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What's the role of the board of directors and Executive Director of a nonprofit corporation?

The National Council of Nonprofits says, "Just as for any corporation, the board of directors has three primary legal duties known as the "duty of care," "duty of loyalty," and "duty of obedience."

These duties are defined as follows:

1. Duty of Care: Take care of the nonprofit by ensuring prudent use of all assets, including facility, people, and good will;
2. Duty of Loyalty: Ensure that the nonprofit's activities and transactions are, first and foremost, advancing its mission; Recognize and disclose conflicts of interest; Make decisions that are in the best interest of the nonprofit corporation; *not in the best interest of the individual board member* (or any other individual or for-profit entity).
3. Duty of Obedience: Ensure that the nonprofit obeys applicable laws and regulations; follows its own bylaws; and that the nonprofit adheres to its stated corporate purposes/mission."

Typically, the board delegates responsibility for managing the functions that fulfill its role in meeting these legal requirements to the Executive Director. It is the Executive Director who ensures much of the execution of these duties by either hiring others to fulfill these duties (such as performing the audit, filing the annual tax return) or by delegating these functions to staff.

What does an Executive Director have to know to succeed?

An Executive Director cannot succeed without having a basic understanding of how accounting works in a nonprofit. Accounting and compliance is a large part of each of the three duties listed above. So what does an Executive Director have to know to succeed? We will try to answer that in this paper.

Annual plan and annual budget – what is the difference?

The first thing that an Executive Director needs to be comfortable with is establishing an annual plan and an annual budget. What is the difference?

Purpose and content of the annual plan

The annual plan is a written document which sets out the strategy and benchmark about the core activities for the nonprofit. Sometimes this is hashed out by pulling together the management team and, sometimes, stakeholders for a meeting to talk through the opportunities and challenges to the organization. The output from this meeting will then drive the drafting of the written annual plan.

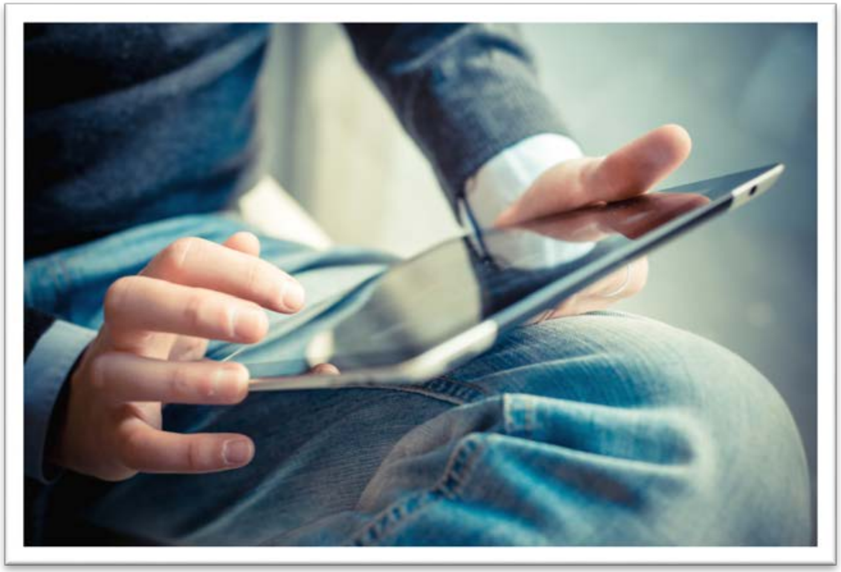
The annual plan should discuss what the factors are in determining whether fundraising or revenue from the core activities will be up or down and by how much. For instance:

- Is the new tax law going to effect fundraising in 2018 since some people contributed extra in 2017 to take advantage of the ability to itemize in 2017 when they will not be able to in 2018?
- Or if the nonprofit is in the security training area, is government spending projected to be up or down?
- What are the opportunities to increase the revenue or contributions?

When these types of projections are done, the sources should be cited so that fiduciaries of the business can follow along with the projections.

The annual plan should also discuss expense items and whether those expense lines will be up or down due to inflation or other factors. What is driving the expense factors of the business? Are there particular challenges such as in the Bay Area where employment is low and it is hard to keep employees. What is the plan to address that challenge? Or it could be a challenge for office space. Maybe there is an opportunity to reduce expenses. These should all be fully discussed in the annual plan before coming to some type of conclusion.

The annual plan should address each one of these opportunities and risks so that the reader can see that the Executive Director and the staff have addressed each one of the issues facing the business and can begin to quantify the opportunity or risk.



