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River Voices

FINANCIAL MANAGEMENT:

Basic Knowledge for Financial Success

by Bill Davis Nonprofit Management Consultant

When I became an Executive Director for the first time, I had never created a budget or read a balance sheet. I learned these skills on the fly and often the hard way. Over time, I learned that my budget was not just a column of numbers—it actually was directly related to the overall operations of my organization. Eventually I could, at a moment's notice, state the total cost for each staff person to perform an hour's work, and I became able to answer tough questions that my board of directors would ask, such as: "How much we will be in the black this year?" or "What is the big source of restricted revenue on the balance sheet?"

Financial management involves understanding and tracking the flow of money, goods and services through an organization. Financial management, along with other key priorities such as personnel management, is part of the "business" side of running an organization. Even though an organization is non-profit, it is still a business and needs to be run accordingly to be efficient and effective.

Here's a quick exercise for you. Ask yourself these questions:

- $ Are you spending resources on things that really don't reinforce your organization's mission and strategic plan?
- $ Are you unsure at the beginning of each fiscal year whether you will be in the black each month of the year?
- $ Have you ever been unable to sleep worrying about whether your organization is going to make an upcoming pay roll?
- $ Have you ever had to scramble at the last minute to put together the financials for a grant report?

If you answered "yes" to any of these, you may not have the necessary financial tools and practices in place to efficiently and effectively management your organization. This is not necessarily surprising; you are not alone.

Like me, many managers of river and watershed conservation organizations have a background in technical issues and do not have backgrounds or training in financial management. My training was in ecology and water law, but I now have more than fifteen years of experience as an Executive Director of three different organizations. I realized the importance of solid financial management practices and dedicated myself to learning more. I encourage you to use this publication to do the same. Start slowly, and don't get overwhelmed. Getting your organization on track is doable, and it is absolutely necessary.

Financial management provides your organization with:

- $ **Peace of mind.** Knowledge that the organization has enough revenue to cover immediate expenses such as payroll, rent, etc. throughout a fiscal year.
- $ **Sound basis for decision making.** You're "buying" time for making decisions by projecting further down the road, which is crucial in taking best advantage of good times, and avoiding or mitigating bad times.
- $ **Increased efficiency.** Understanding exactly how much it will cost an organization to perform particular work so it can raise sufficient revenue to carry out its program.
- $ **Funder confidence.** Ensuring funders that restricted revenue is tracked and expended for its designated purposes.

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River Network

Connecting People, Saving Rivers

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River Network is a national, nonprofit organization whose mission is to empower and unite people and communities to protect and restore rivers and other waters that sustain the health of our country.

FROM THE CHAIR

Photo Credit: Suzi Wilkins Berl

Finances. The very word strikes fear in some; for others, the eyes glaze over.

The exciting part of our work is saving rivers, improving water quality or protecting recreational resources. Nonetheless, no matter our size or particular focus, we all have to be equally attentive to our organization's operational side: What's our long term plan? How do we communicate the value of our work to others? How do we secure and oversee the funds necessary for our operation?

All groups need financial support to undertake their work. The key is making sure that both our income and expenses are accounted for properly. Since it is the Board of Directors that holds the fiduciary responsibility for the organization, that group needs to insure that financial systems are understandable and transparent. In addition to approving an annual operating budget—be it $8,000 or $800,000—the board sets financial policies and systems to guide the organization's operations. We need to make sure that we account for restricted and unrestricted funds separately and that we know what our cash flow looks like throughout the year.

This issue of *River Voices* is chock-full of information to help your organization avoid financial management pitfalls. Take advantage of the materials found here as well as other valuable resources that River Network and others can provide. Having appropriate financial systems in place will allow you to sleep more peacefully at night.

Happy calculating!

Suzi Wilkins Berl

Suzi Wilkins Berl
River Network Board Chair

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Let's start with a few basic understandings. First, it must be stated that nonprofit financial management is significantly different than for-profit financial management. Unlike for-profits, nonprofits have three types of revenue: 1) unrestricted, 2) temporarily restricted, and 3) permanently restricted. It is very important that an organization understand the distinctions and implements the systems to correctly track and account for the different types of revenue.

The differences in the rules for how revenue is recognized must also be understood. (Learn more about this on page 9, "Understanding Nonprofit Financial Statements"). If your board members or funders come from the for-profit world they initially may not be able to accurately interpret your organization's financial statements.

Five Financial Tools

One of the primary fiduciary duties of a board of directors is to ensure that an organization is run in a financially sound manner. In order to carry out this duty, the board needs timely and accurate information about the finances of the organization.

In my opinion there are five major tools every organization must have at the core of its financial management system:

1. A program-based budget.
2. Income/expense statements.
3. Balance sheet.
4. A cash flow projection.
5. A revenue projection (can go in either the balance sheet or cash flow projection).

These tools will look different depending on the size and complexity of an organization, but all organizations should have some version of each of them. They may also look different from organization to organization because individuals think about and relate to numbers differently and will structure their tools to be most useful to them.

Done well, these tools will "describe an organization in numbers." If these tools are created properly, anyone properly trained to interpret them will understand the financial health and stability of the organization. Ultimately, they allow you to ensure that an organization is actually carrying out its mission since an organization is what it spends its money on.

Understanding your organization's finances is the building block to building a solid management system for your organization. There is a lot of information out there. I'd encourage you to learn what you can about your structures and look at continually improving them, adapting to what works best for you.

SOME BASICS...

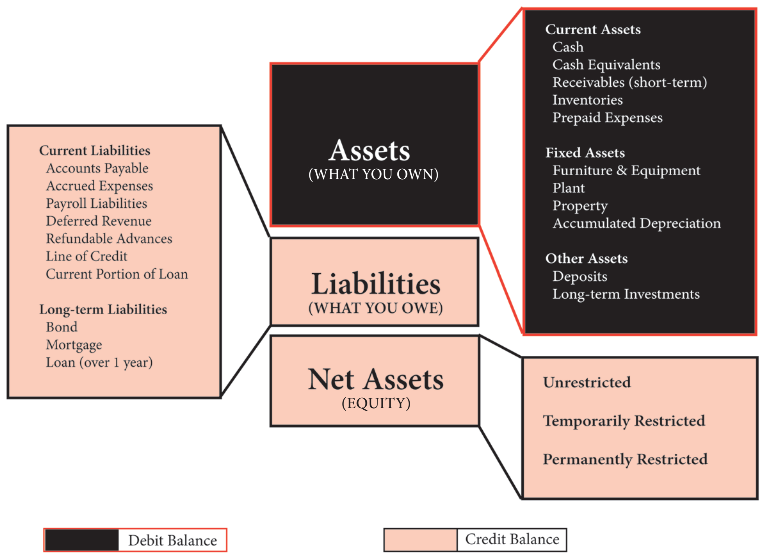
Accounting 101

by Hillary Coley, CPA
Trout Unlimited

Accounting allows organizations to identify how much money is coming in and being spent. Without accounting there is no way to accurately predict cash flows, raise money for projects, or know if you can afford to purchase equipment or hire new staff. Good accounting also allows for grant applications to be more accurate in requesting funding for projects. Without good accounting, an organization has little hope of effectively expanding and maintaining that expansion.

The end product of accounting allows the user to generate reports to show the organization's monetary transactions and net worth. The two most helpful summary reports are the balance sheet (in the nonprofit world, also known as the Statement of Financial Position or SOP) and income statement (also known as the Statement of Financial Activity or SOA).

