by programs are considered. Management staff should be included in discussions for their own departmental budgets and how these relate to programmatic objectives. You can rely on past experience, as reflected in budget to actual reports, to determine some of this information for continuing programs. Make sure to take into account upcoming changes, especially in areas such as insurance, which are subject to significant fluctuations.

Since personnel costs typically account for 60 to 70 percent of a nonprofit's total expense budget, be sure to plan carefully for this line item. There can be a lot of hidden costs associated with new programs. For example, hiring new staff entails: training and support in addition to salaries and benefits; advertising new positions; evaluating your need for additional office space, furniture and equipment; and considering that an expanded staff, whether paid or unpaid, requires additional time for staff meetings, supervision, coordination.

You must budget for income as well as expenses. Even though unpredictable events may influence fees and contributions, you can estimate revenues with some degree of accuracy based on past experience. As with any budgeting based on the past, it is important to make adjustments for future plans and changes when you have sufficient information to anticipate. Grants from foundations, corporations, and government agencies can be more difficult to predict. The financial and fundraising staff, in collaboration with the executive director and fundraising committee of the board, have to make the most realistic assessment possible for budgeting purposes. It may also be useful to develop contingency budgets for more conservative or optimistic projections of revenue.

Note: Contributed revenue should be projected using the best information available. It is not a number derived from the gap between projected fees and other earned income and projected expenses.

Finally, compare revenue and expense projections. At different times organizations will choose to incur a deficit, realize a surplus, or simply break even. No rule says that budgets must balance in each budget period. If you are anticipating a deficit, is it because you are investing monies raised in prior years into new programs? Does a surplus reflect a board policy to establish an operating reserve to guard against loss of future funding or cash flow shortfalls? Certainly, large deficits can lead to bankruptcy, and large surpluses may mean that the organization is not investing enough of its revenues in serving the public interest. However, for any given budget period, revenue and expenses should be in the relationship that the organization chooses, rather than mechanically balanced.

If a preliminary budget has been prepared and revenue and expenses are not in the desired relationship, programs and management activities must be reevaluated and adjustments made. Typically, nonprofit organizations find that their initial projections for income and expenses anticipate an unacceptable deficit, and either additional revenue must be generated or activities must be cut back. When reviewing the revenue budget, it is important to avoid the temptation of raising the estimate without changing the plans for generating revenue (We'll try harder to raise money this year.) The budget should be based on reasonable assumptions you have some grounds for making.

If expenses need to be reduced, it is helpful to determine what each program would cost at different service levels. A fixed percent cut across all expense lines is often not the most effective way to reduce expenses. For instance, do not assume that benefits and costs move together, with each additional dollar spent resulting in an additional dollar of results.

**Preparing a Monthly Budget**

It is useful to prepare monthly budgets that reflect the anticipated timing of revenue and expenses instead of dividing the full budget into twelve equal parts. Therefore, your December fundraiser revenues would be included in your monthly budgets for October through January, to correspond when ticket sales are coming in. Similarly, if your insurance is due once a year, the entire insurance premium would be reflected in that month's budget, rather than divided into twelve equal parts throughout the year. By preparing monthly budget breakdowns and comparing them with actual dollars spent and received, you can more accurately spot real changes and revise the budget accordingly. Budgets and the budget process can be an important vehicle for better programmatic and financial management and can help your organization better achieve its mission.

## ACTIVITIES IN YEARLY ACCOUNTING CYCLE: Financial Statements and Analysis

### Financial Statements

In order to know how your nonprofit is doing, you'll do some ongoing financial planning and analysis. In this planning and analysis, you'll likely use your bookkeeping information to produce various financial statements, including a cash flow statement, statement of activities and a statement of financial position.

### What financial statements are nonprofits required to issue?

The end products of the accounting process are the financial statements, summarizing all of the financial transactions of the organization for the period. The Financial Accounting Standards Board issued Statement of Account Standards No.117, *Financial Statements for Not-for-profit Organizations* requiring nonprofits to prepare three primary financial statements:

- Statement of Financial Position (Balance Sheets)
- Statement of Activities (Income Statement)
- Statement of Cash Flows

In addition, nonprofits must provide information about expenses as reported in their functional classifications (program services and supporting services.) Voluntary health and welfare organizations are also required to present a statement that reports expenses by their natural classification (e.g., salaries, rent, telephone, printing, etc.) Other nonprofits are encouraged to report in both formats as well.

The following briefly describes the information included in each statement.

### Statement of Financial Position

Reports amounts of the organization's assets, liabilities and net assets (fund balances) at a specified date. This statement was previously known as the Balance Sheet.

**Assets** are properties and resources the agency owns and can use to achieve its goals.

**Current assets** include cash accounts, certificates of deposits and other investments, and items such as receivables which will be converted to cash within one year. **Fixed assets** include land, buildings and equipment.

