

GELMAN, ROSENBERG

& FREEDMAN

CERTIFIED PUBLIC ACCOUNTANTS



Proud Sponsor of Maryland Nonprofits

Financial Leadership: Best Practices

Maryland Nonprofits

Audit Partners:

Amy Boland, CPA

Jackie Oneto, CPA

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Amy Boland, CPA

Audit Partner, Gelman, Rosenberg & Freedman CPAs

- **17 years** of experience in auditing, consulting and accounting
- Specializes in audits for domestic and international nonprofit organizations, including foundations
 - Focuses on planning and budgeting audits in accordance with Yellow Book and OMB Circulars A-122 and A-133
- **Community Involvement:**
 - Treasurer of the American Association of Suicidology
 - Member, Institute of Management Accountants' Small Business Committee



Jackie Oneto, CPA

Audit Partner, Gelman, Rosenberg & Freedman CPAs

- **17 years** of experience in auditing and accounting
- Specializes in audits of nonprofit organizations including associations
 - Qualified to perform employee benefit plan audits, including 401(k), 401(a), 403(b), profit-sharing, pension and health and welfare plans
- **Community Involvement:**
 - Membership Committee Member of the Nonprofit Roundtable of Greater Washington
 - Community Council Member of the Tree House Child Assessment Center of Montgomery County



Agenda

- Management Responsibilities
- Board Responsibilities
- Key Financial Roles
- Overview of Financial Statements
- Operating Reserves
- Internal Financial Statements





Standards for Excellence

**MARYLAND
NONPROFITS**



**STANDARDS FOR
EXCELLENCE**

As the *Standards for Excellence™* states, “Nonprofits must practice sound financial management and comply with a diverse array of legal and regulatory requirements. A nonprofit's financial system should assure that accurate financial records are kept and that the organization's financial resources are used in furtherance of the organization's charitable purposes.”



Standards for Excellence (cont)

Nonprofits should invest the time and energy necessary to develop effective financial policies. Such policies should be adopted by the board of directors who are ultimately responsible for the financial state of the nonprofit.

**MARYLAND
NONPROFITS**



**STANDARDS FOR
EXCELLENCE**



Management's Responsibilities

- Establishing and maintaining internal controls
- Selection and application of accounting principles
- Establishing an accounting and financial reporting process



Management's Responsibilities (cont)

- Ensuring fair presentation of the financial statements in conformity with U.S. generally accepted accounting principles
- Management decisions



Management's Responsibilities (cont)

Those charged with governance:

- Designate individuals with suitable skills, knowledge or experience to oversee the programmatic, financial and tax needs of the organization



Management's Responsibilities (cont)

Those charged with governance:

- Establish and maintain internal controls
- Monitor financial and programmatic performance (financial reporting)



Accountability

“The state of being accountable, subject to the obligation to report, explain or justify something; responsible; answerable”

- Webster's Dictionary





Ingredients of Accountability

- Budgeting
- Timely and accurate financial reporting
- Internal controls and procedures manuals
- Functional expenses
- Cost allocations
- Restricted contributions



Board Members

- Trustees of the organization's assets; stewards of public trust
 - Objective, honest, efficient
 - Must exercise good decision-making, without placing organization at unnecessary risk



Board Members (cont)

- Does $1 + 1 = 3$?
 - Understand financial basics
 - Terminology
 - Read financial statements
 - Judge soundness
 - Recognize warning signs
 - Need to be a financial inquisitor



Board Members (cont)

- Set up and monitor key financial indicators
 - Agree on general guidelines and standards to measure effectiveness
 - Use proper tools to monitor and policies to guide decision-making



Board Members (cont)

- Ensure adequate control mechanisms
 - Prevent fraud
 - Clarify job descriptions
 - Define accounting procedures (signing checks, handling cash, approving expenses)
 - Manage potential conflicts of interest



Board Members (cont)

- Approve the budget and compare actual figures to projected ones
 - Prevents boards from micromanaging



Board Members (cont)

- **Oversee nonprofit's legal obligations**
 - Verify that all filing requirements and tax obligations are completed
 - Must regularly withhold and pay employment taxes
 - Document executive compensation and financial transactions



Getting Comfortable with Financial Statements

- All board members should receive financial statements at least seven days before the board meeting
- As part of the board orientation process, have new board members spend two hours with chief financial officer and chief executive officer



Recommendations



- 1) Give the entire board a half-day educational/training session conducted by executive management
- 2) Have external auditors attend the training and provide independent comments to enhance the training