STATEMENT OF FINANCIAL POSITION - DIAGRAM



Balance Sheet (SOP)

A balance sheet shows an organization's assets, liabilities, and net assets. The basic layout of the balance sheet is based on the following formula:

ASSETS = LIABILITIES + NET ASSETS

ORG NAME Statement of Financial Position as of [DATE]	Current Year				Note	Prior Year
		Unrestricted				
	Total to Date	*Operations*	*Board Designations*	*Restricted*		
ASSETS						
Current Assets	50,000	25,000	15,000	10,000	A	42,000
Fixed Assets	20,000	-0-	20,000	-0-		20,750
Long-term Assets	-0-	-0-	-0-	-0-	B	
TOTAL ASSETS	70,000	25,000	35,000	10,000		62,750
LIABILITIES						
Current Liabilities	3,000	3,000	-0-	-0-		3,500
Long-term Liabilities	-0-	-0-	-0-	-0-		-0-
TOTAL LIABILITIES	3,000	3,000	-0-	-0-		3,500
NET ASSETS						
Unrestricted						
Undesignated	22,000	22,000	-0-	-0-		26,500
Board Designated	15,000	-0-	15,000	-0-	C	
Property, Plant & Equip	20,000	-0-	20,000	-0-		20,750
Temporarily Restricted	10,000	-0-	-0-	10,000		12,000
Permanently Restricted	-0-	-0-	-0-	-0-		
TOTAL NET ASSETS	67,000	22,000	35,000	10,000		59,250
TOTAL LIABILITIES & NET ASSETS	70,000	25,000	35,000	10,000		62,750
Note A (Narrative explanation)						
Note B (Narrative explanation)						
Note C (Narrative explanation)						

Assets

Assets are what your organization has, what is owed to you, what you have invested in, and what you have deposited with others.

What you have:

- $ Cash in bank accounts, investment accounts, and petty cash
- $ Things your organization has bought for future use, such as merchandise inventories or supplies
- $ Fixed assets such as furniture, equipment, and improvements to your facility, listed at cost, that are non-liquid, as the cash has already been spent to acquire them

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Income Statement (SOA)

An income statement shows an organization's revenue, expenses and net income. The revenue and expense categories are determined when you build your chart of accounts.

RECOMMENDED FORMAT

Show context: History; YTD; Budget; Forecast to year end; Explain variances

	ORG NAME *Statement of Activities*	Prior Year Actual	Current Year to Date	Current Year Budget	% Budget to Date	Year End Forecast	Budget to YE Variance	NOTES
Income by source	Earned Revenue							
	Contributed Revenue							A
	Released from Restriction (1)							
	Total Unrestricted Revenue							
Expenses by function/ activity	Program Expense							B
	Development Expense							
	Admin Expense							
	Total Operating Expense							
	NET UNRESTRICTED INCOME							
Separate restricted	Restricted Contributions							C
	Released to Unrestricted							
	NET RESTRICTED INCOME							
	NET ALL ACTIVITY							
Narrative notes	Note A (*Narrative explanation*)							
	Note B (*Narrative explanation*)							
	Note C (*Narrative explanation*)							

- Accumulated Depreciation, a "contra asset" (against asset) indicating the extent the fixed asset has decreased in value as it is used up (depreciated) over its useful life
- Collections of art, artifacts, other valuables related to your mission
- Payments your organization has made for goods or services that have not yet been received or used such as annual insurance premiums that could be refunded to you if cancelled, or expenses relating to future fiscal years paid in advance (prepaid expenses)
- Long-term investments of unrestricted or temporarily restricted funds
- Long-term investments of permanently restricted principal such as endowment funds that cannot be used for operations

What is owed to you:

- Grant awards promised to your organization but not yet received
- Revenue earned from services provided by your organization for which payment has not yet been received
- Loans your organization may have made to others

What you have deposited with others:

- Deposits your organization has paid to others and is held by them on your behalf such as advance rent, utilities security deposits, payroll bonds, etc.

Assets are usually listed in order of declining liquidity. Short-term assets are those available as cash or equivalent within one year, and long-term after one year. Assets are a natural "debit balance" meaning that, in an accounting entry, a debit to an asset account will increase it. A negative number (credit balance) in the assets section of a balance sheet is unusual, and should be questioned and explained. The exception is Accumulated Depreciation, which, as noted above, is a "contra asset" (against asset) account that tracks the depletion of the value of fixed assets as they are used.

What you might want to ask when looking at the asset balances:

CASH

- $ Do we have enough cash to pay our bills?
- $ Is there too much cash in non-interest bearing accounts?
- $ Are our investments diversified per our investment policy?
- $ Have we protected the restricted funds?
- $ Is our cash balance increasing or decreasing?

ACCOUNTS/PLEDGES RECEIVABLE

- $ Are we collecting what is owed to us in a timely way?
- $ Are there any we will never receive?
- $ Do we have an allowance for doubtful accounts?
- $ What are current vs. long-term portions?

PREPAID EXPENSES

- $ Are we preparing for future programming?

INVENTORY

- $ Do we have too much on hand or is the inventory too old?
- $ Do we need to replenish?

OTHER (Deposits, etc.)

- $ How much of our assets are held by others and for what purpose?

FIXED ASSETS *(property, plant, equipment, accumulated depreciation)*

- $ Have we invested enough (too much) in property and equipment?
- $ Do we need to upgrade our equipment or technology?
- $ How much did we invest in capital assets during the year?

Liabilities

Liabilities are what your organization owes to others or holds on behalf of others.

What you owe:

- $ Vendor accounts payable (bills for goods and services)
- $ Amounts payable on company credit cards
- $ Payroll liabilities (withholdings, federal, state, and local payroll taxes owed; unemployment owed)
- $ Accrued expenses (usually estimated rather than based on actual bills, for instance: accrued vacation pay or accrued interest)
- $ The amount accessed from a bank line of credit
- $ Short-term or long-term loans

What you hold on behalf of others:

- $ Deferred revenue or refundable advances (funds paid to your organization in advance for services not yet delivered; your organization would be liable to return these funds if the service is not delivered, for example, play subscriptions or tuition for future classes)
- $ Conditional contributions (funds given to your organization that you are entitled to only if the condition is met, such as a matching grant)

Liabilities are presented in declining order

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cont. from page 7 of their maturity. Short-term liabilities are those due within a year. Long-term liabilities are multi-year loans such as mortgages or other funds borrowed by the organization and payable over more than one year. Liabilities are a natural "credit balance" meaning that, in an accounting entry, a credit to a liability account will increase it. A negative number (debit balance) in the liabilities section of a balance sheet is not normal and should be questioned and explained.

What you might want to ask when looking at the liabilities balances:

ACCOUNTS PAYABLE/ ACCRUED EXPENSES

- $ Are vendors being paid in a timely way?
- $ Do we have enough cash to pay our bills?
- $ Are we carrying balances on high-interest credit cards?
- $ How long have we had these liabilities on the books?

PAYROLL LIABILITIES

- $ Are we meeting our tax liabilities in a timely way?

DEFERRED REVENUE/ REFUNDABLE ADVANCES

- $ Are we recognizing revenues as they are earned? (This balance will decrease and income increase as services for which the deferred revenue was given are performed.)
- $ Are we sure no restricted contributions are included as deferred revenue?

CONDITIONAL CONTRIBUTIONS

- $ Can we raise the matching funds; meet the condition that gives us the right to the funds?

LINE OF CREDIT

- $ Do we have the means to repay our line of credit?
- $ Are we strategically using our line of credit?
- $ Are we using the line of credit to meet our operating expenses?

LOANS/MORTGAGES

- $ How much has the organization borrowed?
- $ Is the loan internal (from cash reserve) or external?
- $ Is there a plan for repayment of the loan/mortgage?

NET ASSETS

The net assets of a nonprofit organization are equivalent to the net worth of the organization. Net assets can be liquid (comprising cash and short-term receivables), or fixed (furniture, fixtures, equipment, inventories, and land & buildings net of long-term debt), or long-term. Generally accepted accounting principles (GAAP) call for an organization's net assets to be classified as unrestricted (UR), temporarily restricted (TR), or permanently restricted (PR).

Small and midsize nonprofit organizations usually do not have PR net assets such as endowments, and it is usually not advisable, as having an endowment ties up a lot of cash that is not accessible to the organization for operations or program delivery. It is far more advisable for small and midsize nonprofits to build a working capital or operating cash reserve fund before attempting to create an endowment. If a small or midsize nonprofit does have PR net assets, such as an endowment, these net assets usually comprise long-term investments and are not considered liquid.

http://www.nonprofitaccountingbasics.org/accounting-bookkeeping/accounting-101

Understanding Nonprofit Financial Statements

Reviewing Financial Statements

by Dugan & Lopatka, CPAs in Wheaton, IL

SOME BASICS...