**Liabilities** are debts of the organization, what is owed. **Current liabilities** typically include accounts payable to vendors, short-term loans due, withheld payroll taxes due, etc. **Long term liabilities** include long term debt, mortgages, etc.

**Net Assets** (previously called fund balances) represents the net of assets over liabilities. Three classes of net assets must be reported on unrestricted, temporarily restricted, and permanently restricted. Restrictions are determined by the conditions which donors place on their contributions.

### Statement of Activities

Reports revenues, expenses, and the resulting change in net assets for the year. Charges are reported for each of the three classes of net assets (unrestricted, temporarily restricted, and permanently restricted.) This statement was previously known as the Income Statement or Statement of Revenue, Expenses and Changes in Fund Balances.

**Statement of Cash Flows**
Reports how the organization's cash position changed during the year. Cash flow information is divided among receipts and disbursements from investing, financing, and operating activities. Many nonprofits ask their auditors to prepare this statement.

**Other Related Documents**
In addition to the financial statements required for audit purposes, nonprofits are required by federal and state governments to file various information returns to maintain their tax-exempt status and document tax compliance. The primary federal reports are the annual Form 990 and Schedule A to the 990. State governments may require additional reports.

**Sample Statements of Financial Position and Activities**

**<u>Statement of Financial Position</u>**

Statement of Financial Position
(Balance Sheet)
Year Ended June 30, 20xx

| ASSETS | 20xx | 20xx |
|---|---|---|
| Cash and Cash Equivalents | $11,400 | $6,300 |
| Grants Receivable | 2,500 | 0 |
| Prepaid Expense | 950 | 1,300 |
| Fixed Assets at Cost: | | |
| Office Equipment | 15,496 | |
| Less: | | |
| Accumulated Depreciation | <15,496> | |
| Net Fixed Assets | - 0 - | - 0 - |
| Total Assets | $14,850 | $7,600 |
| LIABILITIES | | |
| Accounts Payable | $1,500 | $4,500 |
| NET ASSETS (Fund Balance) | $13,350 | $3,100 |

**Statement of Activities**

Statement of Activities

Year Ended June 30, 20XX

*FORMAT A*

*Functional Expense Classification*

| | |
|---|---|
| REVENUES | |
| Government Grants | $ 35,000 |
| Other Grants | 50,000 |
| Individual Contributions | 25,000 |
| Fees for Service | 45,000 |
| Interest | 2,000 |
| Total Income | $157,000 |
| EXPENSES | |
| Counseling Program | $ 52,800 |
| Training Program | 62,100 |
| Management and General | 21,865 |
| Fundraising | 9,985 |
| Total Expenses | $146,750 |
| Increase/<Decrease> in Net Assets | $ 10,250 |

**Statement of Activities**
Statement of Activities
Year Ended June 30, 20xx

*FORMAT B*
*Natural Expense Classification*

| | |
|---|---|
| REVENUES | |
| Government Grants | $ 35,000 |
| Other Grants | 50,000 |
| Individual Contributions | 25,000 |
| Fees for Service | 45,000 |
| Interest | 2,000 |
| Total Income | $157,000 |
| EXPENSES | |
| Salaries and Fringe: | |
| Executive Director | $ 38,000 |
| Program Directors | 50,000 |
| Secretary | 27,000 |
| Rent | 12,000 |
| Supplies | 11,000 |
| Telephone | 3,300 |
| Postage | 2,500 |
| Copying | 2,950 |

| | |
|---|---|
| Total Expenses | $146,750 |
| Increase/<Decrease> in Net Assets | $ 10,250 |

## Statement of Cash Flows

Statement of Cash Flows
Year Ended June 30, 20xx

| | |
|---|---|
| Change in Net Assets | $10,250 |
| Adjustments to reconcile change in net assets to net cash <used by> operating activities: | |
| <Increase> in grants receivable | < 2,500> |
| Decrease in prepaid expenses | 350 |
| <Decrease> in accounts payable | < 3,000> |
| Net cash <used by> operating activities | < 5,150> |
| Net increase in cash and cash equivalents | 5,100 |
| Cash and Cash Equivalents — Beginning of year | 6,300 |
| Cash and Cash Equivalents — End of year | $11,400 |