Getting Comfortable with Line Items

- Board members should take the opportunity to understand every line item
 - Ask executive management to explain each summary line item
 - Each line on the financial report is important and has meaning
 - Set goals around these numbers



Role of the Treasurer

- Is familiar with organization's activities and understands nonprofit accounting requirements
- Gatekeeper and communicator of financial information
 - Chair of finance committee



Role of the Treasurer (cont)

- Communicates directly with chief financial officer
 - Assists, when needed, with budget presentation and preparation
 - Reviews audit process and answers questions about the audit report



Financial Committee

- May recommend financial policies, help review the budget and take a first look at financial statements
- May oversee the audit process
- May draft investment policies and hire and oversee the performance of an outside vendor



Role of the Chief Financial Officer

- Varies depending on size of nonprofit
- Principally responsible for preparing the budget, ensuring organization has viable business plan, communicating new nonprofit accounting laws and principles and safeguarding ethical standards



Budgets

Staff prepares and presents to the finance committee or board



Finance Committee revises and makes recommendations



Board approves a budget that reflects organization's goals and board policies

Financial Statements

Staff monitors income and expenses on a daily basis and prepares financial and program reports



Finance Committee reviews monthly financial statements with chief financial officer and executive director



Board reviews monthly or quarterly financial statements

Controls

Staff raises policy issues and provides information for standard accounting policy decisions



Finance Committee reviews accounting and control policies and makes recommendations for changes and improvements



Board ensures adequate financial controls and that financial reporting is in accordance with accounting practices



Audits

Staff provides information and offers recommendations to finance committee and responds to the management letter



Finance committee reviews the audited financial statements, management letter and response to management letter



Board hires auditor and reviews the audited financial statements, management letter and response to management letter

Investments

Staff provides information and analysis if needed



Finance Committee regularly reviews and makes recommendations about investment policies



Board approves the organization's investment policies and reviews them annually

Financial Communication

Staff provides training and information as requested



Finance Committee coordinates board training on financial matters and acts as liaison between board and staff