The annual budget and its use

The annual budget is a quantification of the annual plan: turning the projections in the written document into numbers. Sometimes while there are ranges in the annual plan, the authors of the annual budget will need to figure out what number to actually use in the range. The authors may have to determine a risk factor in determining the final number. They will have to determine a number for revenues/contributions for each core activity and each expense line item for each core activity. Each nonprofit activity should be budgeted separately and then aggregated so the business can be properly managed. At the end of each month, there should be a budgeted profit or loss.

The author of the budget will then need to construct a budgeted balance sheet by month. The tricky part here is determining how much in contributions or revenue will be received each month and, if the nonprofit has receivables, how much will be carried in receivables. Similarly, the budget author must make assumptions about how fast the payables will be paid and what will be carried in payables. Once this is determined, it is easier to determine how much cash you will carry each month. Once you have the balance sheet completed, then you can do a budgeted cash flow.

Why is it so important to go through these steps? Because numbers do not lie and the comparison each month between actual and budget will help you learn a great deal about your organization. Without this first step, you will be essentially flying blind and will not be able to explain to your stakeholders why and how your organization activity has differed from what you thought it would be.

Budgets and Forecasting

The next thing an Executive Director needs to know are forecasting. It is said in the finance world that a budget is obsolete the day after it is made. That is true to some degree. That is why it is important for a management staff not to stay too focused on budget variance analysis. Too many management staff are too concerned about "hitting the budget" when there is good reason why you may not hit the budget.

So at least quarterly, the management staff should be putting together a forecast of what the remainder of the year looks like and a rolling twelve month projection. This means evaluating what is happening with current revenue/contribution streams, shifts in programming and strategic opportunities. This should include columns on the income statement that compare actual/forecast to budget and call out the variances.

This may seem like a daunting task, but once a projection model is set up, it should take a couple days to update a forecast each quarter.

In some cases, Excel may work, but the formulas should be audited carefully before presenting it to stakeholders. Be warned though, one wrong keystroke within an Excel spreadsheet can cause a big problem in the projection.

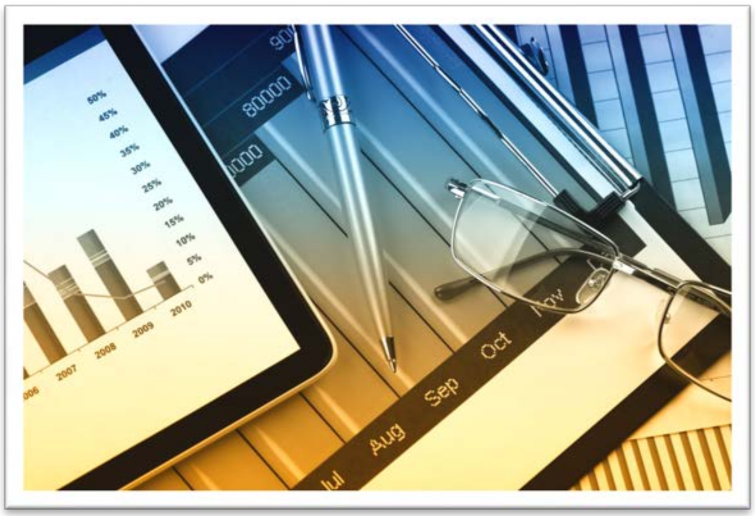
There are some good software models that can automate your budget and forecasting. This is worth reviewing and finding a software package that suits your needs.

Be careful in getting packages that are overly complicated for your organization. There are some packages that take a great deal of training and charge for any help. That is a situation that can be frustrating (and costly) for a nonprofit.

Seek to Diversify Funding - Don't Put All Your Eggs in One Basket

Just as in the investment world where you are told to diversify your investments, you should also diversify your revenue or source of contributions. Consider the dependability of the stream of revenue. There are some nonprofits that are successful and have government funding that is dependable while another nonprofit may be dependent on a multitude of small corporate and individual donations.

If you have multiple revenue streams, each revenue stream may need a complete new business process surrounding the revenue stream. This can be costly and may not be effective diversification that the organization is seeking. Some of the best nonprofits focus on getting a certain type of funding growth by securing multiple payers of the same type to support their work. In other words, they find one type of niche donor or revenue source and find multiple benefactors like those.



Cash Projection - Cash is King

A cash projection forecasts your cash flow over a certain period of time. The most important thing an Executive Director can have is the knowledge of an upcoming cash flow shortage. If projected ahead of time, an Executive Director can take action to deal with the cash flow crunch.

If the cash flow crunch is a timing issue, that can be resolved by deferring some bills until payments come in, having a line of credit, or working with other stakeholders on a strategic solution.

If this is a deficit that is due to shortfalls in projected funding, difficult decisions then need to be made to cut expenses to absorb a shortfall.

How to create a cash projection

To put together a cash projection, the Executive Director should work with the finance team to model an inflow and outflow of cash on a daily or weekly basis. This can be modeled based on the budget, but will need to be a bit more granular to get it down to a weekly forecast.