## Statement of Functional Expenses

Statement of Functional Expenses
Year Ended June 30, 20xx

| | Counseling Program | Training Program | Total Program | Mgt and General | Fund-raising | Total Support | Total All Expenses |
|---|---|---|---|---|---|---|---|
| Salaries and Fringe: | | | | | | | |
| Executive Director | $12,500 | $12,500 | $25,000 | $7,000 | $6,000 | $13,000 | $38,000 |
| Program Directors | 25,000 | 25,000 | 50,000 | | | | 50,000 |
| Secretary | 7,000 | 10,000 | 17,000 | 8,000 | 2,000 | 10,000 | 27,000 |
| Rent | 4,000 | 6,000 | 10,000 | 1,565 | 435 | 2,000 | 12,000 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Supplies | 2,500 | 4,500 | 7,000 | 3,000 | 1,000 | 4,000 | 11,000 |
| Telephone | 1,000 | 1,100 | 2,100 | 1,000 | 200 | 1,200 | 3,300 |
| Postage | 500 | 1,000 | 1,500 | 800 | 200 | 1,000 | 2,500 |
| Copying | 300 | 2,000 | 2,300 | 500 | 150 | 650 | 2,950 |
| Total Expenses | $52,800 | $62,100 | $114,900 | $21,865 | $9,985 | $31,850 | $146,750 |

## How do we interpret our financial statements?

Readers of financial statements can learn a great deal about the health of a nonprofit organization by examining the numerical information presented. In particular, financial information helps readers:

- **Measure the organization's efficiency, using factors such as:**
    - Units of service produced compared to costs
    - Fundraising income compared to amounts spent on fundraising
    - Net income in a fee-producing program compared to the fees received
- **Evaluate the adequacy of financial resources, often through:**
    - Liquidity ratios, such as the current ratio
    - Comparison of total liabilities or total assets with net assets (formerly called fund balance)
    - Cash flow projections

**Seek significant financial trends by:**

- Vertical analysis (looking at a simple line item as a percentage of total revenue or expense)

- Horizontal analysis (comparing prior periods with the current period)

In several cases, ratio analysis is used to evaluate the organization's financial health. Ratios are a tool for comparing numbers representing different aspects of an organization's financial status. The value of the tool is in identifying which numbers to compare, and determining what the comparison might indicate. Although accountants have determined certain standard ranges for these ratios within some nonprofit industries (arts, libraries, human service agencies, etc.), it is most important to identify the trends in your own organization and analyze changes over time. Therefore, instead of giving specific ranges in the following examples, this article indicates the likely significance of a "high" or "low" relationship between the numbers compared in the ratio.

**Financial Indicators from the Statement of Activities (Income Statement)**
**Surplus or deficit**
If income is greater than expenses within a given period, say a year, the organization has generated a surplus. If expenses are greater than revenue, the organization experiences a deficit for the period. There is no rule that says organizations should have surpluses, deficits, or break even. Typically nonprofits budget to break even. However, organization may deliberately decide to spend down their cash reserves (expandable net assets) for a specific purpose such as starting a new program. Doing so results in an operating deficit, but one which is planned. Similarly, if a nonprofit has determined that it needs a cash reserve for specific future purposes (cash flow, investing in a new program guarding against future declines in funding, etc.), the Statement of Activity should reflect an operating surplus. An "unplanned" surplus, deficit, or even a break even position should be analyzed to determine its causes and to plan for the implications.

**Budget to Actual for Revenue and Expense**
Perhaps the most commonly used financial indicator is a comparison of budgeted revenue to actual revenue, and budgeted expense to actual expense. These comparisons are made on both a monthly and a year-to-date basis. Significant variations from budget should be investigated to see whether new projections should be make based on actual experience, and/or whether managerial intervention is appropriate.

**Functional Expense Ratios**
When completing Federal Form 900, nonprofits must report expenses functionally, broken down into the categories of Program , Management and General Activities, and Fundraising. Donors and agencies who evaluate nonprofit performance, often look to see that most of your organization's funds are being used for programmatic purposes. However, different sources recommend differing practices and policies for allocating expenses among the functional expense categories. As a result, it is important to develop consistent guidelines within your own organization to determine which of your expenses go to program support, and which to management and general activities or fundraising.

**Some functional expense ratios are:**
Take Program Expense and divide by Total Expense
If high, most of the expenses are related to program. Relatively little is spent on management or on fundraising.

Take Fundraising Expense and divide by Total Expense

If high, a large percentage of expenses are spent on fundraising efforts. Prospective donors may draw the conclusion that too high a portion of their contribution will be spent on fundraising, rather than on program services.

**Financial Indicators from the Statement of Position (Balance Sheet)**
**Short term liabilities coverage ratio (quick ratio)**
Will there be enough cash to pay bills in the immediate or near future? Add together all assets that can be used to pay bills over a specific period of time, such as one month or three months and compare this with the bills that must be paid within that same period of time.

Take Cash + Unrestricted Investment + Accounts Receivable and divided by Current Accounts Payable + Current Accruals
If high, there may be too much in cash, some could be earning more if invested. If low, you may be in danger of a cash flow crisis, not enough cash to pay pressing bills.

**Current Ratio**
Will cash flow be adequate to pay bills over the next year?

Take the Current Assets and divide by Current Liabilities
If high, Same as above. Caution: Even if current ratio is adequately calculated for the year, there may be periods within the year where there is an inadequate cash to pay bills.

