

SECTION III: FINANCIAL MANAGEMENT AND OVERSIGHT

Summary

A nonprofit board of directors has clear fiduciary responsibilities and is charged with safeguarding the assets of the organization. One way to ensure prudent financial management is for the board of directors to adopt financial policies. Financial policies clarify the roles, authority, and responsibilities for essential financial management activities and decisions.

Financial Oversight Starting Point

When you are determining the procedures you wish to put in place to ensure that your organization is managed with fiscal prudence and transparency, you should start with some simple requirements.

- The board should be provided with regular financial reports.
- The organization needs an annual budget to be approved well before the start of the fiscal year. Who is responsible for generating it?
- There are financial policies in the organization's bylaws and should be reviewed annually.
- There should be internal control procedures.¹⁸
- There should be an Audit Committee or group that reviews the annual financial report prepared by the organization's auditors.
- There should be a committee or group who independently review any potential conflicts of interest and the organization's whistleblower policies.
- The entire board is tasked with approving the IRS Form 990 before submission.

Reporting to the IRS – Form 990: One of the most important documents that an organization will produce is its annual report to the IRS. The 990 is a public document; it is available on the web in a number of different places and anyone who asks for a copy must be provided with one. Therefore, this document is more than a financial return demonstrating to the U.S. Government that the organization has used its funds in service of its nonprofit purpose. It is also the primary means of communicating to the public at large the work the organization is doing and that it is well governed and efficient. A well-constructed 990 may serve as a kind of 'annual report' if it includes all of the basic disclosures that should be in such a document – such as mission, summary of program achievements, list of board members and officers, and a financial summary listing total income versus expenses broken out by program, administration and fundraising, plus ending net assets.¹⁹

¹⁸ For more information on internal controls, see New York State's *Internal Controls and Financial Accountability for Not-For-Profit Boards* at http://www.charitiesnys.com/pdfs/Charities_Internal_Controls.pdf.

¹⁹ For more information on Annual Reporting and Better Business Bureau of Metropolitan NY standards, see Standard 16 at <http://give.org/for-charities/How-We-Accredit-Charities/>.

Some key sections of the 990 include:

- Front page: This is the summary financial review document. It should be signed by a member of the Board (either the Chair or the Treasurer). By the time the reader gets to the end of this page he/she knows how many board members the organization has, how many staff, whether it spent more or less than it earned in the past two years, and where its money comes from.
- Part III, Page 2: This section asks about the work the organization has done of the past year. You should use this section to toot your own horn – report on the depth and impact of your programs and key accomplishments. If the space provided is not enough, you can add addenda. This is an opportunity to tell your impact story in a key document that funders will look at; everyone should take advantage of it.
- Parts IV, V, VI and VII: Many people think that the Sarbanes-Oxley Act, which was created to rebuild public trust in the corporate community in the wake of corporate and accounting scandals, applies only to for profit corporations. In fact, some key provisions also pertain to the nonprofit sector, many disclosures of conflicts and policies that your organization should have policies regarding.²⁰
 - For example, Part IV asks if the organization conducted activities that require disclosure. Several questions ask if the organization made grants or loans to employees, board members, and/or their relatives. If your organization is going to answer “yes” to these questions, it is essential that you have a policy in place regarding conflict of interest issues, established in accordance with relevant laws, and that you follow the policy.¹⁹
 - Similarly, Part V requires the disclosure of many details of the organization’s governance – were relatives involved, were all decisions made by the entire board, did the board delegate its authority to any other entity. Again, if your answer is “yes”, you need to have thought all of this through. It also asks if you have whistleblower, conflict of interest, and document retention policies in place. In certain cases you may be required by law to have some of these policies in place. As a best practice, you might want to consider having all of them in place, so you can check the “yes” boxes in this section.
 - In Part VII, the organization lists its board members, key employees, and highly compensated. It also lists the organization’s five highest paid consultants. Board members should check this section for accuracy (including name spelling), as this is going out on the World Wide Web. The names and compensation of the consultants should not be a surprise.

²⁰ Please note that *certain* policies are now required by New York State law. Visit http://charitiesnys.com/nonprofit_rev_act.jsp and reference the Nonprofit Revitalization Act of 2013 for further guidance.

- The rest of the document is straightforward disclosure of financial information. Every board member should be familiar with this information, which flows from the annual audit. There is a section where the names and addresses of the organization's largest donors are disclosed. This section is redacted from the version made available to the public.

The Mission and Financial Oversight

An organization's mission addresses the tax-exempt purposes for which resources are to be devoted. It is the board's fiduciary obligation to ensure that all money raised and spent is in furtherance of it successfully carrying out this mission. The general duties of care, loyalty, and obedience have been addressed in depth previously (Section I). As they pertain directly to the board's financial obligations, they include building the financial health of the organization by making and acting on sound financial decisions, policies, budgets, and controls that:

- Are mission, ethics, and priority-driven
- Ensure accuracy, integrity, transparency, and compliance
- Create stakeholder and public confidence
- Strengthen viability and build, protect, and best utilize corporate assets
- Follow an accountability structure

Interests and Requirements of Regulators and External Stakeholders

Charities are a public trust, and there are many regulatory entities that monitor their performance in order to protect the donors who support them and the constituents they serve. In addition, many donors want to review an organization's finances to ensure that their donations are being well spent.

A few regulatory/funding government agencies whose oversight your nonprofit may be subject to are: the IRS, New York Attorney General's Charities Bureau, and any government agency that funds your organization.

If you receive discretionary funding from elected officials, they are run through New York State and/or New York City agencies. For example, if your local assembly member secures a grant to help repair your playground, it will be run through a contract with the Office of Children and Family Services (OCFS).

