Governinggood

Governance and Financial Management

by E. Grant MacDonald

Most non-profit boards of directors know that they should pay attention to their organization's financial management practices. Exactly what information or reports to pay attention to and understand is often unclear. In response many boards waiver between micro-management of the executive director and glossing over whatever reports they receive for fear of entering territory where they are out of their depth.

Board interest in non-profit financial management has been underscored in recent years by the often over-hyped, but still real worry about directors' personal liability, the increased attention by many funders with financial accountability, and the specter of financial scandals in both the non-profit and corporate world. This being said, the board's financial oversight role does not have to take over the governance agenda, nor do directors need to close their eyes for fear of opening a Pandora's Box.

Not all non-profit boards need to give the same level of attention to financial issues. The board's interest in financial management will rise and fall with the circumstances of the organization or its stage of development. Interest will be high when the organization is newly minted and hiring its staff, when a new executive director is hired, when there has been a dramatic change in the predictability of funding, and, of course, at time of impropriety, financial or otherwise. At times like these, a board meeting agenda can be dominated by financial matters, otherwise, it ought not to.

Financial oversight often becomes problematic when it swings from micro-management to rubber-stamping. This can happen merely with changes in the personalities, preferences and leadership orientation of the board of the day. Inadvertently, a lack of trust in the executive director is implied where boards get too focused on their financial oversight role. By putting in place a foundation of four relatively simple elements, boards and executive directors both can be more comfortable and disciplined in their financial oversight and increase the time they have available for more strategic conversations. These elements are:

1. Financial management policy
2. The budget and other key financial indicators
3. Annual audit
4. Evaluation of the executive director.

1. Financial Management Policy

Operational policies are the board's instructions to the executive director. **The financial management policy provides the cornerstone of the board's role in directing the financial management practices of the organization.** It is also key in raising the board's comfort level and protecting the organization.

© 2016 Governing Good

For an established and ongoing agency, one with a conscientious executive director, a single board level policy, or several more focused policies, is essential and for most can cover the key financial management concerns in two or three pages. The policy will outline the executive director's responsibility for ensuring sound financial practices under each of the following headings and identify what reports need to be seen by the board and when:

a) Financial controls

Financial controls are about record keeping, cash flow management and a system of checks and balances required for systematic scrutiny of all financial transactions. A non-profit organization ought to have in place a set of accepted accounting practices for handling and recording revenues received (including cash and donations), making bank deposits, paying invoices received in a timely manner, invoicing for the services it provides, issuing payroll and submitting employee deductions and taxes to government.

b) Budgeting

A budget is essentially a revenue and expense statement that looks forward rather than backward. It is the organization's financial plan.

The board must decide what form and level of detail they want in the budget. The policy should direct the executive director to take responsibility for preparing the organization's budget, to obtain board approval of it and to use it to guide the financial affairs of the organization throughout the fiscal year through a comparison of actual to predicted results. Approval of the budget authorizes the executive director to spend money as planned without have to seek permission for the expenditures contained in it. Budgets from year-to-year should be organized on a similar basis so that comparisons can be made.

The policy should instruct the executive director to bring a revised budget to the board for review and approval if significant changes are anticipated. The policy should also indicate the level of authority the executive director has to adjust the amounts budgeted for administrative and program expenses without having to seek board approval for the changes.

c) Contracts

A financial management policy ought to specify the executive director's authority to enter into contracts on behalf of the organization or change its banking relationships. Most boards will want to give the executive director some authority to enter into and sign contracts if they are not large in value or in duration, but will want board approval, and the chair's signature, if the contract is significant enough that it exposes the organization to significant risks. This is especially true where government contracts and foundation grants are involved.

d) Reporting and record keeping

The policy will want to specify the executive director's responsibility for reporting on the organization's financial performance to the board, the frequency of such reporting and the level of detail the board requires in terms of financial statements (e.g. the budget, year-to-date results), payroll and other tax remittances and key performance indicators.

e) Purchasing decisions and protection of assets

A board may wish to provide in the financial management policy some clear expectations regarding purchasing decisions. One important consideration may be at what price level should the executive director solicit formal quotations from two or more vendors?

© 2016 Governing Good

The board should be concerned too about the protection of the organization's financial, physical and intellectual assets and the financial management policy may be the place to be explicit about the executive director's responsibility for ensuring adequate insurance coverage, the safe storage of paper and the offsite back up of electronic files and records.