What should you look for when you review a financial statement? Start with the surplus or deficit. Nonprofit organizations can have either in any year, but repeated deficits or results that differ greatly from budgets are cause for concern.

Other important topics to consider in your financial review include:

Donor restrictions. The financial statements should use net asset classes to reflect donor restrictions, including both temporary restrictions that will be removed by events or the passage of time and permanent restrictions, such as donor-established permanent endowment funds.

Board designations. Only donors can impose restrictions. The board may choose to use unrestricted assets for a specific purpose. Unlike donor restrictions, board designations can be changed at the governing board's discretion.

Donor conditions. Donor-imposed conditions on contributions are outside your control. For example, matching requirements mean that contributions are not recorded. But if donors have not imposed conditions, donor-pledged contributions should be recognized in the financial statements even if you won't receive them until a future year.

Timeliness. The date financial information is available depends on your nonprofit's complexity and need for outside information, such as invoices from suppliers and reports from investment managers. But in general, information the organization prepares should be available within four to 12 weeks after the balance-sheet date.

Investments. Look at your investment return. Have you adopted a sound and prudent investment policy, taking into account how long the money can be tied up? For example, have you placed funds that can be invested for only a few weeks or months in money-market accounts, and invested endowment or retirement-plan funds in a diversified portfolio of stocks and bonds? Ask board members or outsiders with financial expertise to help develop your investment policy. Most important, make sure your organization follows the policy.

Functional expenses. Expenses should be reported by the function they accomplish. Each major program can be a function. Together these are referred to as program expenses. Operating costs should be classified as management and general. Costs to bring in contributions and donations should be classified as fundraising costs.

Some organizations also have membership-development costs. Supporting services include management and general, fundraising and membership development.

Aging of amounts owed to the organization. The age of receivables due the organization is important. The older these become, the less likely they'll be collected. Watch the trends here. Be sure a collection policy is in place and that it is followed.

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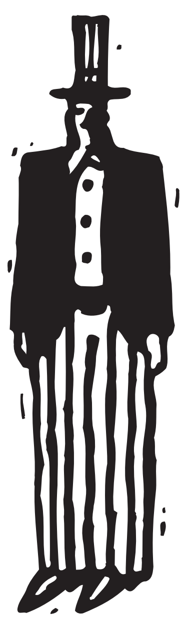
Ratios. Important ratios that will help you understand financial statements include:

- **Current ratio.** Obtain this ratio by dividing current assets by current liabilities. This ratio shows the non-profit's ability to pay its current bills and should generally be not less than 1 to 1.
- **Program services percentage.** Dividing program services by total expenses shows what portion of your expenditures you use to provide direct service. Dividing program services by total support and revenue gives insight into how much of your total budget you spend on program services. Generally, a percentage of 70% to 85% or more is good, but this depends on the nature of your organization. Organizations must spend at least 75% of their total revenue each year on program services to be a part of the combined federal United Way campaign.
- **Ratio of fundraising costs to fund-raising revenue.** This ratio gives insight into the cost of raising money for a specific event and also for your entire fundraising activity. Although this ratio varies widely, fundraising costs exceeding 50% of the revenue raised may cause questions about your primary purpose. When calculating fundraising costs, do not classify direct expenses, such as meal costs for a fundraising dinner, as fundraising costs.
- **Tax-filing requirements.** Be sure that annual filings are complete and familiarize yourself with the content of these public documents that anyone may peruse. Some important federal filings include:
  - ✔ Form 990 or 990EZ
  - ✔ Schedule A for all organizations eligible to receive contributions,
  - ✔ Form 990T for organizations that conduct unrelated business activities, and
  - ✔ Form 5500 for organizations with employer-funded qualified retirement plans or employee benefits plans.
- **Computer security.** Determine what computer-security measures the organization uses, including backups and off-site storage of backups, password and surge protection, and up-to-date antivirus software.



Understanding Is Key

These explanations of balance sheets, activities statements, cash flow statements and explanatory footnotes should help demystify the language of accountancy. With demystification should come understanding, allowing you to interpret the numbers like a pro. The importance of understanding financial statements can hardly be overemphasized.

http://www.duganlopatka.com/resources/articles/published-articles/39-not-for-profit-articles/265-financial-statements-article

ACCOUNTING METHODS:

Cash vs. Accrual

by Hillary Coley, CPA
Trout Unlimited

Generally, there are two methods under which you can do your accounting; the cash method and the accrual method.

The cash method of accounting is focused on the inflows and outflows of cash. Much like your personal finances, organizations have revenue when we make a deposit and incur an expense when we cut a check. There is little regard to when the revenue was actually earned or the expense was actually incurred, we just worry about the cash flows.

The accrual method of accounting doesn't worry about cash flow and instead focuses on when revenue was actually earned and when expenses where actually incurred. For example, let's say you purchase office supplies in the month of April on your credit card and pay for the purchase in May when you receive the credit card bill. Under the accrual method of accounting we would record the expense for supplies in April.

The other main difference between the two methods is the ability to budget accurately. Accrual method of accounting allows for better budgeting and planning because it looks at when liabilities are incurred and revenue earned and not when cash is paid. This method puts on the books liabilities that might otherwise be forgotten, like accrued vacation. The cash method doesn't worry about accrued vacation until it is required to be paid. This could create a very painful situation for a nonprofit that hasn't planned to pay out an accrued vacation balance and is now faced with cutting expenses in other areas to have enough cash to pay the outstanding balance.

Which Method to Use

The cash method of accounting is the easiest method, but not necessarily the most accurate. If you have paid staff you should not use the cash method of accounting. Be sure to check your state regulations. Some states require the accrual method of accounting to be used. The cash method of accounting is best used by very small nonprofits with no paid staff, no set programs, and little to no plans for expansion.

The accrual method of accounting should be used by organizations starting out with larger amounts of funding, paid staff, and plans to raise additional funds from larger donors such as foundations or government entities. Generally accepted accounting principles also require the use of the accrual method of accounting. If you wish to have an audit done under generally accepted accounting principles you should use the accrual method of accounting.

http://www.nonprofitaccountingbasics.org/accounting-bookkeeping/cash-vs-accrual

SOME BASICS...

BUDGETING…

Budgeting Overview

NONPROFITS ASSISTANCE FUND
Helping Nonprofits Thrive

10 STEP ANNUAL BUDGETING CHECKLIST

A budget is a planning tool that reflects an organization's programs, mission, and strategic plan. Typically the budgeting process should begin at least three months before the end of the fiscal year to ensure that the budget is approved by the board of directors before the start of the new year.

1. Determine timeline

- ☐ Set target date for board approval
- ☐ Allow time for each step and for review and discussion
- ☐ Approve before beginning of fiscal year

2. Agree on goals

- ☐ Prioritize program delivery goals
- ☐ Set organizational financial goals
- ☐ Clarify annual goals from strategic plan

3. Understand current financial status

- ☐ Review current year income and expense compared to budget
- ☐ Forecast to the end of the year
- ☐ Analyze and understand any variances

4. Agree on budget approach

- ☐ Assign roles and responsibilities
- ☐ Agree on authority to make decisions
- ☐ Agree on how much uncertainty can be included (how many unknowns)

5. Develop draft expense budget

- ☐ Determine costs (expenses) to reach program goals
- ☐ Determine costs to reach organizational and strategic goals

6. Develop draft income budget

- ☐ Project income based on current fundraising and revenue activities
- ☐ Project new income based on new activities

7. Review draft budget

- ☐ Verify that the draft meets program and organizational goals
- ☐ Review and discuss all assumptions
- ☐ Make adjustments, based on goals and capacity, to match income and expenses
- ☐ Review final draft for all goals and objectives

8. Approve budget

- ☐ Present to any committees as needed
- ☐ Present to the board for approval

9. Document budget decisions

- ☐ Create a consolidated budget spreadsheet and file
- ☐ Write down all assumptions

10. Implement budget

- ☐ Assign management responsibilities
- ☐ Incorporate into accounting system
- ☐ Monitor and respond to changes as needed

WHO WE ARE

Nonprofits Assistance Fund's mission is to build financially healthy nonprofits that foster community vitality.