It is also important to implement this tool before you really need it. It will take time to fine-tune the projection tool. Do not abandon it when times are good. This should become a financial discipline that should be reviewed consistently so the model will be able to accurately predict a cash crisis before it occurs.

Plan for Reserves

All nonprofits want reserves. A reserve is something that can help you weather the inevitable recession or a temporary cash crunch. It is **not** something that should be used to fund a long-term gap in funding. It allows a nonprofit to think strategically rather than having to panic.

First determine what the surplus needs to be. Usually, a building a surplus is not the concern of the IRS as long as those funds are generated from the 501(c)3 purpose of the organization.   Typically, the minimum reserve should be 3 – 6 months of operating expenses. The board should be consulted about how much of a reserve the organization should carry. This is a strategic decision that is unique to the organization.

Once the decision is made as to the size of the surplus, this amount needs to be integrated into the budget so the unrestricted fund generates a profit. This means that either the nonprofit will need more fundraising or decrease expenses in order to build the reserve. This could be difficult. That is why the board and the staff should be included in the decision to build a reserve. This will help generate a team approach to building a reserve. If both the board and staff are part of the decision-making process, they are more likely to work hard to build that desired reserve.

Think Broadly about Restricted Funding

Sometimes you have an easier time getting restricted funding than general funding. There is a tendency to accept the funding on the grantor’s terms. Think carefully about accepting as the “devil is in the details.”

You need to take a very broad view in negotiating restricted grants. For instance, you may need to hire additional program staff, marketing and outreach, staff development, program evaluation, and other types of overhead.

It is up to the Executive Director to fight to get these grants classified correctly and not just in overhead. Grantors that understand the value of the mission can provide a strong revenue stream allowing you to properly fund the organization. However, you need to have proper, well-thought out programs and budgets that show the effect on the organization before taking on a new grant so you have a good understanding of the effect it will have on the organization.

Properly Staff the Finance Function

An Executive Director who does not properly staff the finance function is essentially dooming his or her own chances of success. Without the proper finance people, there will be legal and financial issues that emanate from this failure. All of the things we talked about thus far are predicated on a strong finance team.

There are two ways to staff the accounting department: You can outsource the accounting to a professional firm or hire individual staff to serve in-house.

By hiring a staff, you are responsible for:

- vetting the candidates
- staff performance reviews
- managing personnel and accounting issues that arise
- ensuring cross-training among the staff
- investing in/maintaining technology sufficient for the organization
- disaster recovery of the software
- being alert for fraud, and
- ensuring proper controls are in place to prevent assets from disappearing

You will also need to determine what position should be doing what work. For instance, you do not want a Finance Director entering payables and issuing invoices for receivables. You also do not want a payables clerk making financial decisions or accrual decision that are above their ability. This is the old (last century) staffing model for a nonprofit accounting department.

By outsourcing this function, you do not have people onsite working on the finance function. Instead you get a professional team that works remotely that handles all the financial transactions. An infrastructure of technology with policies and procedures and best practices is built by the team on your behalf.

This allows an Executive Director to feel comfortable that they have the most efficient accounting team that their money can buy. Generally, outsourced teams will be up on the latest technology and best practices. When you outsource, turnover within the accounting department is no longer an issue for you. If a person leaves the outsourced accounting firm, they are replaced with no disruption to your organization. There is no interruption of business as successful outsourcing teams cross-train their staff to ensure continuity for their clients. Usually the outsourced option is 10-15% less expensive than having an in-house staff due to not having to pay benefits.

Accurate, meaningful, understandable board reports

The Executive Director and the Finance Staff should design board reports that are understandable to non-accountant board members. The type of reports needed will depend on the size of the organization.   Board Books with dashboard reporting is a great way to ensure that the board members are seeing the key performance indicators. The board members should not be getting detailed accounting reports unless they actually want them. They could get lost in the detail. In today's best nonprofit accounting solutions, the software actually has the ability to prepare a board book with insightful analysis at the touch of a button.

We use Sage Intacct in our practice. Sage Intacct is uniquely suited for nonprofits and provides a board book that is flexible and can be modified to fit your needs. It can also provide board members with a virtual dashboard so they can stay up to date with anytime, anywhere access. The more a board has access, the more they feel included.

When you present options to a board, make sure the board has the background and situation/scenarios based on two or three actions. The board should not be inundated with detail and asked to problem-solve. Make sure the reports you are giving them follow this form.

Insurance is boring – until you have a problem.

