

Financial Responsibilities of the Board

Governance and fiscal oversight is an essential role of the Board.

Specific Fiduciary Activities:

- Set policy
- Oversight and monitoring
- Measuring Progress
- Risk Management
- Approve the budget
- Monitor and enforce the auditing process
- Drive the organization's growth
- Legal compliance

Nonprofit Financial Statements

Nonprofits are not owned by shareholders nor do they intend to earn profit to distribute back to shareholders. Instead, nonprofits seek to earn revenue to support their program activities which are related to their mission. The mission is the key driver for nonprofits, not a return of profit to its shareholders. Financial statements are key components in revealing the financial health of an organization whether nonprofit or for-profit.

Statement of Financial Position

The nonprofit balance sheet is also commonly referred to as a statement of financial position or statement of financial condition. This statement is based on the accounting formula, assets equal liabilities plus net assets. The balance sheet offers the best overall perspective on the nonprofit's financial health and stability. In particular, readers evaluate the relationship of assets to liabilities.

Statement of Activities

Often referred to as the income statement since the term is more commonly associated with for-profit companies and earnings, the nonprofit statement of activities follows the basic formula: revenues less expenses equals the change in net assets. The nonprofit statement of activities shows the funds coming into the organization less the costs of operating the organization.

Statement of Functional Expenses

The statement of functional expenses is only used by nonprofit organizations based on the importance of monitoring expenditures. In general, this statement breaks down organizational expenses into common categories. This breakdown helps a nonprofit track how it spends its money.

Statement of Cash Flows

The statement of cash flows presents operating, investing and financing activities to show the sources and uses of cash.

Nonprofit Budgeting

What is nonprofit budgeting?

- The process of building a budget is fundamentally a planning process.
- A budget is a financial document that provides an overview of how an organization is planning to spend its money.
- It is essentially the financial reflection of what a nonprofit business expects to accomplish over a 12-month period (annual budget).

Operating Budget vs. Capital Budget

The operating (broad scope) budget reflects the organization's planned financial activities for the year ahead, showing how much revenue it expects from which sources and how much it will spend on operations. It's a key tool in effectively and efficiently achieving the organization's stated purpose, and should always align with an organization's strategic plan. The operating budget must be centered around the primary goals and objectives of the organization.

The capital budget may include projects which will have ongoing effects on operations. (Virginia Society of Certified Public Accountants) The capital budget can also be used for construction and other big, one-time spending projects that often take more than a fiscal year to pay for.

The Board's Role

- Establishing general budget policies
- Formally reviewing and approving the budget
- Regularly reviewing financial and narrative reports on budget implementation and planning for any needed corrective action.

Six Steps to Improve Board Financial Oversight from BoardSource

Through effective financial oversight, the board assures the public-at-large that all resources and benefits received are used to support the nonprofit's mission.

- 1. Recruit Financial Expertise.** A board that lacks financial expertise is financially illiterate. Every board must have at least one superstar member who, at a minimum, knows how to read financials, develop and monitor budgets, and manage cash flow.
- 2. Active Finance Committee.** This committee should do most of the heavy lifting in terms of budget development, creating financial policies, and day-to-day financial monitoring and oversight. The committee must alert the entire board to financial issues, provide objective financial reporting at each meeting, and ensure that financial information provided is transparent and accessible.
- 3. Financial Policies.** Another important oversight tool is a financial policies document. These policies are developed jointly by staff and the finance committee. However, they are approved by the entire board.
- 4. Audit.** Whether to audit or not to audit...that is the question! For many smaller organizations, the cost of obtaining an audit may far outweigh the benefits. However, before foregoing audits altogether, it's important to remember that some funders (especially government) require audits. The auditor must be vetted and hired by the board.
- 5. Financial Statements.** Usually a review of financial statements is part of every board meeting. The following financial information, at a minimum, must be included in the board packet: Statement of Financial Position (aka Balance Sheet) Statement of Activities (aka Income Statement) Cash Flow Projection Current annual budget (usually presented with Statement of Activities)
- 6. Board Financial Training.** Most likely not all board members will feel comfortable or competent interpreting financial statements or conducting a budget review. Thus it's important that financial literacy training be provided to members in regular doses

Indicators of Financial Health

Adequate Operating Reserves

Operating reserves are calculated from the Statement of Financial Position (balance sheet) as follows: unrestricted, undesignated net assets less net fixed assets (property & equipment net of depreciation and net of any borrowing secured by fixed assets).

Regular review of budget to actual expenses and revenue

The budget is a board-approved planning tool to guide the organization on where/how to spend to achieve the organization's mission. Regular review, at a minimum every quarter, of expenses compared to the budget allows leaders to either course correct and adjust spending.

Maintaining a surplus

Covering operating expenses and contributing to reserves is a sign of a healthy organization. While deficit spending may at times be necessary, especially for planned major expenses, care should be taken to finance the spending through borrowing funds, tapping into operating reserves, or reliance on special funding to cover the deficit.

Timely Financial Reports

While there is always some delay between financial reports and their availability to leadership due to internal processes, care must be taken to limit the delay. At a high-level, the organization's leadership must have regular understanding of where the organization is on both revenue and expenses.

Expense Recovery

Understanding your organization's full costs is essential to proper pricing.

Internal Controls

separation of duties, adherence to organizational policies and procedures, etc., can sound rather dull. However, internal controls are key towards any risk management process by providing reasonable assurances that financial reports are reliable and applicable laws/regulations are followed.

Let's hear from an expert **Tim Schupick**