Our financial experts help nonprofits strengthen their capacity to address unexpected events, finance new opportunities, and realize strategic goals. We fulfill our mission by helping you thrive.

Find out more about Nonprofits Assistance Fund's loans, training, resources, and financial advice tailored for nonprofits at www.nonprofitsassistancefund.org.

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REVENUE FORECASTING

Principles & Procedures for More Reliable Forecasts & Better Budgets

by Don Elder
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There is a time-honored way to develop a household budget. First, determine the income you are virtually certain to have. Then, develop a realistic plan to live within your means.

Far too often, nonprofit groups do just the reverse. First, we determine what it will cost to do everything we want. Then we project as much revenue as necessary to match projected expenses.

Of course, this can easily lead to fundraising goals that are based on nothing more than wishful thinking. That is a recipe for disaster.

Rosy nonprofit revenue scenarios are often generated by intelligent people who are otherwise rational and responsible in their personal and professional lives. It's easy to see why. Passion for mission, commitment to programs, pride in work and care for staff are frequent causes.

Another reason is the inherent difficulty of projecting a budget revenue figure for a future full of uncertainties. Most households budget to a known salary figure. Most agencies budget to appropriations that are known in advance. Even businesses can usually project revenue with more accuracy and confidence than most nonprofits, which depend on major gifts, contracts and grants that are never certain until they are received.

There is one more major cause of rosy nonprofit scenarios: they allow hard decisions to be postponed. Need to avoid trimming programs, cutting salaries and benefits, or laying-off staff? It's all too easy. Simply assume more revenue.

This ever-present temptation is one of the reasons that turnover of development staff in small- to medium-sized nonprofits is extraordinarily high. That high turnover rate is the number one reason many nonprofits are not raising more money today. It's also one of the major reasons that turnover of executive directors is high.

Nonprofit budgets *must* be based on realistic revenue forecasts. Here are some principles and procedures for developing them.

Principles:

1. ***Begin early.*** It takes time to develop a good budget. When the process gets rushed, rigor always suffers. The detailed work needed to develop a good revenue forecast is the most common casualty. Make sure you *budget the time necessary* to *build your budget* properly.

2. ***Start the budget process with your initial revenue forecast.*** Complete the first draft of your revenue forecast before you even begin developing the expense side of your budget. Try not even to *think* yet about what expenses are likely to be. There will be plenty of time for that later.

3. ***Break your revenue projections into major categories.*** Different revenue streams (such as individuals, foundations or businesses) behave differently. Projecting revenues from them often requires different methods. Documenting your projection and underlying rationale for each category makes your overall revenue projection more reliable, transparent and defensible. It also makes later review and revision much easier.

4. ***Be conservative with your assumptions.*** Err on the side of caution with each of your assumptions, such as those about renewal rates, new donor acquisition and the amount of work you can get done with the people you have.

BUDGETING...

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If you later feel that being cautious with every single assumption has led to a revenue projection that is unreasonably low, you can adjust it.

5 ***Run your revenue projections at least three different ways.*** Many forecasting methods have merit. Several are described below. But no one method is perfect—and all can lead to bad results if they are based on bad assumptions. If three methods produce results in the same ballpark, you may proceed with confidence. If they produce widely varying results, go back and take a hard look at each. When in doubt, err on the safe (low) side with your revenue projection. In any case, don't base a budget revenue recommendation on a high-side outlier that hasn't been intensely scrutinized.

6 ***Generate and consider alternate scenarios.*** "Worst-case" and "best-case" scenarios have limited utility. There is always an outside possibility that something catastrophic will occur to limit fundraising—or that there will be some windfall, such as a large bequest. Instead of dreaming about best- and worst-case scenarios, think in terms of scenarios that are 80%, 50% and 20% likely. Given the results of your projection methods, what is the figure that you think you have an 80% chance of exceeding this year? 50%? 20%? Most organizations seem to peg their budgets on figures in the 50%-likely range. But that simply ensures that even if their projection methods are good, they will fall short half the time—perhaps by a great deal some of the time. That is no way to build a steadily stronger organization. I encourage groups to peg their budget revenue figures at levels they are 80% confident they will exceed and that they are virtually certain they will not fall short of by much.

7 ***Make a clear distinction between a budget recommendation and a fundraising goal.*** While budget revenue recommendations should be cautious, fundraising goals should be ambitious. I like to see fundraising goals that are significantly higher than budget figures. That builds in reasonable margin for error in the budget if the ambitious fundraising goals are not met. As a way to express *how* ambitious your goals are, you might say what chance you think you have of reaching them. It's fine if that's only 50%, or even 20% —provided your budget recommendation is a figure you are much more confident about, something in the 80% realm described above.

8 ***Support ambitious fundraising goals with solid fundraising plans.*** Ambitious does not mean pie-in-the-sky. Your ambitious fundraising goals should be supported by well thought-out action plans you can implement with the people, time and resources you have. If they aren't, they are just meaningless figures on paper.

Exceeding budget figures most of the time and meeting ambitious fundraising goals some of the time results in happy development staff, program staff, executive directors, boards and funders. Most of all, it means a strong, nimble, resilient organization capable of fulfilling its mission over time.

Methods

As stated above, there are many methods for forecasting revenue. None is perfect. Each is only as good as the assumptions behind it—and the care with which its results are interpreted.

With those caveats, here are a few revenue projection methods worth consideration. All can be used to project overall revenues, revenues for major categories (foundations, individuals, businesses, etc.) or both.

Back of the Envelope

Don't be fooled by the name I've given this method; it's not pejorative. A simple, macro-level analysis at the beginning of your revenue projection process is useful. It may overestimate or underestimate next year's results, but so may other, more elaborate methods. It can be as simple as this:

STEP	EXAMPLE
Consider results for the last three years.	We raised $400K overall two years ago, $550K last year and $500K this year.
Identify special considerations.	Last year we received a one-time $100K gift. Excluding it, the adjusted figures for the three years are $400K, $450K and $500K.
Project next year's results.	*If recent trends continue, we should be able to raise $550K next year.*

Renewals Plus New Gifts

This method requires a little more time and thought than the first, but it is still fairly simple. I find it is usually a good second step.

STEP	EXAMPLE	RESULT
Identify renewable gifts. Multiply by a reasonable assumed renewal rate.	• This year 50 donors made gifts totaling $500K. • Of those, 10 totaling $80K were one-time gifts. • The other 40 totaling $420K were gifts to our annual fund that we have a good chance of renewing. • Our renewal rate for these types of gifts in recent years has been 80%. • To be safe for budget purposes, we will assume a renewal rate of 70% next year.	$420K x 70% $294K
Determine reasonable expectation for new gifts.	• Our results for new donors for the last three years have been $70K, $85K and $100K. • We expect the pace of growth to increase this year due to a major new campaign beginning now. • We believe we can raise $125K next year but will assume only $115K in our budget calculations to be on the safe side.	$115K
	TOTAL	***$409K***

cont. on page 16

cont. from page 15 In our hypothetical example, this method returned a projection nearly 20% lower than the first. A discrepancy this large should give some serious pause. It certainly suggests a need for more thought and work before making a budget recommendation.

Donor-by-Donor Projections

This method is widely used. It is sometimes the only method used. Like the rest, it has its strengths and weaknesses.

Typically, all larger donors and prospects are listed, along with expected ask amounts and estimated likelihood of success. Smaller donors (say, all individuals giving between $1 and $99) can be clumped into a single group.

DONOR	Ask amount	Likelihood	Projection
Jane Doe	$100,000	60%	$60,000
John Hancock	$60,000	50%	$30,000
Mary Green	$50,000	70%	$35,000
Bill White	$25,000	90%	$22,500
Etc... (All other major donors/ prospects, listed separately)	*$1,100,000*	*various*	*$531,000*
$100-$249 donors	$60,000	80%	$48,000
$1 - $99 donors	$40,000	90%	$36,000
TOTAL	**$1,210,000**		**$762,500**

One of the benefits of this method is that it produces an actual list of asks to be made. It can be turned into a real workplan by adding a few more columns, such as Date of Ask, Date of Expected Response, Lead Staffer, and so forth. There is great value to this.

