Financial Management

Principles

Nonprofits have an obligation to act as responsible stewards of their financial resources. ▶ *Nonprofits must comply with all legal financial requirements* and should adhere to sound accounting principles that produce reliable financial information, ensure fiscal responsibility, and build public trust. Nonprofits should use their financial resources to accomplish their missions in an effective and efficient manner, and should establish clear policies and practices to regularly monitor how funds are used. Adherence to best practices, especially for those nonprofits that do not receive an annual audit or financial review, is critical to maintaining compliance and public trust.

Practices

Functions

1. Financial Reports – A nonprofit organization should produce consistent and accurate financial reports at least quarterly. The income and expense reports should also compare the budget for the same period to the actual income and expenses, along with explanations for significant variances.

2. Board Review of Financial Statements – All board members should receive appropriate training on how to read and understand nonprofit financial statements. Board members should be actively engaged in reviewing financial statements and providing fiscal oversight.

3. Internal Controls – A nonprofit should devise and implement internal control procedures in order to ensure accurate information and to help prevent fraud.

Compliance

4. Compliance ▶ *A nonprofit organization must comply with all financial reporting and tax laws, including withholding and payment of federal and state income taxes and Social Security payroll taxes.*

5. Review of IRS Information Returns – A nonprofit's chief executive officer, chief financial officer (or equivalent), board, and audit committee should thoroughly review and approve the IRS Form 990 and 990-T (if applicable) to ensure that the organization's filings are accurate, complete, and filed on time with the IRS (*990*).

6. Audits – A nonprofit organization should have a qualified independent Certified Public Accountant audit or review the financial statements annually or in a manner appropriate to the organization's size and scale of operations. In the process of the audit, the auditor should be given the opportunity to meet in executive session with the organization's board separately from management and staff. The independent financial audit or review should be reviewed and approved by the board of directors.

7. Audit Committee – The board should designate an audit committee to hire the auditor, oversee and evaluate the audit process, meet with the auditor to review the audit's content, and present the audit to the full board for its review and approval. It is permissible to have a combined finance and audit committee. If possible, an audit committee should be independent of the finance committee because the auditors are effectively assessing the performance of the finance committee (*990*).

8. Auditor Rotation – The audit committee should evaluate the quality of the audit firm and periodically put the audit out to bid. If maintaining the same firm, a nonprofit should consider requesting, if possible, a new audit partner every three to five years in order to ensure a fresh, objective perspective.

Policies

9. Open Communication ▶ *A nonprofit organization must openly communicate the annual reporting information contained on its Form 990 to constituents and others who request such information (IRC § 6104; 990).* In addition, nonprofits should share, at least annually, an overview of data regarding sources of revenue, functional expenditures, and related outcomes.

10. Protection of Assets – A nonprofit organization has a responsibility to ensure that its assets are used solely for the benefit of the organization, and not for personal or other gains. A nonprofit should establish a policy regarding the personal use of assets such as computers, phones, copy machines, etc.

11. Whistleblower Policy – A nonprofit organization should have a system in place that allows individuals to report financial and other misconduct, ▶ *and must ensure that there is no consequence for doing so – commonly referred to as a "whistleblower policy" (18 USC § 1107 – a.k.a. Sarbanes-Oxley; 990).*

12. Management of Funds ▶ *A nonprofit organization must manage and invest funds prudently and in compliance with conditions attached to funding (CRS § 15-1-1103–1109); 990).* A nonprofit should adopt and periodically review a sound investment policy.

13. Expense Reimbursement – A nonprofit organization should establish and implement policies that provide clear guidance on its rules for paying or reimbursing expenses incurred by anyone conducting business on behalf of the organization. The policy should specify the types of expenses that can be reimbursed, the approval and review process of expense reports, and the documentation required to substantiate expenses. Such policies should require that travel and other expenditures on behalf of the organization be undertaken in a cost-effective manner.

14. Related Persons Expense Reimbursement – A nonprofit organization should neither pay for nor reimburse travel expenditures (other than minor and incidental expenses such as refreshments served at an organization meeting) for spouses, dependents, or others who are accompanying individuals conducting business for the organization unless there is a business purpose for their attendance and participation. If, however, expenses without a business purpose are reimbursed, the person in receipt of the reimbursement must treat it as compensation.

15. Loans to Board Members and Key Personnel ▶ *A nonprofit must not make any loans to board members or officers (CRS § 7-128-501).* It should also expressly prohibit loans to key personnel *(990).*

16. Personal Use of Nonprofit Funds ▶ *A nonprofit must not allow personal use of its funds or business credit cards because any such transaction may constitute private inurement or an excess benefit transaction under the intermediate sanctions rules (IRC § 501(c)(3) and 4958; CRS § 7-133-101; 990).*

17. Credit Card Use – A nonprofit should establish and implement a policy that provides clear guidance on the appropriate use of business credit cards. The policy should also provide consequences for unsubstantiated expenses and personal use of credit cards. The policy should specify oversight procedures including board oversight of the chief executive officer's credit card expenditures (*990*).

Financial Responsibilities

18. Annual Budget – The board of directors should review and approve an annual budget for the organization. While the board should determine the appropriate budget needed to achieve its mission, the board should also consider applicable industry benchmarks for expenditures on programs, administration and fundraising.

19. Revenues – A nonprofit should work toward diversifying its funding sources as much as possible in an effort to strengthen the organization's sustainability and public support ratio, and to lessen the impact of a potential loss of a significant amount of its funding from any one source. Funding sources could include grants and contributions, earned income, and unrelated business income.

20. Donor Restrictions ▶ *A nonprofit must comply with specific conditions placed upon donations (CRS § 15-1-1103-1109; CRS § 6-16-111(1)(i)). Donated funds must be clearly categorized as unrestricted, temporarily restricted or permanently restricted in the organization's financial statements and communications in accordance with the donor or grantor wishes/stipulations (990).*

21. Public Support Test – To be considered a public charity, an organization must generally receive financial support from a sufficiently broad base of donors to meet the public support test or the facts and circumstances test. ▶ *A public charity that normally receives more than one-third of its total support from "public support" sources is generally considered a public charity. If the organization fails the public support test, it may still qualify under the facts and circumstances test (IRC § 170(b)(1)(A)(VI) and 509(a)(1)).*

22. Expenses – A nonprofit organization should spend a high percentage of its annual budget on programs in pursuance of its mission. A nonprofit should consult industry and subsector standards to determine an appropriate range for administration and fundraising ratios. An organization should also provide sufficient resources for effective administration of the organization and, if the organization solicits contributions, for appropriate fundraising activities.

23. Reserves – A nonprofit should plan, establish, and maintain a financial reserve at a level determined by the organization's management and board to adequately support its operations. A recommended target for reserves is three to six months of operating expenses. Organizations with capital property should also consider an appropriate capital reserve policy.

24. Cash Flow – In order to facilitate smooth fiscal operations, a nonprofit should project, monitor, and make adjustments to cash flow as needed to ensure appropriate cash flow.