FINANCIAL MANAGEMENT

Best Practices in Nonprofit Financial Management

- The Board has ultimate responsibility for ensuring that an organization’s funds are properly utilized.
- The Board should establish clear policies and procedures to protect an organization’s financial assets and ensure that the organization is following best practices.
- Board is responsible for ensuring that the organization has sufficient funds to carry out its mission.

Board of Directors – Financial Controls

- Board should:
  - Ensure that there is a financial control environment.
  - Develop, implement, and monitor proper policies and procedures.
  - Ensure compliance with applicable laws and regulations.
  - Make sure that the organization is using its resources for its purposes and specific missions (does not engage in unauthorized activities).
  - Set the tone from the top.

Examples of Fiscal Policies and Procedures

- The Board should develop:
  - Conflict of Interest Policy and a procedure for enforcing policy.
  - Whistleblower policy.
  - Procedure for determining compensation and benefits.
  - Document retention and destruction policy.

The Fraud Triangle

- There are several factors that can cause an employee or volunteer to commit fraud. The Board's duty is to protect against these factors:
  - *Incentive / Pressure* – i.e. - pressure to meet the board expectations or personal pressure such as individual credit card debt.
  - *Opportunity* – Poor internal controls leave opportunity for fraud.
  - *Attitude / Rationalization* – Board and management's attitude from the top (disregard for need to monitor controls or reduce risk of misappropriation of assets).

Internal Controls

- Internal Controls –process that is designed to prevent fraud and promote reasonable assurance that the following objectives are met:
  - Effectiveness and efficiency of operations.
  - Reliability of financial reporting.
  - Compliance with applicable laws and regulations.
- In other words, it is the responsibility of the Board and management to establish effective internal controls that ensure that someone is not using his or her position to defraud the organization.

Segregation of Duties

- One important facet of a strong internal controls is segregation of duties.
- Organization should divide the responsibilities among different individuals within the organization so one individual does not control all aspects of a financial transaction.
- Types of Functions:
  - Authorization of payments.
  - Custody of funds.
  - Record keeping of revenue and expenses.
  - Reconciliation of financial records, such as bank statements.

Segregation of Duties

- Segregation of Duties for cash receipts and cash disbursements
  - Avoid an employee who has control over all aspects of the check disbursement process.
  - Bank reconciliation should be completed by an individual who does not do the bookkeeping. Bank reconciliations should also be reviewed.
  - Payroll – same individual should not be responsible for hiring personnel and placing them into payroll system.

Control Oversight

- Bank Statement Review – Open and review of monthly bank statements. Must be done within time specified by the bank (typically 60 days) or the Bank is not liable for errors, including forged checks and similar malfeasance.
- Two signatures should be required for disbursements over specified amount – typically $250 or $500 (never have a signer sign blank checks or use a signature stamp.)
- Cash Disbursements – must have the same controls over wire disbursements and electronic transfers as with checks.
- Checks received should be deposited promptly and a receipt log maintained.
- Make sure that people take vacations – make it mandatory so that someone else takes over from time to time.

Internal Control Limitations

- Common limitations that impact the ability to maintain internal controls:
  - Limited staff to perform several tasks.
  - Software limitations.
  - Human judgment.
  - Control breakdowns – people fail to follow controls because of time, resources, and the failure is tolerated.
  - Management override – common source of control breakdown – “Its ok if a Board member does it.”
  - Collusion between two individuals and no other oversight.
  - Conflict of Interest –when two related parties, such as a husband and wife, are the signatures on an account.

Tips on Implementing Internal Controls with Limited Resources

- Utilize non-accounting staff and volunteers to perform certain duties.
- Utilize Executive Director to perform certain review or reconciliation processes.
- Utilize the expertise of the Board to perform review of certain financial information.

Additional Board Responsibilities

- Board approves annual budget. After approval, Board should ensure:
  - Organization has an accounting system that regularly tracks revenue and expenses.
  - Expenditures are made in accordance with budget.
  - Material variations are approved by Board.
- Board should receive monthly reports of revenue and expenses as compared to approved budget.
  - For very small organizations, quarterly may be sufficient.
  - The report should show:
    - donor restricted funds separately from unrestricted funds.
    - material variations in revenue and expenses from budget and explain the reason.

Additional Board Responsibilities

- Board is responsible for making adjustments to budget depending on interim financial results.
- Board is responsible for ensuring that organization maintains adequate reserves.
- Board ensures that expenses are reimbursed in accordance with expense reimbursement policy and only with proper receipts. (IRS requirement – otherwise reimbursement is treated as taxable income.)
- Board ensures that proper receipting of contributions occurs.

Independent Audit

- Organization must decide when to have its financial statements reviewed or audited by an independent auditor.
  - Review is a less rigorous process; is less expensive but does not provide the level of assurance.
  - The IRS does not require an independent audit, but audit may be required by funders – especially if organization receives government grants.
  - In many states, charitable solicitation statutes require organizations with annual contributions over dollar amount (could be as low as $100,000) must have a financial review performed by an independent CPA. Other states require an independent audit.

Role of the Board of Directors Regarding Independent Audit

- It is important for Board to take the lead with audit. Board should include members that are competent and financially literate in nonprofit accounting.
- Board is responsible for selecting the auditor and overseeing the audit process (These tasks may be delegated to an audit or finance committee, but should not be delegated to employees.)
- There should also be regular communication between Auditor and the Board.
- After conclusion of audit, Board should meet with auditor.