**Deffered Revenue or Net Temporarily Restricted Assets**
Deferred revenue traditionally refers to cash which has been received for some restricted condition which has not yet been met. Under the new Statement of Financial Accounting Standards No.116 issued by the Financial Accounting Standards Board (FASB), most of these funds will be held not as deferred revenue, but as an addition to temporarily restricted net assets.

To determine the ratio, take the Deferred Revenue and divide by the Cash + Savings - or - take the Temporarily Restricted Net Assets and divide them by the Cash + Savings.

If deferred revenue or temporarily restricted net assets exceeds cash and savings, you may be spending restricted cash for purposes other than those which the funder intended, or using monies designated for future purposes (such as magazine subscription fulfillment) to meet current expenses.

**Financial Indicators Using Information from More Than One Financial Statement**

**Fund Balance Ratio or Unrestricted Net Assets Ratio**
The fund balance ratio, now called the unrestricted net assets ratio, measures the amount of unrestricted, spendable equity to the organization's annual operating expense.

To determine the ratio, take Expendable Unrestricted Net Assets and divide them by Annual Expenses.

If low, the organization has little unrestricted, spendable equity available to meet temporary cash shortages, an emergency, or deficit situation in the future. This may be the case even in organizations with significant unrestricted net assets, if the major portion of equity is tied up in fixed assets.

**Days Receivables**
The days receivables ratio measures the average number of days it takes to collect on a sale or service performed for a fee. This ratio is useful to organizations which earn significant portions of their revenue from fees charged to clients or from product sales.

To determine this ratio take the Accounts Payable times 365 days and divide by purchases.

If high, payments taking longer than 30 or 60 days are inconsiderate and may result in friction with community vendors. In addition, the organization may be incurring additional costs as a result of late or deferred payments (e.g., late fees, interest expense, etc.). A very long days payables ratio or a sudden increase in days payable may indicate an inability to pay bills.

**Failure to Produce Financial Information**
In order to assess the financial health of your organization, timely and reliable financial information must be available. Lack of adequate financial information may indicate that not enough time is available from staff or outside contractors to perform the accounting function, that staff needs more training in financial statement perpetration, or that financial systems need to be improved.

**Final Comments**
Ultimately, the most important performance measure of a nonprofit is not to be found in financial statements at all. To determine "success," a nonprofit must measure progress against its goals. For example, perhaps an organization has set as a goal providing 200 terminally ill patients with hospice care over twelve months. Determining how many patients were served and at what cost is not difficult. But these calculations show how efficient the has been - not how effective the group has been at providing compassionate, professional care for these patients. It is important to remember that financial indicators are powerful tools for nonprofit managers, when used in pursuit of meaningful goals.



## Reporting Obligations

**What reports must my organization file with the IRS?**
Nonprofit Section 501(c)(3) organizations that normally have more than $25,000 in gross receipts must file Form 990 each year. There are two exceptions: private foundations must file Form 990-PF every year no matter what their gross receipts are, and churches (a tax category that includes synagogues, mosques, zendos, and similar houses of worship) and church affiliates are exempt from filing Form 990.

Nonprofits with unrelated business income over $1,000 must file Form 990-T. This obligation extends to churches. Unrelated business income is income from activities whose conduct, in itself, does not contribute substantially to the achievement of the organization’s exempt purposes. If you think your organization may have unrelated business income, consult legal counsel or an accountant familiar with the laws governing nonprofit organizations.

Nonprofit organizations must file other returns, depending on their activities, whether they have employees, and other factual issues. You should consult an accountant who is familiar with nonprofit organizations to learn what your organization must file and what state and federal agencies expect reports.

**What must my organization disclose to the public, and what can we keep private?**
Nonprofits are obligated by federal law to provide copies, on request, of their tax exemption applications and related correspondence. They must also provide copies, on request, of their three most recent tax returns. If the organization's returns are available on the Internet in a form that may be downloaded for free, such as .pdf format, the organization need not provide paper copies.

Public charities need not disclose the statement of major donors that Form 990 requires, but private foundations must do so. Nonprofits may not withhold compensation information from public disclosure.

Organizations need not disclose the minutes of Board meetings and other internal records to the general public. However, board members (and voting members of the corporation, if any) have certain inspection rights under state law.

**What must my organization report to our donors?**
If your organization receives contributions of $250 or more from donors, or if your organization provides goods or services to donors who give more than $75, your organization must provide written acknowledgments to your donors. The best source of information on the specific requirements is IRS Publication 1771, Charitable Contributions: Substantiation and Disclosure Requirements. The most recent edition of Publication 1771, updated in March 2002, is available in .pdf format on the IRS web site at www.irs.gov/pub/irs-utl/pub1771.pdf.

