Effective Financial Management Fundamentals for Nonprofits

JENNIFER C. HOCKENHULL, CPA, SHRM-CP

May 15, 2024
Introductions and Logistics

- Hartford Public Library – Daniel Alexandre
- Hartford Foundation for Public Giving – Lucas Codognolla
- Facilitator – Jen Hockenhull
Agenda Overview

1. Welcome and Introductions
2. Understanding and Monitoring
3. Planning
4. Resources & Wrap-Up
Understanding and Monitoring
What is Financial Management?

- Systematic accumulation of accounting data
- Reporting on current position
- Planning for future activities
Chart of Accounts

- How the organization’s financial information is organized
- Basis for coding all transactions and budgets
- Unified Chart of Accounts as starting point
- Includes: Assets, Liabilities, Net Assets, Revenue, and Expenses
Accounting Software

- QuickBooks is most common among small organizations
- Available in both on premise and online versions (TechSoup)
- Provides for greater efficiency, reliability and transportability of financial data
Internal controls are a set of policies and procedures to prevent deliberate or misguided use of funds for unauthorized purposes.
Internal Controls – Key Principles

1. Segregation of duties

- no accounting process is handled by one person from beginning to end
- bank statement reconciliation
- two signatures on checks over $ limit
2. Physical controls over assets
   - Checks
   - Cash
   - Equipment

3. Transparency
   - Communicating financial information on a timely basis
Policies and Procedures

- Should be clearly documented and easily understood by “outside” individuals

- Realistic to maintain

- Listed by job title

- Cite relevant forms

- Indicate appropriate timeframes
Any questions so far?

Are we doing ok?
Standard Financial Statements/Reports

1. Statement of Activities (P&L, profit & loss statement)
2. Statement of Financial Position (Balance Sheet)
4. Statement of Functional Expenses
Standard Financial Statements/Reports - Continued

5. IRS Form 990

6. Annual Financial Statement Audit/ Review/ Compilation

7. Annual organization budget

8. Other internal financial statements (year to date budget performance)
1. Statement of Activities

- Identifies the source and use of funds for a specific period of time
- Indicates whether there is a surplus or loss for that period of time

Answers the question:
What has our overall financial performance been this month- and year-to-date?
## Sample Statement of Activities

For the year ending December 31, 2019

<table>
<thead>
<tr>
<th></th>
<th>Without Donor Restrictions</th>
<th>With Donor Restrictions</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>REVENUES AND OTHER SUPPORT</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Contributions</td>
<td>673,493</td>
<td>200,035</td>
<td>873,528</td>
</tr>
<tr>
<td>Government Contracts</td>
<td>157,754</td>
<td>167,754</td>
<td>325,508</td>
</tr>
<tr>
<td>Program Fees</td>
<td>15,841</td>
<td>15,841</td>
<td>31,682</td>
</tr>
<tr>
<td>Interest</td>
<td>87</td>
<td>87</td>
<td>174</td>
</tr>
<tr>
<td>Net assets released from restriction</td>
<td>214,693</td>
<td>(214,693)</td>
<td>0</td>
</tr>
<tr>
<td><strong>Total Revenue and Other Support</strong></td>
<td>1,071,868</td>
<td>(14,658)</td>
<td>1,057,210</td>
</tr>
<tr>
<td><strong>EXPENSES</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Program</td>
<td>847,436</td>
<td>847,436</td>
<td>1,694,872</td>
</tr>
<tr>
<td>Management &amp; General</td>
<td>111,056</td>
<td>111,056</td>
<td>222,112</td>
</tr>
<tr>
<td>Fundraising</td>
<td>78,230</td>
<td>78,230</td>
<td>156,460</td>
</tr>
<tr>
<td><strong>Total Expenses</strong></td>
<td>1,036,722</td>
<td></td>
<td>1,036,722</td>
</tr>
</tbody>
</table>