A thorough review of the insurance should be done when an Executive Director is new to the organization. I have seen many times where the insurance is inadequate and different or new coverage needs to be obtained. Insurance is boring until there is a problem. The areas to focus on:

Directors & Officers – Indemnifies an organization and its directors and officers against allegations of wrongful acts resulting from management and governance of the organization. Claims that are covered include: Acting beyond the authority granted under governing documents; misuse of funds (other than theft); conflicts of interests; and discrimination (other than with respect to employees). This should cover employment practices (hiring or promotion).

General Liability – Covers claims of bodily injury or property damage. Remember if you host events offsite, you will also want the insurance to follow you to the event. That way you are covered. Many hotels will request the certificate of insurance before you hold the event at their hotel. This policy may or may not cover volunteers. You should make sure you are covered if a volunteer causes a claim.

Criminal Acts Insurance – Protects policyholders for losses incurred as a result of theft and fraudulent acts by specified individuals/volunteers. It usually insures a business for losses caused by the dishonest acts of its employees. May be able to secure coverage to cover contractors as well.

Professional Liability – This insurance protects against errors and omissions in delivery of your professional services. Keep in mind that the term “professional” has expanded in recent years. If you engage in counseling, vocational training or other kinds of instruction, you may have professional liability exposure.

Workers’ compensation – This insurance provides coverage for job-related injuries and is usually mandatory under the law. Additionally, you may need to cover volunteers under state law. You should talk to your insurance agent about whether your jurisdiction requires this insurance.

Auto Insurance – There should be procedures in place to ensure that any employee or volunteer driving on behalf of an organization is a safe driver. You should also obtain proof of current automobile liability insurance.

Excess Auto Liability Coverage for Volunteers – This insurance provides extra liability protection above the limits of the volunteer’s personal automobile coverage. Many volunteers only have minimal coverage and can be at risk of a large financial loss if they are at fault in a serious accident while driving on behalf of the nonprofit organization.

Cyber insurance – Protects a company against a breach of its IT system which leads to disclosure of customer/donor protected information.

Umbrella Insurance – Umbrella insurance provides an additional layer above the underlying policies. This insurance is usually very cheap and can provide additional peace of mind.

Other – If you have buildings, office equipment or other property, you may need to obtain additional insurance. You should check with your insurance agent. You may also want to check into business interruption insurance.

One final word of advice – if you have quite a few independent contractors that get 1099’s at the end of the year, do yourself a favor: get an attorney to review if the independent contractors are really independent contractors and not employees. It is better to find out up front rather than incurring an embarrassing audit that requires you to pay all the taxes and penalties because the previous management had them classified incorrectly.

Tax Form 990

Your organization's 990 is due four and one-half months after the close of the fiscal year (May 15 for calendar year-end organizations). You can get an extension for six months to finalize your numbers. **Be advised: penalties are substantial** - so if someone else is responsible for filing the 990, you should put it on your calendar to follow-up with them to make sure it is done on time. Small organizations with annual gross receipts under $50,000 must file a form 990-N (e-postcard).

The importance of this form is, first and foremost, government compliance, but it is also important because it is a public document and listed on Guidestar. Therefore, care should be taken in completing this form and it should be reviewed thoroughly by management to ensure its content is telling the correct story.

Part III of the 990 is the Program Service Accomplishments section that requires you to describe your largest programs and how much you spend on them. Sometimes the Executive Director allows a tax accountant to complete this section. However, this section should be drafted by the Executive Director so the section tells the correct story about the nonprofit mission and accomplishments. Remember that this document will be viewed by potential grantors or contributors and it could make the difference in their decision.

Part VI is the Governance, Management, and Disclosure that asks about the board's structure, policies and practices. Having a conflict of interest policy is advisable. This section also asks whether an organization posts the form 990 on the website and whether there is an annual review for the compensation of the executive director and other key employees.

Part IX is the Statement of Functional Expenses. This is where readers will find out how you spend your money on non-program activities like fundraising and management. This is why your accounting staff has to know how to correctly allocate overhead costs. Both direct and shared costs across the core functions must be classified correctly. Your software should be able to accomplish this task. If you have trouble with this function, you should be looking at a software like Sage Intacct to assist you with this area.

In the form 990, in Section O, in "Other Organization Documents Publicly Available" you should review what documents your organization represents it makes publicly available. If there is a political sensitivity about which organization documents to make public, review this with a professional to understand what you should be providing both legally and to assist others in evaluating your organization.

Summary

Often executive directors feel as though they don't have good choices when it comes to addressing the accounting function in their organization. They need multiple skill levels (bookkeeper, senior accounting, Finance Director), but with limited budgets may only have the funds to hire one position.

That's why outsourcing accounting has become the fastest growing best practice of the 21st Century. For a monthly fee (that is often less that an FTE), Unalp CPA Group can put a team of diverse accountants, who specialize in nonprofits, to work on your day-to-day accounting activities and also provide the strategic, C-Level insight and direction when you need it.