

“All board members should be informed and asking questions about their organization’s finances. The importance of this can not be overstated.” Matt Regin, ANCA Auditor

A FIELD GUIDE TO NONPROFIT FINANCES: Part 1: A Look at the Balance Sheet

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Nonprofit organizations provide services not available from for-profit or government sectors. People affiliate with nonprofits because they embrace the organization’s mission. Often board members are motivated but unfamiliar with the quirks of nonprofit finance. One of the most important questions every board member should know the answer to is: “Do we have enough money to meet our upcoming financial obligations?”

Understanding the basics of a Statement of Financial Position (sometimes called a Balance Sheet) helps all board members feel more comfortable answering this question.

THE LEGS OF NONPROFIT FUNDING

Successful nonprofits have these distinctly different pools of money reflected on their balance sheet:

OPERATING FUND: This covers such day to day operating costs as staff compensation, insurance, rent and supplies. Income typically is generated by memberships, unrestricted contributions, endowment distributions, grants and sales. Both income and expenses are encompassed in the annual budget, which is really just a guide to monitor finances. Once the board approves the annual budget the executive director is responsible for managing it with board oversight. **In general the more diverse the organization’s income stream is the more financially stable it will be.**

You can tell if your organization has enough money to meet its obligations by tracking its current assets and current liabilities on the balance sheet. Simply put, the current assets (what you have) should substantially exceed the current liabilities (what you owe). If not, board members should be asking questions.

All organizations have fluctuations in cash flow throughout the year. While there is no magic formula for how much cash reserves an organization should have, generally having (between) three (and six) month’s cash reserves is a good idea.

RESTRICTED FUND: This is often a hard concept for people coming from the for profit sector to understand. From time to time money is received from grants or contributions earmarked by the donor for a specific use outside normal operating costs. Sometimes restricted (income) assets appear (s) on the financial statement in one lump but (is) are spent over a longer period. This makes the statement appear more robust than it truly is.

There are two common traps created by restricted (income) assets. First, a cash strapped organization uses it for something other than what the donor intended. This is unethical. Second, sometimes cash strapped organizations go for restricted donations or grants simply because they **can** get the money. If the income does not fit the organization's purpose it creates "mission creep" and the tail begins wagging the dog.

RESERVE FUND: A reserve fund is unrestricted money that can be used for any purpose. It is the rainy day fund. Healthy organizations maintain a cash reserve to meet needs unanticipated in the budget, such as the failure of a septic system. Normally board approval is needed to spend from this fund.

ENDOWMENT: An endowment is neither a contingency nor a reserve fund. Its sole purpose is to provide an annual distribution that normally derives from investment growth. A well-managed endowment will grow over time to provide increasing distributions each year. Generally endowed assets do not appear on monthly financial statements and the management of assets and distribution of funds is best assigned to a group separate from the board of directors. Staff and board members should have no ability to access endowed funds, which have the sole purpose of generating an annual distribution. Sometimes endowed funds bear the name of the donating person, group or family.

There are generally two types of endowed funds.

- Unrestricted endowed funds produce an annual cash distribution that goes into the operating fund and can be used for any purpose.
- Restricted endowed funds produce an annual distribution to be used only as the donor specified and the organization approved. These often support scholarships. Using the distribution for other purposes violates donor intent.

Part II: The Basics of Keeping an Eye on the Finances

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Things to Watch on the Monthly Financial

Board members are often personally interested in what the organization does rather than financial fine print, yet financial health is vital and the board is responsible for it. All board members should receive regular reports that include both statement of financial

position (sometimes called a balance sheet) and a statement of financial activities (sometimes called a profit and loss). It is helpful to report the statement of financial activities as a comparison to budget. A separate and helpful report shows the statement of financial activities as a comparison to the previous fiscal year. Both of these comparison reports can help board members determine whether variations are predictable or exceptions they should be concerned about. Board members should read the monthly financial statement and ask questions if anything is unclear or seems unusual. Some specific items to pay particular attention to include:

Balance Sheet / Statement of Financial Position:

Is the reserve fund growing/shrinking? Is it adequate?

Be aware that land, building and equipment assets are fixed. They do not appreciate on the statement over time. In other words the balance sheet shows the historic value of (the land, not its) these assets not their current value. On the balance sheet (it) these assets may look (s) (like cash) impressive but they are (it is) not cash and cannot be spent.

Profit and Loss /Statement of Financial Activities:

Do expenses/incomes generally fall within budget guidelines?

Do these follow figures of previous years?

Are there unexplained anomalies? Very high/low incomes or expenses?

What is the reason for significant variances between the budget and actual figures?

Trends are important. A multi month deficit trend is concerning.

Generally the *Year to Date* portion of the statement is more useful than the report of the most recent month.

Never hesitate to question the treasurer about finances. Make sure the treasurer and/or director clearly and adequately answers them. If deficits are growing it is important to identify and deal with them early before they become insurmountable. Remember, board members have fiduciary responsibility for the organization, so shortfalls and chronic deficits are your responsibility to address.

Other Items Boards Should Watch

Audits should be conducted annually by an outside auditor. Having an annual audit serves to reassure potential donors, and it also is an opportunity to get expert feedback on the organization's practices. Often, an auditor is receptive to answering questions that come up throughout the year. This can help streamline the audit process and can be a win-win scenario, saving both the auditor and the organization time in the long run.

Internal Controls: Board members should be certain that procedures are in place to reduce theft. Having a good relationship with your auditor is important. They can make appropriate recommendations for "internal controls", which are procedures that make fraudulent practices easier to root out. For small organizations with limited staff, having a board Treasurer receive the unopened bank statements and reconcile them would be an example of an internal control. By segregating duties so that, for example, the person

that opens the mail and receives payments and invoices is not the same person that does the book keeping; fraudulent practices are harder to conceal.

Risk Management: Board members (They) should make sure that insurance is adequate, that reserve funds are high enough to meet unexpected needs and that the investment manager (Board of Trustees) is prudently investing endowed funds. A good auditor will identify areas of concern, such as concentration of investment risks, which (that) a board should address.

Budgeting: Board members are not spectators in the budgeting process. While an Executive Director usually works closely with the Finance Committee to draft a budget, full board input on the draft budget is very valuable. Here are some things to look for:

Are income and expense projections realistic based on past performance?

Does the Development Committee have a sound plan to raise the contributed income goals?

Are staff salary and benefits in line with industry standards?

Think of your budget as your organization's fiscal road map for the next year. If you have a nagging feeling that proposed targets are unrealistic, it is your job as a board member to speak up.

Whether you serve on a board or work with a board at your nature center, the organization will benefit in the long run from having a board more informed and engaged in the fiscal health and well being of your center.