**What are the duties and responsibilities of a charity's Board of Directors?**
While the specific laws governing nonprofit corporate governance differ from state to state, the following duties and responsibilities are generally applicable:

- The Board of Directors, as a group, is ultimately responsible for overseeing the corporation's affairs.
- The Board may delegate its responsibilities to others (staff, professional advisors, officers), but it retains the obligation to supervise those persons. Directors may rely on reports from officers and employees, reliable outside experts, or Board committees, so long as the director has no reason to believe that reliance is unwarranted.
- Directors must act in good faith, in what they believe to be in the corporation's best interests (the duty of loyalty), with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under the circumstances (the duty of care).
- Board functions generally include: strategic planning; hiring, firing, reviewing and compensating (if applicable) the Executive Director; approving the annual budget and annual financial statements; overseeing investments; fundraising (if necessary); ensuring legal compliance (including tax-exempt status) in administration and program operations. Boards should avoid micromanagement.
- Individual directors have no authority as such over the corporation or its staff.
- Boards are required to ensure that assets are spent for the charitable purposes for which they were received by the corporation (the charitable trust doctrine), in

accordance with the Articles of Incorporation, the Bylaws, and the donor's intent. Deviation from such purposes may require court approval.

- The Board must ensure that assets held for investment are invested prudently.
- A director's breach of fiduciary duty that causes harm to the corporation will make the director personally liable to make the corporation whole. The Attorney General is responsible for enforcement.

| **Form 10-1 Financial Empowerment Self-Assessment** | | |
|---|---|---|
| | **Yes** | **No** |
| *Do you have at least 30 days cash on hand?* | **2** | **0** |
| *At least 60 days?* | **3** | **0** |
| *At least 90 days?* | **3** | **0** |
| *Has your organization been profitable in the past three years?* | **3** | **0** |
| *Do you have financial policies that have been updated in the past 18 months?* | **2** | **–3** |
| *Do you know which of your programs make money and which lose money?* | **4** | **–2** |
| *Do you have an endowment?* | **1** | **0** |
| *Do you get 5% of your income from earnings on your endowment?* | **4** | **0** |
| *Do you have and distribute a mission reserve chosen by line staff?* | **3** | **–1** |
| *Do you consider debt as an option to get a new service up and running?* | **1** | **0** |
| *Do you and your board view your expenditures as investments?* | **2** | **0** |
| *Do you involve staff in budget development?* | **1** | **–1** |
| *Do you involve staff in budget implementation?* | **2** | **–1** |
| *Do you share your financial information widely inside the organization?* | **2** | **–1** |
| *Do you have a banker with whom you meet regularly?* | **1** | **0** |
| *Do you have a line of credit?* | **2** | **0** |
| **Total of column score**<br>Add each column up and put the answer here | | |
| **TOTAL SCORE**<br>Add total scores from Yes and No columns and put the answer here | | |

**SCORING ANALYSIS:**

36 – 31 Excellent
30 – 23 Very Good
22 – 14 Adequate
Less than 14 You Need Help Now

## Form 10-2 Financial Status Self-Assessment Form

| Indicator | Instructions | Point Calculation | Score |
|---|---|---|---|
| 1. Did the organization have a positive net revenue<br>•Last month?<br>•Last fiscal year?<br>•The previous fiscal year? | Look at your income and expenses. If revenues exceeded expenses, you had a positive net revenue. | For profits<br>•Last month: 2 points<br>•Last year: 3 points<br>•Previous fiscal year: 2 points<br>BONUS—if all were yes, add 3 points | |
| 2. Liquidity (current ratio) | On your most recent balance sheet, take your current assets and divide them by your current liabilities. | •1.5 to 2.5 gets 3 pts<br>•1.0 to 1.49 gets 2 pts<br>•.75 to .99 gets 1 point<br>•over 2.5 gets 1 point<br>•under .75 gets no points | |
| 3. Debt to net worth | From your balance sheet add up all your debt. Divide this number by your net worth (total assets minus total liabilities). | •.1 to .24 gets 1 point<br>•.25 to .4 gets 3 points<br>•.41 to .8 gets 2 points<br>•.81 to 1.0 gets 1 point<br>•over 1.0 gets no points<br>•under .1 gets no points | |
| 4. Fixed asset component | Take your total net fixed assets (minus depreciation) and divide them by total assets. | •up to .5 gets 3 points<br>•.51 to .6 gets 2 points<br>•.61 to .75 gets 1 point<br>•over .76 gets no points | |
| 5. Receivables component | Divide your receivables by your total assets. Compare this to the past six months' balance sheets. | •For a percentage that has grown or shrunk more than 15%—0 points<br>•For a percentage that has stayed ± 15 points—2 points | |
| 6. Payables component | Divide your payables by your total liabilities. Compare to the last six months. | •For a percentage that has grown or shrunk more than 15%—0 points<br>•For a percentage that has stayed ± 15 points—2 points | |

