**Lesson 1 Notes**

The Executive Director (ED) of nonprofits and board members must have the information they need to make sound decisions for their organizations. They are assisted in that quest by two important groups. The Financial Standards and Accounting Board, known by its acronym, FASB (pronounced “Fazz – B”), and by the American Institute of Certified Public Accountants (AICPA). The accounting profession continues to use the term “not-for-profit” for nonprofit organizations. Most state law now uses “nonprofit,” as does the academic community, and the Oxford English Dictionary. Therefore, throughout this material, the term “nonprofit” is used.

FASB, a nonprofit organization, publishes what are known as Generally Accepted Accounting Principles (GAAP). These are the primary guidelines for accounting practices that specify common and standardized formats that allow information to be consistent across the wide range of different business enterprises, whether it is General Motors or your neighborhood health food store.

Nonprofit organizations are private organizations but are different in substantive ways from for-profit businesses. The publisher, John Wiley and Sons, specialists in nonprofit publications, annually issues Not-For-Profit GAAP, which describes those accounting principles unique to nonprofit organizations and any changes approved by FASB during the previous year.

The American Institute of Certified Public Accountants (AICPA) adds to the standardization by periodically issuing opinions on how to treat accounting situations. For example, a recent Technical Practice Aid provides instruction on how to account for nonprofit organizations’ fund raising expenses. The website, <http://www.aicpa.org/download/acctstd/TIS6100_21_22.pdf> contains Technical Practice Aid (TPA) Section 6140, Not-for-Profit Organizations Fund Raising Expenses.

The US Government is also involved in regulating the reporting of financial information related to nonprofit activities. This is done through the Internal Revenue Code and the requirements for annual reporting through the IRS Form 990. The IRS revised the Form 990 in 2009 and it now requires more information than in previous years. There are four different versions of the Form 990 (990N, 990PF, 990 EZ, and the regular 990) depending on the size and purpose of the nonprofit.

The IRS is not the only federal agency to exercise influence over the nonprofit sector. One recent and important example was the American Competitiveness and Corporate Accountability Act of 2002 (Sarbanes-Oxley Act) passed in response to for-profit corporate scandals in companies such as Enron and WorldCom. The purpose of the legislation was to rebuild public trust in the corporate sector and ensure that investors and employees of corporations were not hurt by fraudulent activity by corporate decision makers. Although most of the provisions of the Sarbanes-Oxley Act (commonly referred to as SOX) apply only to publicly traded corporations, two provisions apply to all entities including nonprofit organizations:

1.   Provisions prohibiting retaliation against whistleblowers

2.   Provisions prohibiting the destruction, alteration and concealment of certain documents or the impediment of investigations.

Individual nonprofit organizations wishing to explore the provisions of the Sarbanes-Oxley Act in more detail can refer to a paper published by BoardSource ([www.boardsource.org](http://www.boardsource.org/)). This paper summarizes the main provisions of Sarbanes-Oxley, explains each provision's relevance to nonprofit organizations, and lists recommended actions.

More recently, the IRS has begun to publish materials focused on the governance of nonprofit organizations. Although this has sparked considerable controversy because many believe this exceeds the authority of the IRS by a huge margin, the IRS defends their position by claiming that good governance of nonprofits leads to better compliance with IRS regulations. That is worth thinking about.

The point is that nonprofit organizations are becoming increasingly regulated, primarily because people have taken advantage of opportunities they had to misuse the resources of the nonprofit. One way the nonprofit can defend it, is to manage its finances carefully and ensure that the full board understands the financial condition of the organization and can effectively monitor it to protect against future threats.

We begin this course with the understanding that nonprofit organizations, although private enterprises, do provide public goods and are funded by donated or public money, and are given tax-exempt status by the government. Consequently, these factors bring responsibilities and with those responsibilities people, advocacy groups, and the media will likely be looking over our collective shoulders. This, in turn, means we must be good stewards of other people’s money and operate in the public’s interest. The primary way we can demonstrate that conscientious behavior is to manage our finances responsibly.