2. The Budget

As stated above, a budget is essentially a revenue and expense statement that looks forward rather than backward. *The approval of the budget is the principal financial management decision of the board in any given year, and the budget and the year-to-date revenue and expenditure figures ought to be the main focus of the executive director's regular financial report to the board.* In other words, the board's financial oversight should principally involve reviewing the organization's budget performance for signs of any problems and opportunities. The budget report to the board (the financial report) need not occur monthly for boards that meet monthly. As the board calendar below suggests, quarterly financial reports as agenda items may be sufficient for organizations that are operating in a fairly predictable financial environment.

Most complex nonprofit organizations will want to consider a budget detailing the main revenue sources and breaking down expenditures into administrative and programmatic or project areas. The major expense item for most organizations will be salaries and wages and these should be distributed, like other costs, to the programs on which people are working. Separating out the program areas in the budget allows the board to better see how financial resources are allocated in terms of priorities.

In creating and approving the budget, the board may want the executive director to provide a list of major purchases or other non-routine expenses anticipated in the coming year. Although a board ought to approve changes to the budget if the organization's financial situation changes dramatically, as long as there is a financial management policy or policies in place, the budget decision becomes one of the two or three main financial management decisions a board needs to make over the course of a fiscal year. The others typically are the acceptance of audited statements and auditor's recommendations (sometimes called a "management letter") if any, and additions to, use of, and management of cash reserves and investments.

3. The Audit

Most mid-size and larger non-profit organizations scrutinize their financial management practices annually by means of an independent audit conducted by a professional accountant (a Chartered Professional Accountant or CPA in Canada). There are several levels of independent review (e.g. audit, review engagement report) with various professional fees attached to each. All provide some measure of assurance that the organization's financial management house is in order. An annual audit is recommended for larger non-profits (those with annual revenues in excess of $1 million); smaller ones will likely opt for a less expensive review at least every other year.

An auditor's report is the board's primary means of assuring good financial practices. A board may wish to appoint an Audit Committee so that they can seek the auditor's advice on improving their organization's financial management policies and practices. Examples of terms of reference for nonprofit audit committees are readily available.

4. The Executive Director Evaluation – Financial Management Responsibilities

The formal evaluation or assessment of the executive director can also play an important role in increasing the board's comfort level in terms of the organization's financial management practices. While

the audit will constitute important independent evidence of there being adequate financial controls and practices in place which the executive director is responsible for, the executive director's financial reports to the board (budget performance, tax remittances) constitute additional evidence that other aspects of financial management policy are being followed. A board may also wish to ask the executive director to provide an account of one two aspects of the organization's financial practices as outlined in the policy with each evaluation.

5. Key Financial Indicators

Most non-profits will have financial issues and challenges specific to their own circumstances that the board and executive director will want to monitor regularly or from time-to-time. These may include *cash flow* (will revenues predicted be received in time for us to meet our expenses – wages and salaries), *extraordinary changes in assets and liabilities* (e.g. higher than normal levels of unearned income), *revenue source distribution* (are our sources of revenue diverse enough to provide us with some security and flexibility), *fund raising revenues to fundraising expense ratio* and *program and administrative expenses ratio* or *overhead*[1] (percentage of our revenue that is directed to program delivery or benefits to clients versus percentage to administration and infrastructure).

Also, some nonprofits are now looking at the area of social accounting, developing a "report card" outlining the benefits that accrue to the community from their work not only in term of mission success but employment and volunteer contributions.

Board Planning Calendar
Example of Financial Management Items Only

January	***February***	***March***	***April***
Financial Report- update on actual to budget /Draft budget for next fiscal year	Approve budget for next fiscal year	End of fiscal year (March 31)	Start of fiscal year (April 1)
May	***June***	***July***	***August***
Financial Report- update on actual to budget Draft auditor's report Audit Committee Meeting	Organizational Annual Report/Treasurer's report Annual General Meeting		
September	***October***	***November***	***December***
Financial report- update on actual to budget		*Financial report – update on actual to budget*	

[1] There is much debate, especially from a funder or donor perspective, about what level of overhead is acceptable in nonprofit organizations in general and charities in particular. Low overheard may not always be a good thing. Nonprofits that have not invested sufficiently in their infrastructure can find themselves continually in a precarious position.

© 2016 Governing Good