**SCORING ANALYSIS:**

19 – 17 You Are in Good Initial Shape
16 – 14 Not Bad, but Can Use Some Work
13 – 10 You Can Get a Lot More Out of This Area
9 – 4 You Need Help Now

| Form 10-3 Management Status Self-Assessment Form | | | |
|---|---|---|---|
| **Indicator** | **Instructions** | **Point Calculation** | **Scoring** |
| 1. Reporting | Look at your financial reports. Examine who gets which reports. For example, does the senior management team get the same monthly income and expense report as the board? | •If everyone gets the same monthly report: 0 points<br>•If *all* staff see monthly figures: 3 points<br>•If monthly reports show actual, budget, and the difference for each line item: 3 points<br>•If staff see their division's own income and expense statement monthly: 2 points | |
| 2. Controls | Get out your financial policies. | •If your financial policies have been reviewed in the past 24 months: 2 points | |
| 3. Budgeting | Think through your budgeting process. | •If only the CEO does the budgeting: 3 points<br>•If senior managers develop their budgets: 1 point<br>•If the Finance Committee reviews the budget prior to the board seeing it: 2 points<br>•If all staff are involved in the budget development process: 4 points | |
| 4. Pricing | Think through your pricing process. | •If your prices are reviewed at least quarterly: 2 points<br>•If you have a fixed allocation for administration: 1 point | |
| 5. Monitoring | Go to your financial policies and reporting. | •If you calculate financial ratios each month: 2 points<br>•If you share those ratios with senior managers and the board finance committee: 1 point<br>•If you have benchmarks or goals for the ratios: 2 points | |
| 6. Checks and Balances | Go to your financial policies. | •If the board (or board representative) must approve taking on any debt, including borrowing on the line of credit: 2 points<br>•If you have a two-signature requirement for amounts greater than 1% of your budget: 2 points<br>•If you have a two signature requirement for checks less than 1% of your total budget: 1 point | |

## SCORING ANALYSIS:

31 – 25 You Are in Good Initial Shape;
24 – 20 Not Bad, but Can Use Some Work;
19 – 10 You Can Get a Lot More Out of This Area
9 – 2 You Need Help Now

## Form 10-11 Financial Reporting Questionnaire

| Questionnaire for Staff and Board | Financial Reporting |
|---|---|

This questionnaire is intended to help us get the right information to our staff and board. We realize that some people probably get too much information, and some not enough. Thus, we have listed a number of reports, and ask you to fill in what you would like to see, how often you would like to see them, and whether you want a detailed report, or a summary report. There is also space for you to ask for information that is not listed. Thanks for your input.

Please fill this out and return to ______________________ by ________ ______

Name: ____________________________________ Date: ____________ ______

| Report or Display | I do not need to see this | I need this report | Check how you would like the report | | | |
|---|---|---|---|---|---|---|
| | | | Summary | Detail | Monthly | Quarterly |
| Cash Flow Projection | | | | | | |
| Income and Expense—Overall | | | | | | |
| Income and Expense—by Area | | | | | | |
| Balance Sheet | | | | | | |
| Balance Sheet Ratios | | | | | | |
| Staff Turnover | | | | | | |

Other financial information I would like to see:

## D & O Coverage Forms: Cutting through the confusion

Unlike general liability insurance, where there is standardized policy language that is amended by specific endorsements, each insurance company writes its own specialized D&O policy. This can make determining what coverage is provided a very difficult process. This is often more complicated for nonprofits because many of the D&O forms are "cut and paste" versions that were initially designed for for-profit organizations.

There is a wide variety of policies available on the market today. Your insurance broker can help you evaluate which policy form is best for your organization. There are far too many variables to adequately evaluate the many differences FAQs of this nature. However, there are some important distinctions which make the coverage provided by some of these policies far superior to others. A few of the most desirable provisions of coverage for nonprofits include:

**Broad definition of insured**
With a broad definition, the named insured includes "any natural person who was, is or becomes a director, trustee, officer, employee, committee member, or volunteer" as well as the nonprofit organization itself. This is a major departure from for-profit policies which typically cover only the directors and officers.

To check if a nonprofit policy contains this broader coverage, look at the definition of insured. If the organization is not a named insured, and its only coverage from the policy is for reimbursement of monies paid to indemnify directors and officers for claims made against them, there are serious unaddressed exposures. Nonprofit managers should ask their insurance professionals to advise them of any potential gaps in coverage of this nature.

**Requirement to advance defense costs**
Unfortunately, deciphering the language which states the manner in which the insurer will pay for defense is often quite difficult. It might be reasonable to assume policy language stating that "the Company will pay on behalf of the Organization any Loss..." is a commitment to advancing defense costs. However, later in this policy, "Loss" is defined as "amount paid by the Insured or Organization." This reimbursement language is easily missed, but it can be disastrous to the nonprofit that is required to reach into its own funds to pay the bills.