However, because this somewhat detailed projection method seems highly rational, it tends to inspire excessive confidence in its results. It can actually lead to projections that are quite unrealistic. The reason? There are several.

- It's easy to make a list of prospects that is longer than you can work effectively throughout the year to get gifts in the door by the end of the year.
- It's easy to come up with unrealistic ask amounts that you must reduce later when you do more research, or when you get more information from the donor.
- It's very easy to be a little too optimistic in the "likelihood" column, which is after all, a guess. It may be a fairly educated guess for some prospects on the list, but even then, it's a guess.
- Jane Doe may have a projection of $100K. But what does a 60% likelihood of a "Yes" to a $100,000 ask really mean? There are many possible outcomes, but the two most likely

are $100,000 and zero. Still, it's often said in a case like this that Jane is "in the budget" for $60,000. If a few of the top prospects on the list give little or nothing, the results can be very far short of the projection this method generates.

Perhaps the biggest danger of this method is the ease with which it can be used to *justify any number you want*. Do you need to find another $100K to balance the budget? Just add a few more prospects and jiggle a few assumptions about "Ask" and "Likelihood" here and there, and it's done! This is systematic self-delusion—and it's practiced in thousands of nonprofit groups every year.

Excessive optimism in the use of this method allows an organization to believe in a rosy scenario. That just puts off necessary hard decisions and allows financial holes to be dug deeper. Conversely, undue pessimism or timidity in the use of this method can return unreasonably low revenue forecasts that cause unnecessary budget cuts that pain and weaken an organization.

In short, while this method may appear on the surface to be the most reliable, I believe it may actually be the least reliable overall. I believe it has its merits and its place, but I never like to see a group use it *exclusively.*

Projections by Subcategory

One of the best ways to ground-truth the above method is to take it one more step. Simply group your donors in a given category such as Individual Giving by gift size ($25K & up, $10K-$25K, $1K-$10K, etc.). Then ask yourself some questions about each group, such as:

- $ How much did you get from that group as a whole last year?
- $ How confident are you that you will actually make the assumed asks of everyone in the group in the coming year?
- $ Do you expect to identify additional prospects in this gift range?
- $ If things go about as well as you hope, how much do you think you will raise from the group?
- $ What's the most likely scenario (the one you have a 50-50 chance of realizing)?
- $ If a few of your top donors don't come through, how much less will you see?
- $ And so forth…

After thinking the questions through, assign a projection for each subcategory. Then add them up.

This method is somewhat subjective, of course. But so are the others, in different ways. Over the years I have found this method to be as reliable as any—particularly when it is used to cross-check projections made in other ways.

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Final Thoughts

There are other methods you might employ. You might invent some of your own. The important things are to:

Category (# this year)	This year (projected year-end)	Next year's projection
$100K and up (1)	$100K	$0
$25K - $99K (5)	$175K	$225K
$10K - $24K (12)	$150K	$180K
$1K - $9K	$35K	$70K
$250 - $999	$25K	$35K
$1 - $249	$15K	$20K
TOTAL	**$500K**	**$530K**

- Run the numbers at least two different ways.
- Don't assume that more complex methods are always more accurate.
- Be skeptical of outliers—and throw out any results that don't pass the laugh test.
- Make your budget recommendations conservative. Make your fundraising goals ambitious.

- Develop a solid fundraising plan to give the organization a good chance of exceeding the fundraising goals by a little, and the budget figures by a lot. (It's infinitely better to adjust the budget upward by a lot at mid-year than to have to do the opposite.)
- Boil down the rationale for your final budget recommendations in a brief memo so that others in the organization understand it—and so that you can easily revisit it at mid-year and revise your projections as appropriate.

Details for Budgeting Program Expenses

by Nancy Church, CPA
Not-for-Profit Accounting Help
www.NFPAccountingHelp.org

Just as it is important to understand where your money will come from, it's equally important to be able to predict how you will spend it.

First, let's agree on what a program is so we can go about this process without omitting any activity of your organization. I define programs as the main functional activity areas in the organization, including fundraising, administrative and general, and (in many organizations) shared costs, in addition to the functions that carry out the organization's mission more directly (e.g. Water Quality Monitoring Programs, Education and Outreach, River Cleanups, etc.).

Expenses that can be associated directly with any of these functions should be charged to those functions, and those that cannot should be charged to a shared cost pool. For example, postage for a direct mail campaign will be charged to fundraising while general postage will be charged to shared costs and allocated out later. Administrative and general expenses are those that are incurred in the general management of the organization. In other words, just because someone does "administrative tasks" in the course of their work day doesn't mean that the expense of employment (wages and/or salary, payroll taxes, and fringe benefits) shouldn't be charged to program functions. For example, a program assistant or office manager who provides support for a few different funded projects should charge a fair portion of her time to the programs her work supports.

Involve managers in the expense projections from the very beginning. Provide them with tools that can guide them through the process and get you the information you need in a form which you can use.

1. **Start with your staffing plan for the budget year.** Ask each manager to tell you what percentage of a staff person's time they intend to use for each program they manage. Help them out with information about how percentages translate into work hours: e.g., 2,080 is the typical 100% (1.0 FTE = 40 hours/week times 52 weeks); 10% = 208 hours or 5 weeks, including one day of vacation.

2. **Then take this information and start to build a spreadsheet** (see example on the next page) so that you'll be able to determine actual costs of your staffing plan. List each position on a separate line (if you want to use names of staff, do so, but consider hiding the column later).

3. **Make a column for each department or program, and add a "total" column** to the right. Insert the utilization from #1, and ensure the total utilization for each person is 100%, not more and not less. On the first go-around, this is unlikely to be the case, so work with your managers until you've got it sorted out. Be realistic.

4. **Now calculate the cost of the staff by adding a column with each person's projected salary.** Enter formulas that multiply the percentage by the salary (e.g., F4 = $F3*E4 where F3 is the salary; the "$" sign will "lock" the salary figure). Also, put a totals line at the bottom, so you have a total for each department (in building the "total" formula, be sure not to include the % figure).

5. **If you want to be able to show the impact of anticipated raises, you can do this by adjusting the figure in cell D1** ("possible increase factor"). As it is (1.0), the hourly rates are the current rates (no increase), because the formula

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in each cell in the "Hourly" column is the current rate times the "possible increase factor" (e.g., cell D4's formula is $22.66*$D$1). If you change D1 to 1.05 (e.g., a five percent increase), the figure in D4 will change to $23.80. (And "copy down" to change them all.)

6 Also **create a line item for payroll taxes at the current rate in total** —no need to get very specific here, just take your current year-to-date payroll for each program and divide it into the payroll tax expense; that will give you a "general percentage" to use in your calculations. (Take into consideration taxes that disappear, such as unemployment insurance, over the course of a calendar year—there might be significant timing differences between your budgeting cycle and the tax year.)