**Lesson 2 notes**

**Analysis**

Graduate work in any field prepares the student through the familiarization with a body of knowledge, to be able to apply that knowledge to practical applications. The historian is able to place artifacts in the context of human development with an interpretive panel in a museum exhibition. The social worker is able to use counseling skills and techniques to modify destructive behaviors of clients. The clinic supervisor uses management skills to maximize the number of patients seen at the neighborhood free clinic within the constraints of the budget and human resources under her control.

The nonprofit manager does the same thing, using the knowledge of financial management to ensure an accurate picture of the financial condition of the organization is communicated to the board of directors, so they can make wise decisions. Timely and accurate financial reports ensure the organization can monitor its financial stability and enhance its public reputation.

This section in week two of the course looks at the tools we use to capture information we need, and present it in a manner that is useful and informative. First, we begin by learning how we organize the financial information we gather. This is done through the Chart of Accounts.

**The Chart of Accounts**

The chart of accounts is the list of different accounts used to record the financial transactions of the organization. The chart of accounts allows for an organization to keep an accurate record of its business transactions by organizing information according to the work done by the organization. A good chart of accounts will ensure that both management and the board of directors have the information needed for strategic and operational decisions.

The chart of accounts is normally divided into sections and arranged according to the type of transaction. There normally are five major sections in the chart of accounts. The information from the chart of accounts can be used to create the financial statements that allow us to see the financial information from different perspectives and to make comparisons of information over time to spot changes in financial condition and trends that suggest future conditions. The five general categories are:

         Assets

         Liabilities

         Net Assets

         Revenues

         Expenses.

**Accounting Methods**

There are two methods of accounting: cash and accrual. The difference has to do with when transactions are recorded. For example, under the cash accounting method, transactions are recorded when cash is exchanged. When income is actually received it is recorded. Similarly when bills are paid, only then are expenses recorded.

Under the accrual accounting, transactions are recorded as they occur. For example, income is recorded when it is earned, not when it is received. So, if a patient has a diagnostic test done, the fee for that test is recorded as income even thought the insurance company may not actually send a check to the health center for two months. Similarly, expenses are recognized when they are incurred. So, when the health center orders a supply of hypodermic needles, the expense is incurred even though the invoice may not come for a month and the bill may not be paid for two months.

The accrual method is generally considered more appropriate, because when it is used, financial statements accurately reflect all of the organization’s assets and liabilities. There is no confusion around the timing of bill paying or the obligations that are outstanding against an organization’s assets. Accrual accounting gives a more precise representation of the relationship between revenues and expenses and assets and liabilities.

**Fund Accounting**

Fund accounting is used by government and nonprofit organizations. Funds are separate accounts that enable the organization to keep track of money and to keep accurate records of money designated for specified purposes. For example, if the local community foundation provided money for pre-school physical exams for children entering Kindergarten, that money would need to be kept separate from the general operating money for the health center. So, a restricted fund would be established for the grant from the community foundation so that money could be easily tracked, controlled, and reported on as needed. Funds can be permanently restricted, temporarily restricted, or unrestricted.

Fund accounting is often not a familiar concept for those who have only worked in the for-profit sector and sometimes those unfamiliar with fund accounting have difficulty understanding financial statements that appear overly complicated if many different funds are established. We sometimes hear the phrase “color of money” used in this context. The meaning of that term is that not all money is the same. Some is restricted, some not; some permanently restricted, and some only temporarily restricted. In other words, different colors of money. This can be a useful way of communicating to board members who are not familiar with fund accounting.

**Restricted Funds**

Restricted funds are financial resources that can be used only for predefined purposes. Their use is defined in contracts between the donor or contractor and your organization. In the case of government funding, contracts may incorporate statutes and regulations that govern the use of funds. There are several typical sources of restricted funds:

         Government contracts

         Foundation grants

         Loans

         Endowments

         Restricted gifts for specific purposes

Examples of restrictions are:

         Using funds for a specific program such as flu shots for the elderly.