Look for the language that requires the insurer to advance the costs of defense. Reimbursement language requires the nonprofit to pay all costs and attorney fees out-of-pocket and wait for repayment by the insurer. Since D&O cases are often expensive and lengthy, reimbursement policies can severely stretch a nonprofit's resources.

**Broad coverage for employment practices liability**
Employment practices liability coverage is not universally provided in nonprofit D&O policies. In those policies granting coverage, the language is not located in a consistent policy section. In some, it is within the "Exclusions," where employment contracts are exempt from the breach of contract exclusion. In others, coverage may be found in the body of the policy or in the endorsements.

In addition to contract causes of action, such as wrongful termination, nonprofit D&O policies also should address the exposures for employment-based discrimination and harassment. However, not all D&O policies cover these allegations. Those that do, accomplish this either by covering all employment-related suits or by listing specific exposures. If the policy includes a specific list, the reader must determine if all exposures are included. There should be coverage for cases arising under both state and federal laws; those specific to employment and those, such as the Americans with Disabilities Act (ADA), applicable in many contexts.

Of equal importance, and not so easily determined, is an insurer's interpretation of certain definitions. For example, if the insurer defines sexual harassment as sexual abuse, there may be no coverage under that D&O policy if it contains a sexual abuse exclusion. If there is a question on this matter, a nonprofit manager should ask his or her insurance broker to contact the D&O carrier to determine the insurer's interpretation of this, and similar terms and issues.

Most of the lawsuits against directors and officers will involve some form of employment practices liability. Insurers are becoming more keenly aware of this exposure and some have made subtle policy changes which restrict coverage in these areas. The nonprofit manager should request his or her insurance professional to make sure that all of the coverages listed in this section are included in a policy designed to cover the exposures which arise from corporate governance, and should check whether a separate deductible applies to employment-related allegations.

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## Management - Procedures for risk reduction

The primary functions of the American Heart Association's (AHA) internal risk reduction program are to deter, prevent, detect and investigate fraud and abuse that may be committed by staff, other agents and outside third parties. Walter D. Bristol, CPA, executive vice president and chief financial officer at AHA presented the nonprofit's program during an American Institute of Certified Public Accountants conference in San Francisco.

The AHA guidelines state that the benchmark of an effective program to prevent and detect violations of law is the exercising of "due diligence" in designing, implementing and monitoring an internal risk reduction program. The AHA requires "due diligence" to include the following steps:

- Establish compliance standards and operating procedures, to be followed by staff and other agents, that are capable of reducing the possibility of criminal conduct.
- Designate a risk reduction officer along with other individuals to oversee compliance with standards and operating procedures.
- Use "due care" to ensure management and other positions with discretionary authority are not filled by persons with a propensity toward crime.

- Standards and operating procedures must be effectively communicated to all staff and other agents via mandatory training and/or by disseminating publications.
- Monitor and auditing systems must be reasonably designed to achieve compliance with standards and detect criminal conduct by staff or other agents. Must provide a publicized reporting process whereby staff and other agents can report criminal conduct without fear of retribution.
- Standards and operating procedures must be consistently enforced through appropriate disciplinary mechanisms.
- Following the detection of an offense, the association must take all reasonable steps to respond to the offense and prevent similar offenses. This includes any necessary modifications that are needed to the existing program.

# APPENDIX A

## Where Can I Get More Information about the Law of Nonprofit Organizations?

**Free information from the IRS on tax laws affecting charities**
The IRS publishes numerous booklets that explain the tax laws affecting nonprofit organizations. You can order them from the IRS by calling (800) 829-3676 or consulting the IRS website at www.irs.ustreas.gov. Here are some of the IRS publications that may be useful to you:

- *Scholarships and Fellowships* (IRS Publication 520)
- *Charitable Contributions Deductions* (IRS Publication 526)
- *Tax-Exempt Status for Your Organization* (IRS Publication 557)
- *Determining the Value of Donated Property* (IRS Publication 561)
- *Tax on Unrelated Business Income of Exempt Organizations* (IRS Publication 598)
- *Deductibility of Payments Made to Charities Conducting Fundraising Events* (IRS Publication 1391)
- *Charitable Contributions: Substantiation and Disclosure Requirements* (IRS Publication 171)

**Where can I find more information on line?**
The IRS website, www.irs.ustreas.gov, has information on many issues affecting exempt organizations. In addition, your state Attorney General may have a website that focuses on your state's laws governing charities. The tax exemption applications and annual returns of most U.S. charitable organizations are available on the Internet at www.guidestar.org and may be downloaded without charge.

Publications of particular interest to grantmaking charities are available from the Council on Foundations by phone at (202) 466-6512 or on line at www.cof.org.
A searchable database of information on grantmakers is available on line at the Foundation Center's website, www.fdncenter.org. The Foundation Center has libraries in New York, San Francisco, and other cities; addresses are available on the website.