7 **And remember to include fringe benefit costs:** health insurance, dental insurance, whatever your organization provides as benefit expenses. Again, at this point you don't

EXAMPLE

RiverCleaners — Salaries Budget FY 2015 — Salaries Example.xlsx

	A	B	C	D	E	F	G	H	I	J	K	L	M	N
1			possible increase factor:	1.00	Annual:	100 - Mgmt. & Gen.	200 - Development	301 - Program 1	302 - Program 2	303 - Program 3		Total 2014 -2015 Budget		2013-2014 Budget
2	Salaries:			Hourly										
3	FTE:					10.00%	30.00%	30.00%	10.00%	20.00%		100.00%		
4	0.63	Comm. Coord.		$22.66	$29,458	$2,946	$8,837	$8,837	$2,946	$5,892		**$29,458**		$29,458
5	1.00	Prog. Coord.		$21.84	$45,419			$45,419				**$45,419**		$45,419
6	1.00	Dev. Dir.		$37.14	$77,250		$77,250					**$77,250**		$77,250
7	1.00	Assist. Prog. Dir.		$22.28	$46,350			$46,350				**$46,350**		$46,350
8	1.00	Prog. Dir.		$30.95	$64,375			$64,375				**$64,375**		$66,950
9	1.00	Prog. Coord.		$18.75	$39,000			$39,000				**$39,000**		$40,170
10	1.00	Dev, Assist.		$17.38	$36,150		$36,150					**$36,150**		$36,050
11						75.00%				25.00%		100.00%		
12	1.00	Admin. Assist.		$17.31	$36,000	$27,000				$9,000		**$36,000**		$36,400
13	1.00	Prog. Assist.		$16.59	$34,507			$34,507				**$34,507**		$36,635
14						50.00%			50.00%			100.00%		
15	1.00	Exec. Dir.		$51.50	$107,120	$53,560			$53,560			**$107,120**		$107,120
16	0.75	Finance Dir.		$39.62	$61,800	$61,800						**$61,800**		$61,800
17	1.00	Assist. Dev. Dir.		$26.44	$55,000		$55,000					**$55,000**		$47,390
18	1.00	New position			$0							**$0**		$0
19	1.00	New position			$0							**$0**		$0
20	1.00	New position			$0							**$0**		$0
21	7010	**Salaries**	**Total Salaries**	**$322.45**	**$632,430**	**$145,306**	**$177,238**	**$238,489**	**$56,506**	**$14,892**		**$632,430**		$630,992
22	7020	Bonuses				$0	$0	$0		$0		**$0**		$40,000
23	11.38	**Total comp.**			**$632,430**	**$145,306**	**$177,238**	**$238,489**	**$56,506**	**$14,892**		**$632,430**		$670,992
24			Dep't % of total		100.00%	22.98%	28.02%	37.71%	8.93%	2.35%		100.00%		
25														
26	**Payroll Taxes:**		**Factor:**											
27	7110		7.65%		$48,381	$11,116	$13,559	$18,244	$4,323	$1,139		**$48,381**		$52,922
28														
29	7210	Workers Comp	(12 months' total)		$2,756	$633	$772	$1,039	$246	$65		**$2,756**		$2,756
30	7210	WBF	.25%		$1,609	$370	$451	$607	$144	$38		**$1,609**		$1,760
31	**7210**	**Total**			**$4,366**	**$1,003**	**$1,223**	**$1,646**	**$390**	**$103**		**$4,366**		$4,516
32														
33	7310	SUI - "2.7%"	1.70%		$10,758	$2,472	$3,015	$4,057	$961	$253		**$10,758**		$11,768
34		**Total Payroll Taxes**			**$63,505**	**$14,591**	**$17,797**	**$23,948**	**$5,674**	**$1,495**		**$63,505**		$69,206
35														
36	**Benefits:**			7.75	per person	$2	$1	$4	$1	$0		**$8**		$9
37	7410	Medical & Dental			**$7,747**	$15,493	$7,747	$30,987	$3,873	$1,937		**$60,037**		$60,037
38														
39	7440	Life/Disability	1.08%		**$6,830**	$1,569	$1,914	$2,576	$610	$161		**$6,830**		$7,039
40														
41	7450	403(b) contribs	(from actual participation)		**$31,991**	$4,780	$11,789	$11,673	$3,749	$0		**$31,991**		$31,478
42			**Total Benefits**			**$21,843**	**$21,449**	**$45,236**	**$8,233**	**$2,098**		**$98,859**		$98,554
43														
44			**Total Compensation**			**$181,740**	**$216,484**	**$307,672**	**$70,413**	**$18,484**		**$794,793**		$838,752

Spreadsheet by Melinda Storch of Storch Consulting; www.StorchConsulting.com need to spend time matching varying costs for current staff to the programs they currently work in; just take total benefits costs-to-date divided by payroll-to-date and use that percentage to project next year's (consider including an increase for projected health insurance increases).

8 **Bring your totals by program into your budget spreadsheet** by referencing the totals on this spreadsheet on your program budgets (i.e., on your program budget, link the "Salaries" line to Line 21 on this spreadsheet; "Payroll Taxes" to Line 27; "Benefits" to Line 42. On each departmental spreadsheet, total these three lines into "Compensation").

OTHER COSTS:

To help managers budget other costs of their programs, create a template they can use that shows all the costs their program will incur but include only costs that they can manage. For example, rent on the organization's office should not be included here—sure, each program will be allocated a portion of the rent, but the manager has no control over that and won't know what number to put in the template. To create the template, you can use the expense section of your chart of accounts, but black out those expenses you don't expect the manager to include.

Shared costs and administrative and general costs should be budgeted by the accountant, or other individual filling this role, working with the executive director. Yes, shared costs should be budgeted! Common shared costs are rent, postage, telephone, and office supplies, but include any other costs that benefit multiple programs.

Go over the managers' work to make sure they have correctly understood what kind of expenses go on each line. This will avoid difficulties later. For example, if a manager budgets money for contractors, make sure the folks they intend to engage will be legitimate contractors and not new employees. (For information on the difference between a contractor and an employee, go to: irs.gov/pub/irs-pdf/p1779.pdf)

This method encourages managers to look at the needs and plans for each program without thinking about the organization as a whole, which is a good place to start. Once you have added in the cost of personnel and combined the program budgets into one spreadsheet, the management team can look at any areas where there is excess revenue or expense and make adjustments. But remember, good budgets are the financial expression of plans: don't change the budget without changing the plan that underlies it!

SOME DOS & DON'TS

Grant Management for Nonprofits

by Dahna Goldstein
PhilanTech

Google "grant management" and you'll end up with thousands of hits offering grant writing services or articles. (You'll also get links to the grant management divisions of various government agencies, but that's another story.)

So where is a grant writer to begin? This post is intended to provide some very high level dos and don'ts in grant management and for nonprofits. Future posts will address some of the finer points, and will address some dos and don'ts for grant writing as well.

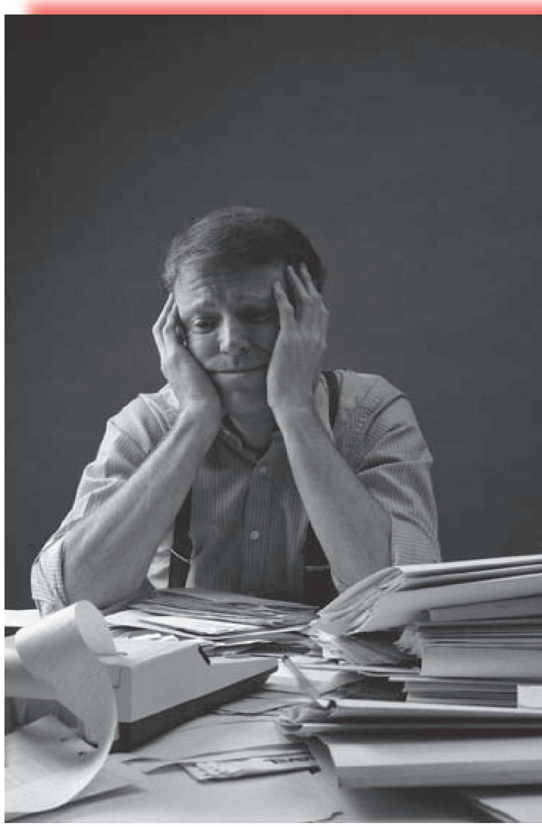
Grant management begins before the grant is received—in order to dedicate sufficient resources to the grant if it is received, you need to know what you're pursuing, why, the likelihood that you'll be successful, and what you're planning to do with the grant once you succeed in getting it.

A Few Dos:

- **Be strategic about which grants you pursue.** Your organization has limited resources. Writing grant proposals that are very unlikely to be funded isn't necessarily a good use of those limited resources. Also, grants can sometimes be costly to an organization once they're funded.
- **Know what your reporting obligations are.** When do you have to submit reports to the funder? What do they need to contain?
- **Use a grant calendar to remind yourself and others in your organization about due dates for reports.** The calendar can be on paper, in Outlook (or another piece of software that provides a calendar), or in a grants management tool like PhilanTrack, but what's important is that:
  - ✔ Deadlines are recorded;
  - ✔ There is a mechanism for reminders;
  - ✔ Everyone who needs to know about upcoming deadlines has access.
- **Communicate with others in your organization who are impacted by the grant requirements** to let them know what those requirements are, what you need from them, when, and in what format it should be conveyed. Be sure to communicate with them frequently; and
- **Understand what kind of financial tracking needs to be in place.** Most government grants require significant documentation of all expenditures related to grants (foundation grants tend to be a little less exacting, but foundations still want to know where their grant money went). Be sure that you have a good financial tracking system in place—or that you're working with someone in your organization (or someone contracted to your organization like an accountant) who has a good system in place.

