Keys to Effective Financial Management for Nonprofits

Kelly Shafer, CPA

November 20, 2020
Serving the Mission

- Not-for-profit does not mean you cannot make money
- Mission driven, not profit driven
- Need cash flow and strategic reserves to effectively carry out the mission
- Requires sound financial management
Keys to Effective Financial Management

- Board Oversight
- Budgeting/Reporting
- Managing Cash Flow
- Internal Controls
- Grant Reporting and Compliance
BOARD OVERSIGHT
Financial management starts at the top with board oversight

- Choose board members wisely
- Leverage individual strengths
- At least one board member should be well versed in financial issues
- Board can play a key role when there is limited segregation of duties
BOARD OVERSIGHT

Make sure board members are getting the information they want/need.

Work with them to understand what information would be most helpful to them.
BUDGETING/REPORTING
An operating budget is a financial reflection of what a nonprofit expects to accomplish over a 12-month period.
BUDGETING

- Why are budgets so important?
  - Effective planning tool
  - Holds the organization accountable
  - Promotes transparency
BUDGETING

- Elements of a budget
  - Revenue sources
    ▪ Know exactly where your funds will come from
  - Expenses
    ▪ Be precise
    ▪ Use actual numbers as much as possible
    ▪ Document assumptions
  - Net Income
    ▪ Do not always have to break even
BUDGETING

Budgeting Tips

- Focus on the big picture
- Be realistic
- Start with actual results of the prior year
- Factor in any known changes
- Analyze trends (fundraising)
BUDGETING

Budgeting Tips

- Consider restrictions
- Follow the chart of accounts
- Involve everyone
- Don’t forget about in-kind
- Know where you can be flexible
- Monitor BvA monthly
BUDGETING

Be practical when weighing the pros and cons of a new program or service. If it costs too much to implement and deliver, it may not be the best fit.
REPORTING

- Basic Financial Statements
  - Balance Sheet
  - Income Statement
  - Cash Flow Statement
Financial Statements – Internal Users

- What can you learn?
  - Larger Numbers – give the first clue about what is important
  - Comparative Data – more informative when compared across years
  - Analysis – look for trends in accounts and operations
  - Strategy – develop plans to improve finances
Financial Statements – External Users

- What are they looking for?
  - When borrowing money, what do financial statements tell potential lenders?
    - Are you well capitalized?
    - Do you have the capacity to pay loans back?
    - Do you have assets that could be pledged as collateral?
  - When requesting gifts/grants, what do financial statements say to potential donors?
    - Do you steward money wisely?
    - Do you already have enough money? Or are you so strapped for cash that they would be risking putting money into a “black hole”?
MANAGING CASH FLOW
MANAGING CASH FLOW

Many nonprofits live and die by cash flow

More important than ever right now!
MANAGING CASH FLOW

- Best Practices
  - Develop a cash flow projection
  - Know what you have in the pipeline (donors, grants, etc.)
  - Stay on top of changes that impact funding
  - Timing of grant funding is critical to cash flow
  - Be willing to modify the budget as needed in reaction to shortfalls
# MANAGING CASH FLOW

## 6 Month Cash Flow Projection

<table>
<thead>
<tr>
<th></th>
<th>January</th>
<th>February</th>
<th>March</th>
<th>April</th>
<th>May</th>
<th>June</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Beginning Cash Balance</strong></td>
<td>$100,000</td>
<td>$62,000</td>
<td>$76,000</td>
<td>$187,500</td>
<td>$107,500</td>
<td>$77,000</td>
</tr>
<tr>
<td><strong>Cash Inflows</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>$32,000</td>
<td>$70,000</td>
<td>$175,000</td>
<td>$20,000</td>
<td>$60,000</td>
<td>$80,000</td>
</tr>
<tr>
<td>Total Cash Inflows</td>
<td>$32,000</td>
<td>$70,000</td>
<td>$175,000</td>
<td>$20,000</td>
<td>$60,000</td>
<td>$80,000</td>
</tr>
<tr>
<td><strong>Cash Outflows</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>$20,000</td>
<td>$8,000</td>
<td>$15,000</td>
<td>$50,000</td>
<td>$40,000</td>
<td>$25,000</td>
</tr>
<tr>
<td>Payroll</td>
<td>$48,000</td>
<td>$46,000</td>
<td>$46,500</td>
<td>$48,000</td>
<td>$48,500</td>
<td>$47,000</td>
</tr>
<tr>
<td>Loan Payment</td>
<td>$2,000</td>
<td>$2,000</td>
<td>$2,000</td>
<td>$2,000</td>
<td>$2,000</td>
<td>$2,000</td>
</tr>
<tr>
<td>Total Cash Outflows</td>
<td>$70,000</td>
<td>$56,000</td>
<td>$63,500</td>
<td>$100,000</td>
<td>$90,500</td>
<td>$74,000</td>
</tr>
<tr>
<td><strong>Net Cash Flows</strong></td>
<td>$(38,000)</td>
<td>$14,000</td>
<td>$111,500</td>
<td>$(80,000)</td>
<td>$(30,500)</td>
<td>$6,000</td>
</tr>
<tr>
<td><strong>Ending Cash Balance</strong></td>
<td>$62,000</td>
<td>$76,000</td>
<td>$187,500</td>
<td>$107,500</td>
<td>$77,000</td>
<td>$83,000</td>
</tr>
</tbody>
</table>
MANAGING CASH FLOW