Change in Net Assets     | 35,146                     | (14,658)                | 20,488  |
Net Assets at beginning of year | 196,960                   | 107,243                 | 304,203 |
**NET ASSETS AT END OF PERIOD** | 232,106                   | 92,585                  | 324,691 |
<table>
<thead>
<tr>
<th></th>
<th>Cash Basis</th>
<th>Accrual Basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income recorded</td>
<td>Cash is received. (Deposit)</td>
<td>Income is earned or promised. (Receivable)</td>
</tr>
<tr>
<td>Expenses recorded</td>
<td>A check is written. (Expenditure)</td>
<td>An obligation is incurred. (Payable)</td>
</tr>
</tbody>
</table>

Understanding and Monitoring
# Cash vs. Accrual?

<table>
<thead>
<tr>
<th></th>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash Basis</td>
<td>Easy to understand</td>
<td>Not GAAP compliant</td>
</tr>
<tr>
<td></td>
<td>Fewer transactions</td>
<td>Incomplete picture</td>
</tr>
<tr>
<td>Accrual Basis</td>
<td>GAAP Compliant</td>
<td>Harder to understand</td>
</tr>
<tr>
<td></td>
<td>More meaningful data</td>
<td>More transactions</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Modified Basis</td>
<td>Use easier method for internal interim reporting</td>
<td>Audit looks different from internal statements; may lead to surprises</td>
</tr>
</tbody>
</table>
2. Statement of Financial Position

- Lists all an organization’s assets (what it owns), liabilities (what it owes), and resulting net assets
- Assets – Liabilities = Net Assets
- Net assets are broken down into two categories – Net Assets without Donor Restrictions (can often include board designated net assets) and Assets with Donor Restrictions

Answers questions such as:
What is our financial health? Can we pay our bills?
### Sample Statement of Financial Position

**BALANCE SHEET**  
*As of December 31, 2019*

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and cash equivalents</td>
<td>358,953</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>2,700</td>
</tr>
<tr>
<td>Contributions Receivable</td>
<td>77,500</td>
</tr>
<tr>
<td>Property and Equipment</td>
<td>8,855</td>
</tr>
<tr>
<td>Prepaid Insurance</td>
<td>10,756</td>
</tr>
<tr>
<td>Security Deposit</td>
<td>1,460</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td>460,224</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>LIABILITIES</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts payable</td>
<td>73,533</td>
</tr>
<tr>
<td>Refundable Advances</td>
<td>62,000</td>
</tr>
<tr>
<td><strong>Total Liabilities</strong></td>
<td>135,533</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>NET ASSETS</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Without donor restrictions</td>
<td>232,106</td>
</tr>
<tr>
<td>With donor restrictions</td>
<td>92,585</td>
</tr>
<tr>
<td><strong>Total Net Assets</strong></td>
<td>324,691</td>
</tr>
</tbody>
</table>

**TOTAL LIABILITIES AND NET ASSETS**  
460,224
Accounting for Contributions

- Without Donor Restrictions – May be used for any purpose within the organization’s mission.

- With Donor Restrictions – May only be used in the way the donor allows. What matters is the intention of the donor. Funds that have donor-imposed conditions or restrictions that are reasonably expected to be met by the organization (time or purpose) or that carry donor restrictions as to their use which can never expire (typically an endowment).

Only a donor can restrict. The Board can designate.
How Do Your Net Assets Change?

Income – Expenses = Change in Net Assets

Your net assets increase if you have more income than expenses.

Your net assets decrease if you have more expenses than income.