         Using income from a specific invested fund to benefit a certain demographic segment of the population; e.g., pre-school children, residents of a certain neighborhood, or those whose household income is below a certain level.

**Basic Financial Statements**

Most nonprofit organizations produce four types of financial statements in addition to using an annual budget to monitor the organization’s financial health.

         Statement of Financial Position (or Balance Sheet)

         Statement of Activities (or the Income Statement)

         Statement of Changes in Financial Position

         Cash Flow Statement

         Budget

These financial statements are verified and, when necessary, corrected by performing an audit. Audits are preferably done annually by a Certified Public Accountant (CPA) with no direct interest in the organization. The audit provides an accurate picture of the financial health of the organization. External funders usually require nonprofits to provide these financial statements to ensure the financial viability of the organization. It is increasingly common for nonprofit boards to have an audit committee to ensure reliability of the audit as well as to manage the risk to the organization.

The nonprofit’s board of directors is legally responsible for overseeing that the organization’s financial records are maintained appropriately and clearly state what has happened during a given period of time. Although the board will rely on the Executive Director and the staff of the health center to prepare, maintain, and report on the financial activity of the organization, it is ultimately the board’s responsibility to ensure the information is accurate and complete. This is an obligation of the board that falls under the legal term, Duty of Care. Exercising the Duty of Care requires all board members to be familiar with the financial condition of the organization, to ask appropriate questions of management, and to take prudent steps to ensure the financial well-being of the organization is maintained.

Board members therefore rely primarily on financial statements to execute their oversight responsibilities. Well prepared financial statement should have following characteristics:

         Comprehensible

         Concise

         Comparative

         Complete

         Current

The readings for this week will help you understand how these different financial reports can be analyzed to bring clarity and understanding to even the most complicated nonprofit organizations.

**Lesson 3 Notes**

**Tracking Financial Activity**

The content of this week’s learning is essentially the field of accounting. This course is not intended to make you an accountant. However, it is important for any manager to understand basic concepts of accounting. Accounting is defined as, “….a systematic process of measuring and reporting to various users relevant financial information for decision making regarding the economic activity of an organization or unit.” (Salmonson, Hermanson, & Edwards, 1977).

Trying for a little less formality and adapting the definition to a nonprofit corporation, we might say that accounting is a significant tool of both the nonprofit executive and the board to record the economic activities of the organization for the purpose of controlling its resources, planning for the future, and maximizing the organization’s impact on its charitable mission.

For this course, we have the dual obligation to consider the use of accounting on two different levels. First, it is used to help us further the mission of the organization. Just as we employ human resource management, marketing, or program management techniques, we also use accounting practices to help us fulfill our mission. Second, accounting is used in a much less grand way, to simply gather information that can be structured into various forms that will reveal critical information about what is being done by the organization.

The assigned reading in the McLaughlin book for this week provides an interesting discussion about the changes in the requirements for nonprofit organizations. We have long struggled with tracking the funds received which were specified for specific purposes. We are obligated to honor such requests and, in order to show that we had actually done what we said we were going to do; we had to be able to produce accurate reports that proved our claims. Consequently, a nonprofit organization easily could have 20 or 30 different accounts that had to be tracked individually. Add the fact that sometimes one person would split time between several different projects, and the single payroll amount would have to be allocated as an expense between multiple accounts. Nonprofits, usually with fewer financial resources and staffed with people who are not drawn to accounting careers, are saddled with much more complex accounting challenges than many larger for-profit businesses.

The point of this week’s topic is to introduce you to the various ways in which nonprofits account for their economic activity and to make certain you are aware of the government regulations, and the self-regulating obligations of the accounting profession, that affect the nonprofit organization’s attempts to keep track of its money.