A Few Don'ts:

- ✗ **Apply to a prospective funder without doing sufficient research**;
- ✗ **Think that your job is done once the grant is funded**;
- ✗ **Wait until the last minute** to let your CFO, accountant, or anyone else who needs to be involved know what the requirements are for reporting on a grant;
- ✗ **Submit reports late.** This may sound obvious, but I'm consistently amazed by how many grantees miss reporting deadlines. A lot of funders will only consider future grants once reports are received (and if they are received on time), so the timeliness of your submissions to your funder is not only good stewardship of the grant, it's also frequently necessary if you hope for future funding; and



- ✗ **Hide information when things go wrong.** It happens. Sometimes information is misplaced or communications are confused. Address that type of issue by getting out in front of it with your funder, rather than waiting until the last minute, or hiding the information altogether.

http://blog.philantech.com/blog-0/bid/46813/Grant-Management-for-Nonprofits-Some-Dos-and-Don-ts

GRANT MANAGEMENT...

GRANT MANAGEMENT...

MANAGING RESTRICTED GRANTS

Routine or Risky Business?

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For more information on the Center, visit www.nonprofitrisk.org

Nature of the Risk

For many nonprofits, an important category of risk emerges when an agency applies for and receives restricted grant funding. The tremendous competition for grant funds increases the risk that a nonprofit will make promises the organization is unable to keep. Such promises may include overly ambitious goals for client services, or meeting the administrative "strings" associated with the grant.

The failure by a nonprofit to manage grant funds wisely and fulfill its service delivery promises can lead to adverse publicity, litigation, criminal prosecution, and the revocation of grant funding. Nonprofit managers who are attuned to the risks of accepting restricted funds will first avoid making promises that are difficult or impossible to keep. They will also take steps to prevent careless mistakes and establish controls to detect and correct problems quickly. The successful management of restricted grant funds is possible when managers:

- $ Carefully weigh the costs and benefits associated with each grant-funding opportunity and apply cautiously for funding.
- $ Take the time required to fully understand donor requirements and expectations.
- $ Plan ahead, organize effectively, and communicate with staff to ensure that requirements and expectations are understood and met.
- $ Take immediate action when problems occur.

Whether your nonprofit promises too much in the final throes of negotiation or takes on a project you are ill-equipped to handle alone, many different things can go wrong in the solicitation and management of grant funds. Complicated "strings" are increasingly common in the current era of private philanthropy and government grant making.

"It is always difficult to ensure that total spending on a restricted program does not exceed grant revenues. Even when indirect costs are allowed, there are frequently uncovered expenses."

It is also always difficult to ensure that total spending on a restricted program does not exceed grant revenues. Even when indirect costs are allowed, there are frequently uncovered expenses. In many instances, grants cost nonprofits more than they bring in. In addition, restricted grants can encourage institutional growth and/or special projects that may not be sustainable in the long term. A nonprofit can easily fall into the trap of hiring project staff and failing to let them go after a funding cycle concludes.

Risk Modification Techniques

1 **Pursue restricted grants with caution and accept the temporary nature of all projects supported with restricted funds.**

2 **Acknowledge, identify, and monitor the strings which accompany a restricted grant.** Carefully read all grant agreements, donor letters, and other funding documents. Make certain you are clear about what you will do, where you will do it, and when each task is to be completed. Before work begins, compare the proposal with the actual funding agreement for consistency. Periodically during the funding period, reread the grant conditions and scope of work and determine whether you are in

compliance. If changes are necessary and key deliverables are no longer feasible, discuss the matter with your funder and document changes in writing.

3 **Carefully monitor expenditures for restricted grant projects to ensure that total spending does not exceed grant revenues.** Institute controls to ensure that a grantor's funds will be used only to support projects specified in, or appropriate under, the grant.

4 **Avoid restricted grants that require institutional growth or projects that may not be sustainable once the funding cycle is over.**

5 **Plan carefully and communicate expectations to key parties.** Outline responsibilities and authority levels for each staff person assigned to the grant. In most instances, the designation of a "project manager" for each grant is appropriate. The project manager is responsible for service delivery as well as administrative matters concerning the grant. Encourage staff to document information related to grant deliverables and establish a system for filing information on grant-funded projects so that it is readily accessible.

6 **Always assess your grant-seeking practices, prospective funders, and partnership opportunities in relation to the organization's mission and goals.** Will receiving a grant further enable the nonprofit to fulfill its mission and maintain its public trust? Does the nonprofit's request for assistance make sense in terms of the grant-making agency's mission?

Risk Sharing Mechanisms

Insurance

No insurance policy covers all of the potential consequences of failing to meet a funder's expectations. These consequences include the need to return funds, the loss of future funding, and negative publicity. A directors' and officers' (D&O) liability policy should, however, provide funds for, or reimburse the organization for defense costs and any final award in a third-party (funder) claim alleging mismanagement of grant funds.

In addition, proper financial safeguards should be in place to prevent an employee from stealing funds or other resources from the program. An Employee Dishonesty policy offers protection should an employee embezzle or steal the funds associated with the grant.

Contractual Transfer

Many grants involve partnership arrangements which may be necessary to fulfill grant obligations. For example, a nonprofit may use independent contractors to support service delivery funded under a restricted grant, such as a commercial transportation provider or market research firm. Losses stemming from the mismanagement of a grant cannot be transferred completely to another unless that organization is a party to the underlying agreement. Unless the grant agreement contains mutually binding agreements with these contractors, their performance (or failure to perform)

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is ultimately the responsibility of the nonprofit.

A nonprofit should attempt to transfer the risks controlled by the contractor or service provider to that contractor. Carefully evaluate the contractor's capabilities and closely monitor his performance. Determine which outside services are necessary to fulfill the grant obligations and identify ways to ensure that the services will be provided in a timely fashion. Also, make certain that the nonprofit will be compensated if the contractor fails to perform. Once you have identified the service provider, negotiate a hold harmless agreement and indemnification provisions from the contractor for damages resulting from their negligence. These agreements should be supported by adequate financing. In most cases, the contractor should have appropriate insurance coverages and add the nonprofit as an additional insured to the contractor's policy.

QUESTION AND ANSWER:

Is it Time for an Audit?

by Jeanne Bell, CEO

CompassPoint Nonprofit Services

Blue Avocado reader Bill Mitchell writes: "As a board member of both a small ($400K/year) and a much larger ($1.8m/year) nonprofit, what are the criteria to determine whether or not to conduct a formal outside audit? I have worked on staffs, sat on boards and have been a foundation program officer and I have never had a clear set of guidelines. Thanks!"

Blue Avocado columnist Jeanne Bell replies:

Dear Bill: In these tough economic times it makes perfect sense that a board of directors would weigh the costs and benefits of spending $10,000 or more on this administrative expense. The short answer to your question is: "As soon as you have to."

The longer answer: A first tier for nonprofit audit requirements may be set by whether or not you receive federal funding. The federal government has not yet issued an across-the-board audit standard for nonprofits, although it could very well happen, given ongoing federal attention to charity regulation. Currently, nonprofits that expend $500,000 or more in federal contract dollars in a fiscal year must obtain what's called a 'single audit' to test for compliance with federal grants management standards.

Things get a lot more complicated at the state level. State attorneys general, who regulate nonprofits at the state level, have wildly varying standards for nonprofits, ranging from $100,000 thresholds to no requirement at all. You can contact your state attorney general or any auditor for your state's requirements.

And, in 25 states, audited statements must be submitted if you solicit funds in their states, whether or not you are located there. For instance, if you are based in Seattle but raise funds from donors in all 50 states by mail, phone, or other means, you must not only register annually with the 25 states that require it, you must provide an audit with your registration.