## APPENDIX B

What's the best kind of accounting software**?**

***Summary:*** *Fund accounting software is used by larger organizations and those with more complicated accounting situations. Some organizations can use software designed for households or small businesses.*

Fund accounting software programs are sophisticated software for nonprofits that use/need fund accounting methods. They maintain separate balance sheet data (assets, liabilities, fund balance) for each account. Unless you need this level of accounting, you may find a business software suitable i.e. Quicken or Quickbooks or OneWrite Plus. Some of the following fund accounting software packages have not heard about the meaning of "user friendly." (See *note* below. -Ed.)

Whatever package you choose, be alert to complying to the regulations being promulgated by the Financial Accounting Standards Board. Statements 116 and 117 (effective 1/1/95) alter how nonprofits should tabulate gifts and present their financial information in audited statements.

The following are some fund accounting software packages. No recommendations are made. (NPower NY has a page that discusses nonprofit accounting questions at http://www.npowerny.org/tools/accoutingfundraisingsoftware.htm.)

**FundWare** - 16 modules (General Ledger, Accounts Receivable, Payable, etc.) American Fundware (Denver, CO 800-551-4458 $695 - $2395 per module. Average cost $995 per. *Tim Mills-Groninger, Associate Executive Director/Program Director, Information Technology Resource Center [Mailto: itrc@igc.apc.org] added in February 1995*: American Fundware, based in Denver, publishes some of the most respected high-end fund accounting software in the country. Their target market is NPOs w/ budgets over $750,000 and municipalities. They run some very good users groups in the Chicago area, and are quite well regarded here. I suggest giving them a call to see if there are any user groups in your area.

**Blackbaud** (Charleston, SC 800-443-9441) http://www.blackbaud.com/ General Ledger 5.10, Payroll 5 plus others $2000 for single users.

**Fund-Plus** Cougar Mountain Software (Boise, ID 208-344-2540) General Ledger, a spreadsheet-based report writer, automatic tracking of encumbrances. $2000 single user, add $1000 for multi-user, add $150 for add on modules.

**Version 5.01** Echo Management Group (Center Conway, NH 800-635-8209) General ledger, accounts payable, quick receivables, financial report writing, budgeting. $4,500 single user, $6300 for multi-users.

**Fund Accounting Software Series**, Version 3.4 for small nonprofits and Version 5.3 for larger nonprofits Executive Data Systems, Inc. (Marietta, GA 800-272-3374) A Windows application. General Ledger, Donor Records, Accounts Payable, and Payroll. $425 for first 3 single user. Plus $425 for payroll.

**Fund E-Z** Fund E-Z Development Corp. (White Plains, NY 914-696-0900) General Ledger plus other modules. Will work on 286's with 20MB HD. $980 for General Ledger single user plus $500 for multi-users.

**Institutional Data Systems** (New Rochelle, NY 914-632-2332 or 800-322-4371). Version 3.6 General Ledger with Budgets, Accounts Receivable, Accounts Payable with Check Writing, Costs Allocations, 7 modules in all. $395 per module plus annual support.

**Fund Accounting** 4.0 Kenrick Technologies, Inc. (St. Louis, MO 800-659-2022) $1295 for general ledger single user, Network starts at $995, and add on modules are $595 or more.

**Micro Information Products** (MIP), NonProfit Series- Windows based fund accounting software- Pricing starts at $1,995-additional modules available. Advantage NonProfit Series- fund accounting for mid-to large-size organizations, utilizes Microsoft SQL Server 2000- Pricing starts at $5,790. (Austin, TX - 800-647-3863, info@mip.com). If you are a small nonprofit with relatively simple financial reporting needs, consider one of the small business packages as mentioned in the first paragraph. Unless you have an accountant or experienced bookkeeper using the packages listed here, you will most likely find them daunting. Recommend you ask others in your local area what software they are using. Then you will have someone to talk with when you have questions.

*NOTE (11/9/00): There are many websites with more active discussions of accounting issues. One worth exploring is http://www.computercpa.com/. Its accounting software vendors page (http://www.computercpa.com/asw.html) includes more sources than are listed here.*
*This note was posted to NONPROFIT (http://www.rain.org/mailman/listinfo/nonprofit) on 10/15/02:*
"Several months ago, I was evaluating accounting solutions and found that this was going to be another expensive software investment. However, I found out about a solution called 'Nonprofitbooks' that works with Quickbooks. We decided to go with it since the cost was less than $1000. Looking back, we are glad we chose Nonprofitbooks. We ended up saving thousands of dollars for a system that can handle all our requirements." (See http://www.nonprofitbooks.com/ -Ed.) There is also a book that walks you through using QuickBooks for keeping accounts for a nonprofit organization. It's available through CompassPoint in San Francisco. See
http://www4.compasspoint.org/p.asp?WebPage_ID=380