**Lesson 4 Notes**

**Financial Operations**
Nonprofit organizations have remarkable flexibility. Remember these are private self-governing enterprises. Although they provide public benefits, they are unlike cumbersome government bureaucracies. Nonprofits can be very responsive, if the leadership of the organization creates such a culture.

For managing the nonprofit’s finances, this flexibility is a valuable characteristic. McLaughlin, in the assigned readings for this week, lays out several general areas including Cash Flow, Pricing, Debt Financing, and Indirect Costs, which can influence the nonprofit’s financial condition.  Nonprofit managers should understand these options for effectively managing their organizations.

An example of how that may work comes from a private nonprofit fine arts college. One of the many difficulties in managing that organization was the cash flow problem. Tuition revenue came in August and September for fall semester, December and January for spring semester and then a small amount came in June when children’s summer classes started. This placed the school in jeopardy during several months during the year, especially July and early August. The objective was to even out the flow of cash. That objective was met when the management offered parents a monthly payment plan that ensured revenue was received more evenly throughout the year. This also slightly increased the total revenue because it was possible to charge a modest fee for the extended payment plan (a Pricing option). Placing that cash flow adjustment in perspective, it established a less anxious environment because income became more regular and predictable. That was a positive result of the change but the adjustment did not change the expense side of the equation. That had to be dealt with through other actions such as eliminating staff positions and deferring maintenance.

The point is that reliable financial information makes it possible to understand the financial condition of the organization. Reliable and current financial information enables the ED and the board to test various hypotheses on the impacts different decisions will have on the organization.  For example, if we add another program assistant to relieve stress on the staff, will that position generate more fee revenue than the cost of the position? Or, how much does it cost to offer one unit of service and does our current pricing structure generate a net surplus per unit? If each child in the afterschool program costs the nonprofit $29.00 per month, is it appropriate to charge parents $25.00 per month to consume that service?

We can think of Financial Operations as being the management steps we take to collect information, analyze it, and act upon it in fulfillment of the organization’s mission. When we think about financial operations we can ask ourselves; is our accounting system recording and reporting the information we need in the format we must have to adequately analyze it?  Once we gather the data, are we investing the time and energy into fully understanding the information? Are we looking for adjustments to our operations that are consistent with the nonprofit’s mission? Are we able to prove that our mission was implemented?

**Lesson 5 Notes**

**Financial Control Measures**

Control is a big issue. We look to the board of directors to exercise their legal Duty of Care as the highest level of control within the organization. The Duty of Care requires board members, and that is all board members not just members of the finance committee, to read and understand the financial statements of the organization. This responsibility cannot be delegated.  Each board member must be actively involved in the monitoring of the financial condition of the organization, including the processes used to track the flow of financial activity and the steps taken to ensure accuracy of the financial statements. It is recommended that two of the four standing committees of nonprofit organization boards of directors be the finance committee and the audit committee. Both are actively involved in providing oversight.

The policies enacted by the board, always flowing from the mission, also play an important role in making sure there is control over the financial resources of the nonprofit. The board member who takes on the treasurer position should also be knowledgeable about financial matters. If the board does not have someone experienced in this area, then the board development committee needs to add that to their list of “needs” and begin actively recruiting for someone to bring that expertise to the organization.

When we think of control we often skip over the board’s role and concentrate on the management side of the organization, especially the person who is conducting the work of the chief financial officer. This is another key individual within the organization and this is usually where we find transgressions in the category of fraud. The chief financial officer, CFO, is the person who is most directly involved in handling the money for the organization and is the most involved in reporting those activities to the Executive Director and the board finance committee.

The first line of defense for an organization is to pay close attention when hiring the person to fill that finance position. Doing a thorough background check, speaking with former employers, checking credentials for validity and conducting a formal interview with several interviewers is critical.