Board is well-informed about the organization's finances

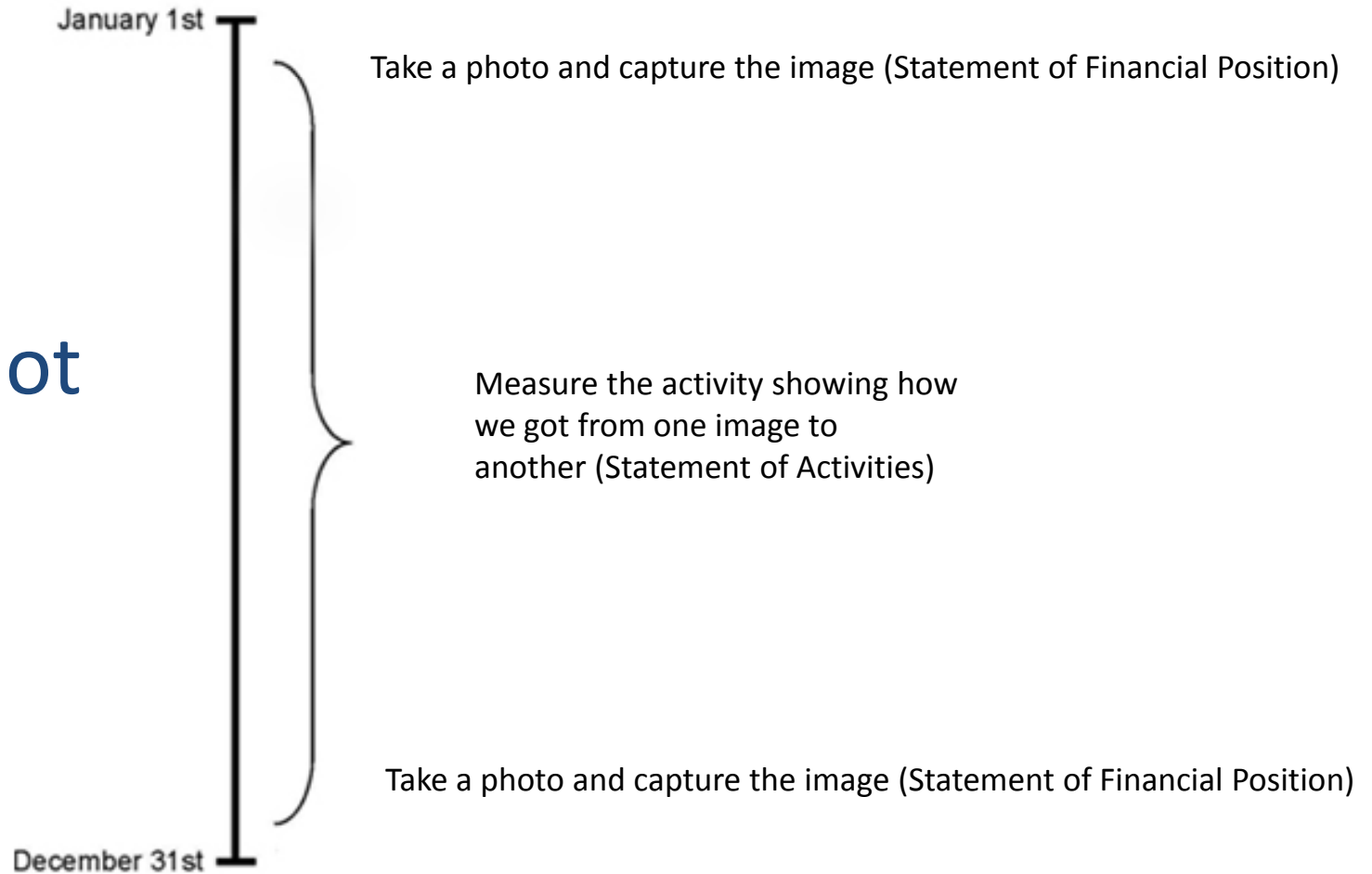


Financial Statements Overview

- Snapshot
- Reading financial statements
- Components of financial statements
- Nonprofit example
- Functional expenses example



Snapshot





Reading Financial Statements

- Who is reading your financial statements?
 - The purpose of financial statements
 - The story your financial statements tell about your organization



Components of Financial Statements

(refer to handout)

- Statement of financial position
 - Snapshot in time
- Statement of activities and change in net assets
- Statement of functional expenses



Components of Financial Statements

(cont/refer to handout)

- Statement of cash flows
- Footnotes
- Supplementary schedules





XYZ Foundation
Statement of Activities
For the Year Ended December 31, 2010

	<u>Total</u>
Revenue	
Contributions	\$ 15,000
Interest income	<u>100</u>
Total Revenue	<u>15,100</u>
Expenses	
HIV-AIDS	7,450
Nutrition	<u>2,000</u>
Total Program Expenses	9,450
Administration	<u>1,050</u>
Total Expenses	<u>10,500</u>
Change in Net Assets	<u><u>\$ 4,600</u></u>

- Functional Classification ([see glossary](#))
- Natural expense classification ([see glossary](#))
- Shows expenses by function instead of natural classification
- For a nonprofit entity, who are the users of the reports?
 - Management, potential donors, funders, board members, banks, regulatory agencies



**XYZ Foundation
Statement of Activities
For the Year Ended December 31, 2010**

	Temporarily		Total
	Unrestricted	Restricted	
Revenue			
Contributions	\$ 4,500	\$ 10,500	\$ 15,000
Interest income	100	-	100
Release from restriction	9,000	(9,000)	-
Total Revenue	13,600	1,500	15,100
Expenses			
HIV-AIDS	7,450	-	7,450
Nutrition	2,000	-	2,000
Total Program Expenses	9,450	-	9,450
Administration	1,050	-	1,050
Total Expenses	10,500	-	10,500
Change in Net Assets	\$ 3,100	\$ 1,500	\$ 4,600

- Show restricted categories in separate columns
- Show expenses by natural category in a statement of functional expenses



**XYZ Foundation
Statement of Functional Expenses
For the Year Ended December 31, 2010**

Expenses	Program Services		Admin.	Total
	HIV-AIDS	Nutrition		
Salary	\$ 5,050	\$ 1,500	\$ 450	\$ 7,000
Consultants	1,600	300	100	2,000
Travel	500	200	-	700
Program Materials	300	-	-	300
Rent	-	-	500	500
Total Expenses	\$ 7,450	\$ 2,000	\$ 1,050	\$ 10,500

- Administration and fundraising are called "supporting services"
- Page is optional for most organizations (but encouraged)

Note these interchangeable words: "administrative," "management and general," "general and administrative" and "overhead"



Audited vs. Unaudited

- Audit
- Review
- Compilation



GAAP vs. Non GAAP

- Generally Accepted Accounting Principles (GAAP)
- Tax Basis
- Cash Basis



Cash vs. Accrual Accounting

- **A** - On Jan. 12, a donor pledges to donate \$1,000 monthly for three months starting next month.
- **B** - On Feb. 8, you collect a donation of \$5,000 from a donor who had promised it last year.
- **C** - On Feb. 28, a customer uses your classroom for an agreed upon rent of \$800. You send them an invoice on March 2 and collect it on April 7.