- Have a reserve fund in place
  - Critical for long term sustainability
  - Helps to make it through phases of decreased support and economic downturns
INTERNAL CONTROLS
INTERNAL CONTROLS

By nature, an effective internal control structure is critical to nonprofits. However, they often have the least amount of resources available to put a sound structure in place.
INTERNAL CONTROLS

- Why do you need controls?
  - Effective internal controls can prevent, deter, and detect fraud
  - Controls limit opportunities to hide the fraud trail

Remember: Even the strongest internal control structure cannot guarantee fraud will not occur.
INTERNAL CONTROLS

- Consequences of fraud:
  - Financial loss
  - Unwanted media attention
  - Damage reputation with donors, grantors, and community
The “Fraud Triangle”

Opportunity

Incentives/Pressures

Attitude/Rationalization

FRAUD TRIANGLE
The “Fraud Triangle”

Opportunity

Circumstances within an organization that allow fraud to occur. This is the area you can control.
The “Fraud Triangle”

Examples of Opportunity

– Weak internal controls
  ▪ Poor segregation of duties
  ▪ Minimal oversight
  ▪ Lack of review (management or board level)
The “Fraud Triangle”

- Examples of Opportunity
  - Poor tone at the top
    - Management and the board of directors should display strong ethical standards and show integrity
    - Communicate core values to employees
The “Fraud Triangle”

- Examples of Opportunity
  - Inadequate accounting policies
    - Having clear policies in place sets a standard for employees to follow
    - Creates expectations
The “Fraud Triangle”

Incentives/Pressures

An employee’s mindset toward committing fraud.
The “Fraud Triangle”

- Examples of Incentives/Pressures
  - Pressured by a superior
  - Personal incentives
    - Wants or needs to earn more money
    - Gambling or drug addiction
    - Fallen on hard times financially
The “Fraud Triangle”

**Attitude/Rationalization**

An employee’s justification for committing fraud.
The “Fraud Triangle”

- **Examples of Attitude/Rationalization**
  - “I don’t get paid enough for what I do”
  - “I’m not appreciated”
  - “I was treated unfairly”
  - “No other option”
  - “No one will notice”
The “Fraud Triangle”

Collusion makes everything worse!
INTERNAL CONTROLS

Common Fraud Schemes in Nonprofits

- Skimming
- Fictitious vendor schemes
- Kickback from vendors
- Theft of physical assets
- Payroll/bonuses

- Ordering merchandise for personal use
- Using credit cards for personal purchases (be cautious of credit cards/gas cards)
INTERNAL CONTROLS

What To Look For – RED FLAGS!

- New/unfamiliar vendors
- Vendors with only a P.O. Box address
- Vendor address matches employee address
- Sudden increase in purchases from one vendor
- Refusal to take vacations/unwilling to share duties
- Transactions conducted on weekends or holidays
- Missing or altered documents
- Questionable or missing signatures
- Living beyond one’s means
INTERNAL CONTROLS

**Controls to Implement**

- **Segregate duties** - don’t have the same person open the mail, prepare deposits, take the deposit to the bank, and record the transaction.

- Access controls – only allow employees access to areas they need to perform their job.

- Employee that can sign checks does not also have access to check stock.

- Dual signatures on checks.

- Monetary authorization limits.

- Avoid signature stamps.
INTERNAL CONTROLS

Controls to Implement

- Monthly bank statements mailed directly to a board member for review or provide access to online banking
- Approval of credit card charges and monthly reconciliation of statement
- If using electronic approvals keep a paper trail (emails)
- Cross training of employees
- Require annual vacations
- Background checks
- Annual audit/review
- Fraud tip line
INTERNAL CONTROLS

Controls not only protect the organization, but employees as well.
GRANT REPORTING AND COMPLIANCE
GRANT REPORTING AND COMPLIANCE

- Federal Grants
  - Single Audit (annual expenditures > $750,000)
  - Federal pass-through dollars from the State are still considered Federal funding
  - Subject to federal monitoring
  - Reporting requirements
GRANT REPORTING AND COMPLIANCE

- State Grants
  - $50,000 threshold – based on grants received in a year
  - Must report on whether state grants were spent as intended
  - File within 2 years of the end of the fiscal year when disbursements were made
  - Failure to file results in grantee being barred from receiving State grant funds
GRANT REPORTING AND COMPLIANCE

- Private Grants
  - Varies depending on grantor
  - More flexible
  - Most common:
    - Final grant accounting
    - Project results/outcomes
KEY TAKE AWAYS

1. Leverage your board

2. Controls are critical

3. Know your cash position
Thank You!

Kelly Shafer, CPA
Member
Email: kshafer@suttlecpas.com
Phone: 303-343-4126
Office: Charleston

Charleston Office
1411 Virginia Street East
Suite 100
Charleston, WV 25301
Phone 304-343-4126
Toll Free 1-800-788-3844
Fax 304-343-8008

Parkersburg Office
200 Star Avenue
Suite 220
Parkersburg, WV 26101
Phone 304-485-6584
Fax 304-485-0971

Morgantown Office
68 Clay Street
Suite C
Morgantown, WV 26501
Phone 304-554-3371
Fax 304-554-3410