One of the best policies a board can enact regarding the CFO position is to require the CFO to take a two-week vacation during the year so they are completely absent from the office for two full weeks in one stretch. This gets the person out of the office, enables someone else to handle the mail and take over the CFO’s job, and can uncover irregular activities easily hidden by a CFO who presents him or herself as a tireless worker who never takes time off. If the organization is large enough to have several people in the finance office, this two-week off policy should apply to everyone.

Abuse of nonprofits does occur and none are exempt from attempts at fraud. Small organizations with small staffs and boards that don’t understand their responsibilities are the most vulnerable.

The assigned readings, forum questions, and assignments for this week will help you understand other specific means in common usage that help us control the financial health of the organization.

**Lesson 6 Notes**

**Financial Leadership**

In the previous week, you investigated the rationale for financial management and specific tasks used to control the resources of the organization. This week we turn to the topic of financial leadership. Financial leadership is another way to describe the total package of organizational financial health.

Here is another area in which the nature of nonprofit organizations creates a reality different from the for-profit world. Because nonprofits operate with little contingency money and those charged with the fiduciary responsibility for an organization are volunteers, we have to recognize the importance of financial health, if we are going to be successful. Since the volunteer board has the functional responsibility for resourcing the organization and ensuring its financial health, the board members must oversee the financial condition of the organization and protect its assets. However, the board, being a volunteer component of the organization, must rely on the executive director in order for that oversight to be effective. Consequently, the board relies to a large degree on the leadership of their agent, the Executive Director (ED), to guide them in the process and provide them with the information they need to make the right decisions.

It is obvious that the leadership needed is actually a shared leadership between the ED and the board. The board relies on the ED for information and assistance and at the same time the board must exercise leadership in its oversight (Duty of Care) role to ensure the ED is providing complete, accurate, and timely information.

In your assigned reading this week, *Financial Leadership for Nonprofit Executives; Guiding Your Organization to Long-term Success,* Jeanne Bell and Elizabeth Schaffer write about the struggle of nonprofit organizations to maintain the balance between mission and money. Their argument identifies the central problem in this course and that is, managing the organization to be financially healthy while pursuing the nonprofit’s mission. Another way to look at this is through the lens of revenues and expenses, where expenses are directly related to the pursuit of mission, and revenue is about fundraising and income development that takes money and attention away from serving clients and operating programs. The two authors’ approach to financial leadership is centered on five principles:

* Move beyond mission-versus-money thinking.
* Cultivate financial leadership on both staff and board.
* View the nonprofit business as an interdependent set of programs  and activities.
* Recognize the relationship between strong infrastructure and strong programs.
* Set a tone of financial accountability and transparency.

Complete the assigned reading to gain a solid grasp on these ideas.  Achieving the balance between mission and money will contribute greatly to the stability and success of your nonprofit. But remember, this is not something done alone. This approach to financial management for the nonprofit, like so much else in nonprofit organizations, is a team effort and the board will be a vital component to the team.

**Lesson 7 Notes**

**Financial Health**

As you work through the readings and forum questions on financial health this week, please keep in mind that without financial health, the organization will not meet its mission objectives. This is really about life and death for the nonprofit. When we are confident that our financial information flowing from our accounting system is accurate and timely, we can shift our focus towards assessing our financial health. Bell and Schaffer provide three questions we need to answer:

·         What are our immediate strengths and vulnerabilities?

·         What are our long-term financial strengths and vulnerabilities?

·         Do our constituents perceive us as efficient and competitive?

Although the answers to the first question can be gleaned from a careful review of the financial statements, much information will require investigation beyond the limits of the historical data reporting on past economic activity of the organization. Therefore, we must work to identify how best to assess our longer term strengths and vulnerabilities and to learn how well we are doing in the eyes of our constituents. We strive to achieve adequate revenue streams that are diversified enough to sustain an acceptable level of program activity combined with an agreed upon level of growth. The use of ratios and comparisons can help us identify areas we need to monitor more closely.