Cash vs. Accrual Accounting (cont)

- **D** - On March 20, a foundation offers a donation of \$15,000. You receive the check in May.
- **E** - On Jan. 18, you spend \$5,000 on a project funded by a temporarily restricted donation. The money was collected last year.



Cash vs. Accrual Accounting (cont)

<u>CASH-BASIS</u>						<u>ACCRUAL-BASIS</u>					
	<u>Jan</u>	<u>Feb</u>	<u>Mar</u>	<u>April</u>	<u>Total</u>		<u>Jan</u>	<u>Feb</u>	<u>Mar</u>	<u>April</u>	<u>Total</u>
A	-	1,000	1,000	1,000	3,000	A	3,000	-	-	-	3,000
B	-	5,000	-	-	5,000	B	-	-	-	-	-
C	-	-	-	800	800	C	-	800	-	-	800
D	-	-	-	-	-	D	-	-	15,000	-	15,000
E	-	-	-	-	-	E	-	-	-	-	-
Total	-	6,000	1,000	1,800	8,800	Total	3,000	800	15,000	-	18,800



Red Flags (refer to handout)



- Unrestricted net asset deficit
- Net loss in unrestricted net assets (operations)
- Current liabilities exceed current assets



Red Flags (refer to handout)

- Insufficient current assets to cover temporarily restricted net assets
- Supporting service expenses \geq 25% of total expenses





Red Flags (refer to handout)

- Unrestricted net assets are less than net fixed assets (and deposits)
- Deferred revenue is greater than cash
- Temporarily restricted net assets exceed unrestricted net assets



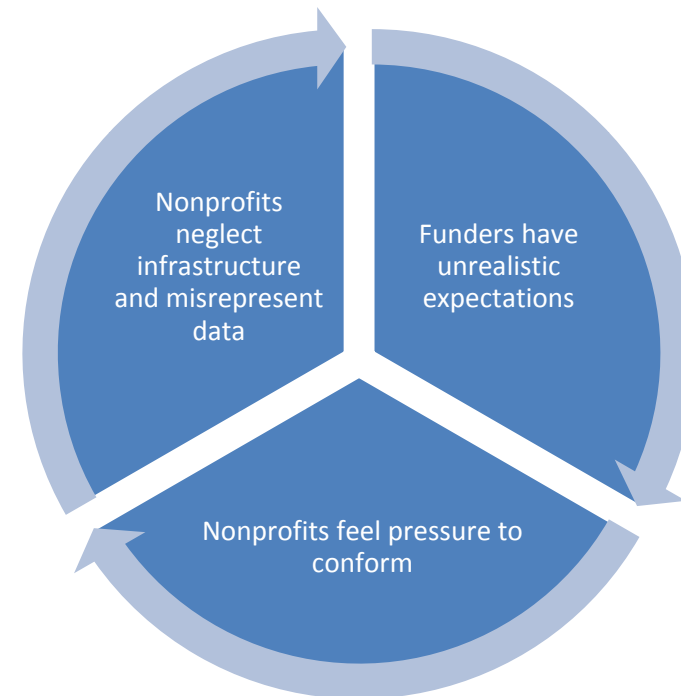
Red Flags (refer to handout)

- Temporarily restricted net assets are greater than cash plus grants receivable
- Accounts payable are greater than liquid assets



Overhead

- The cycle that starves nonprofits
- Cost of running programs (handout)





Reserves

- “Nonprofit” doesn't mean you should not make a profit
- Accumulation of unrestricted net assets
- Increase the ability to enhance and expand programs
- Can carry nonprofits through rough economic times



Reserves (cont)

- What is the appropriate reserve balance?
 - No single benchmark
 - Must evaluate your nonprofit
 - Internal and external factors
 - Stability of revenue/expenses
 - Maturity of the nonprofit
 - Future plans



Reserves (cont)

- Rule of thumb – 3 to 6 months of operating expenses
- Re-evaluate on an annual basis



Restricted Net Assets

- Temporarily restricted
- Permanently restricted



Internal Financial Reporting

- What's in your report?
- Comprehension is more important than completeness or proper form
- Reporting against budget
- Cash projections

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