Board Oversight and Interactions with Auditors

In the state of New York, nonprofits must file their financial information every year with the Charities Bureau. For nonprofits of sufficient size, these must be statements reviewed or audited by an independent accountant, as required by law.

- If you are an organization that is required to file a certified audit, you must have a board or an authorized committee be responsible for retaining the outside auditor and reviewing findings.

- If your organization has revenue in *excess of \$1 million*, the board, or a designated audit committee *comprised solely of independent directors* must:
 - Review with the auditor the scope and planning of the audit prior to commencement.
 - Upon completion of the audit, review and discuss:
 - Any material risks and weaknesses in internal controls identified by the auditor.
 - Any restrictions on the scope of the auditor’s activities or access to requested information.
 - Any significant disagreements between the auditor and management.
 - The adequacy of the accounting and financial reporting processes.
 - Annually consider the performance and independence of the auditor.
 - If this work is performed through an audit committee, a report on the committee’s activities must be made to the board.
 - The board or audit committee must oversee the adoption, implementation of, and compliance with any adopted conflict of interest policy or whistleblower policy if this function is not otherwise performed by another committee.

Whistleblower Policy & Procedures

As discussed in Section I, any nonprofit in New York State with revenues in excess of \$1 million must have a whistleblower policy and procedures. The Audit Committee, which is comprised of independent directors, is responsible for overseeing the creation and implementation of this policy.

The Bylaws-Policy-Procedure Flow

The bylaws, financial policies, and procedures work together through a process of checks and balances to ensure financial accuracy, integrity, accountability, and compliance. Bylaw provisions, policies, and procedures alone do not provide sufficient internal controls –they must be *operationally effective*. Board accountability starts with the bylaws.

Bylaws

- Bylaws are legal documents that state the rules and organization for governance. Compliance is required.
- The bylaws create the framework for financial governance decision making, monitoring, and reporting processes.
- The bylaws serve as a risk management tool.
- Bylaws should be reviewed periodically to consider whether updates are needed for legal compliance or other reasons.
- They are usually not amended without timely notification.

Setting Up the Governance Financial Oversight Structure: Navigating the Maze

Boards have officers whose responsibilities exceed those of other board members (this will be discussed further in Section IV). Among them are a president (or chair), a treasurer, and a secretary.

The treasurer should be carefully selected. It is critical that this individual understands finances and accounting, can ask critical questions, and can identify risks, opportunities as well as red flags.

The treasurer's fiduciary responsibilities include the following:

- Oversees all financial activities of the nonprofit
- Custodian of all funds and securities of the nonprofit
- Ensures that all financial matters are managed in an appropriate manner.
- Ensures that assets are held as designated

The treasurer's duties as an independent board member overseeing fiscal affairs, including the following:

- Regularly reports financial condition to board and at annual meeting
- Serves on/interacts with finance-related committees
- Interacts with auditors
- Works closely with Executive Director or CEO and fiscal officer
- Is a signatory
- Performs other duties, as assigned

The board secretary's role in financial accountability includes ensuring proper corporate recordkeeping and meeting notification.

Minutes are critical and should document:

- Reports and material presented.
- Proper board oversight, inquiry, deliberation, and voting regarding financial decision making (including committees).
- Approval (signature of secretary).

In order for the board to make timely decisions that involve finances, the treasurer and the finance committee must submit an annual budget for approval and make regular reports to the board about the organization's progress versus its budget.²¹

²¹ For more information about Finance-Related Committee Options, see "Section III: Resources" at the end of this section.

SECTION III: RESOURCES

Finance-Related Committee Options

The Finance Committee

- Recommends budget and revisions to board
- Recommends financial policies and monitors compliance
- Reviews new funding and obligations
- Periodically reviews format and adequacy of financial reports and internal controls
- Monitors and ensures adherence to regulatory requirements and filing (IRS Form 990, CHAR 500, etc.)
- Maintains insurance coverage
- Oversees all audit activities (internal and external/independent and other)
- Ensures that audit recommendations are addressed
- Takes financial responsibilities not assumed by other committees
- Oversees and deliberates on conflict of interest disclosures

Audit Committee (Separate)

- Assumes audit and whistleblower policy-related functions
- Policy focus on fraud and internal controls
- “Independence” is valued – composition, interests, access to legal and other expertise, etc.
- Creation depends on organization size and complexity
- Oversees and deliberates on conflict of interest disclosures
- Nonprofits of a certain size may need to meet specific audit committee requirements under New York State law. See *Audit Committees and the Nonprofit Revitalization Act of 2013* at http://www.charitiesnys.com/pdfs/Audit_Committees.pdf.

Tips for Developing Financial Management Committees

- Be clear about committee charge; avoid duplication
- Do not create more than needed or can be supported and sustained
- Keep treasurer fully informed of all financial matters
- Consider chair other than treasurer for the Finance Committee
- Value independence and manage conflicts of interests
- Mix board “experts” with “non-experts”
- Avoid staff as voting members
- Executive Director or CEO should attend meetings with key fiscal staff

Self-Assessment

- The Nonprofit Association of Oregon. *Nonprofit Financial Management Self-Assessment Tool*.
<http://www.nonprofitoregon.org/sites/default/files/uploads/file/Fin%20Mgmt%20Self%20Assessment.pdf>.

Other Useful Resources

- Standards of Excellence in Nonprofit Financial Management
<http://www.humanservicescouncil.org/Commission/Standards%20of%20Excellence%20in%20Nonprofit%20Financial%20Management.pdf>
- Nonprofit Financial Stability KPI Recommendations
<http://www.humanservicescouncil.org/Commission/Nonprofit%20Financial%20Stability%20KPI%20Recommendations.pdf>