However, the 25 states vary in the amount of annual revenue at which they require an audit. If you have donors residing in multiple states, check out the Multi-state Filer Project to research and potentially simplify this cumbersome annual registration process. (There are another 13 states that require fundraising registration but do not require audited statements to be attached.)

What Else Triggers an Audit?

If you're not spending more than $500,000 in federal funds, nor raising money in states that require annual audits as part of state registration, what other factors should you consider? In many cases, foundation funders ask for an annual audit as part of their grant application process. If you are otherwise eligible for the grant, consider contacting a Program Officer or Grants Manager at the foundation and asking if submission of your IRS Form 990 in lieu of an audit will suffice.

The Form 990 actually provides more information about an organization than an audit does, although it lacks a CPA's sign-off attesting to the accuracy of account balances. Many foundations, sensitive to the fact that smaller organizations may not yet be auditing, will accept Form 990 during the application process, but may require a yearly audit after they have funded you.

AUDITING...

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You should also be aware that there are many groups that are establishing their own standards for when nonprofits should obtain audits. The Wise Giving Alliance has a $250,000 annual revenue threshold for audits, while the Standards of Excellence Institute's threshold is $300,000. The Independent Sector recommends a threshold of $1 million dollars. Remember, these are not regulating authorities but rather independent organizations attempting to influence nonprofit practice and how the general public evaluates potential donation recipients.

State Law Nonprofit Audit Requirements

Does your state's law require an independent audit?

You may wonder if your state's laws require a charitable nonprofit to conduct an independent audit.

Remember that some private foundations may require or expect a nonprofit grantee to conduct an independent audit;

A few states have laws that require nonprofits that receive a certain level of state funding to submit independent audits to the state agency that provided the funding or to another state agency(ies). If your nonprofit receives any government funding—state or federal—it is always a good idea to determine whether there is an accompanying audit requirement.

Some state government contracts may require an audit; there is a federal requirement to conduct an independent audit if the nonprofit expends $500,000 or more in federal funds in a single year.

Many states (26) require charitable nonprofits to submit a copy of audited financial statements in conjunction with the process of registering the charitable nonprofit so that it is able to lawfully engage in fundraising activities in that state (commonly known as "charitable registration").

Used with permission from the National Council of Nonprofits. Information is current as of May 2013. Visit the Council of Nonprofits' Nonprofit Audit Guide© at www.councilofnonprofits.org/nonprofit-audit-guide for more detail on these requirements and the most up-to-date information.

Benefits of Audits

Aside from these specific funder and donor-related factors, it's helpful to recognize three inherent benefits that an audit provides to a nonprofit:

1. **Donor and Community Confidence:** An unqualified audit opinion is a universally accepted indicator that an organization is investing in its financial management and that its financial statements are likely to be accurate. Beyond donors, the audit is a symbol to an organization's broad constituency, including the media and watchdog groups, that the organization is committed to fiscal accountability.

2. **Achieving Financial Best Practices:** Board and staff leadership benefit from an audit performed by a CPA who's knowledgeable about current nonprofit accounting standards —such CPAs can help move an organization towards best financial management practices. And even amongst experienced nonprofit finance staff, knowing that they will have to defend accounting judgments to an auditor at year-end encourages accounting discipline throughout the year.

3. **Some Protection Against Fraud:** An annual audit can bolster the soundness of internal controls. But caution: although the prospect of an audit may play a role in deterring malfeasance, a determined staff person or volunteer can find ways to steal that an auditor testing on-site for just two days each year may not detect.

Alternatives to Audits

If your organization's leadership decides that it wants some of these benefits but cannot afford the $10,000+ price tag, it may elect to engage an outside CPA in a financial statement review rather than a full-blown audit. A review does not include on-site testing and therefore does not conclude with an auditor's "opinion" —a technical term for the CPA's expert judgment—as to whether the financial statements prepared by the organization were prepared in accordance with accepted accounting principles.

This report is based on limited document review and communications with staff and/or board, and gives limited assurance that the financial statements reflect an accurate picture. For roughly half the price of an audit, you could share a CPA-prepared document with constituents, albeit one with less "bite."

Another recent wrinkle to factor into your deliberation of when to begin auditing is something called, SAS-112: an accounting standard with the full name of "Communicating Internal Control Related Matters Identified in an Audit." As Kate Barr of the Nonprofits Assistance Fund recently wrote in *The Nonprofit Quarterly,* "At root, the new standards increase the likelihood that control deficiencies will be identified and reported."

In other words, if you are just beginning to professionalize your accounting and have yet to produce audit-like financial statements each month on your own, you will get very little slack from your auditor come audit time. As Barr concludes, "The new standards make clear that an auditor's role is to test and verify the information provided by an organization and issue an opinion, not to calculate and produce financial statements."

Bottom Line on Audits

So what's the bottom line? In most cases, it makes sense for community nonprofit boards with operating budgets in excess of $250,000 to begin considering whether it's time to audit by evaluating their readiness in the context of SAS 112. And recognizing the potential benefits of an audit to build donor confidence and increase protection against fraud will also influence your decision. By the time you reach $500,000, the world at large will expect you to be making this annual investment and your accounting systems should be ready for the scrutiny.

WHAT ARE INTERNAL CONTROLS?

Internal controls are a set of policies and procedures to prevent deliberate or misguided use of funds for unauthorized purposes.

Why have them?

- ✔ Internal controls help to provide reliable data by ensuring that information is recorded in a consistent way that will allow for useful financial reports
- ✔ They also help prevent fraud and loss by safeguarding assets and essential records.
- ✔ Internal controls promote operational efficiency by reducing unnecessary duplication of effort and guarding against misallocation of resources.
- ✔ They encourage adherence to management policies and funding source requirements.

Information from: CompassPoint Nonprofit Services, Oakland, CA. – Jeanne Bell, CEO

AUDITING...

Resources

CompassPoint Nonprofit Services guides nonprofits as they become better managed, more adaptive, and achieve higher impact through teaching, coaching, consulting, and peer learning. ***www.compasspoint.org/***

Not-For-Profit Accounting Help gives expert advice, tailored to the needs of non-profit accounting and finance professionals. They are a community of people with an interest in the fiscal side of the operation of nonprofit organizations. The company is led by Not-for-Profit accounting expert Nancy Church, CPA. ***www.NFPAccountingHelp.org***

GWSCPA Nonprofit Financial Accountability Task Force is a nation-wide collaborative comprised of members of the accounting and nonprofit communities that seek to strengthen the nonprofit sector in the US by improving financial accountability in the sector through ongoing education initiatives and robust discussion of current topics. ***www.nonprofitaccountingbasics.org***

PhilanTech creates and provides technology to help social sector organizations do what they do...even better. Through innovative online products and services, PhilanTech helps organizations maximize social impact while minimizing environmental impact. ***philantech.com***

The Nonprofit Rick Management Center's mission is to help nonprofit leaders cope with uncertainty. They offer a wide range of services, from RISK HELP™ to Web tools, in-person and virtual training, and affordable consulting help. ***www.nonprofitrisk.org/***

The National Council of Nonprofits works through their network of State Associations, Nonprofit Allies, and State Policy Allies to protect and strengthen the capacity of charitable nonprofits so they can achieve their missions and serve their local communities. ***www.councilofnonprofits.org***

GuideStar gathers and disseminates information about all IRS-registered nonprofit organizations. They provide as much information as they can about each nonprofit's mission, legitimacy, impact, reputation, finances, programs, transparency, and governance. ***www.guidestar.org***

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A Co-op of River & Watershed Organizations

www.rivernetwork.org/programs/partnership-program

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Partnership Benefit Highlight

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Nonprofit Organizations & Local, State & Tribal Government Partners

Annual Budget	Annual Partner Dues
<$25,000	$150
$25,000 - $100,000	$200
$100,001 - $250,000	$275
$250,001 - $500,000	$375
$500,001 - $1,000,000	$500
$1,000,001 - $2,000,000	$675
>$2,000,000	$900
Business & Consultant Partners	
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