- Reconciles the organization’s beginning of year cash balance with the end of the year balance.
- Typically includes cash provided or used by:
  -- operating activities
  -- financing activities
  -- investing activities
Sample Cash Flow Statement

STATEMENT OF CASH FLOWS
For the year ending December 31, 2019

CASH FLOWS FROM OPERATING ACTIVITIES

Change in net assets 20,488
Adjustments to reconcile change in net assets to cash provided by operating activities:
  Depreciation 6,445
  Increase (decrease) in cash arising from change in assets and liabilities:
    Accounts receivable 4,450
    Contributions receivable 9,900
    Prepaid insurance 403
    Security deposit 250
    Accounts payable and accrued expenses (48,753)
    Refundable advances 62,000

NET CASH PROVIDED BY OPERATING ACTIVITIES 55,183

CASH FLOWS FROM INVESTING ACTIVITIES

Equipment purchases (3,084)

NET CASH USED BY INVESTING ACTIVITIES (3,084)

CASH FLOWS FROM FINANCING ACTIVITIES

Proceeds from (payment of) short-term debt (75,000)

NET CASH PROVIDED BY (USED BY) FINANCING ACTIVITIES (75,000)

NET DECREASE IN CASH AND CASH EQUIVALENTS (22,901)

CASH AND CASH EQUIVALENTS - beginning of year 381,854

CASH AND CASH EQUIVALENTS - end of year 358,953
4. Statement of Functional Expenses

- Reports all expenses by their natural classification (i.e., salaries, supplies, rent, etc.)
- Typically separates program, fundraising costs, and administrative expenses
Sample Statement of Functional Expenses

<table>
<thead>
<tr>
<th></th>
<th>Program Services</th>
<th>General and Administrative</th>
<th>Fundraising</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salaries</td>
<td>529,983</td>
<td>43,385</td>
<td>48,678</td>
<td>622,046</td>
</tr>
<tr>
<td>Payroll taxes</td>
<td>43,177</td>
<td>3,539</td>
<td>3,971</td>
<td>50,687</td>
</tr>
<tr>
<td>Employee benefits</td>
<td>37,079</td>
<td>3,039</td>
<td>3,410</td>
<td>43,528</td>
</tr>
<tr>
<td>Audit and accounting</td>
<td>0</td>
<td>38,120</td>
<td>0</td>
<td>38,120</td>
</tr>
<tr>
<td>Facility fees</td>
<td>15,257</td>
<td>0</td>
<td>0</td>
<td>15,257</td>
</tr>
<tr>
<td>Depreciation</td>
<td>5,490</td>
<td>450</td>
<td>505</td>
<td>6,445</td>
</tr>
<tr>
<td>Education and staff training</td>
<td>17,288</td>
<td>1,417</td>
<td>1,589</td>
<td>20,294</td>
</tr>
<tr>
<td>Furniture and equipment</td>
<td>11,620</td>
<td>951</td>
<td>1,069</td>
<td>13,640</td>
</tr>
<tr>
<td>Insurance</td>
<td>11,242</td>
<td>921</td>
<td>1,034</td>
<td>13,197</td>
</tr>
<tr>
<td>Interest</td>
<td>0</td>
<td>1,784</td>
<td>0</td>
<td>1,784</td>
</tr>
<tr>
<td>Materials and supplies</td>
<td>17,368</td>
<td>538</td>
<td>603</td>
<td>18,509</td>
</tr>
<tr>
<td>Meeting costs</td>
<td>17,726</td>
<td>1,470</td>
<td>2,493</td>
<td>21,689</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>2,165</td>
<td>7,189</td>
<td>76</td>
<td>9,430</td>
</tr>
<tr>
<td>Postage</td>
<td>463</td>
<td>37</td>
<td>43</td>
<td>543</td>
</tr>
<tr>
<td>Professional Fees</td>
<td>62,910</td>
<td>2,549</td>
<td>7,405</td>
<td>72,864</td>
</tr>
<tr>
<td>Printing and advertising</td>
<td>51,224</td>
<td>3,730</td>
<td>5,184</td>
<td>60,138</td>
</tr>
<tr>
<td>Rent</td>
<td>15,114</td>
<td>1,239</td>
<td>1,390</td>
<td>17,743</td>
</tr>
<tr>
<td>Repairs and maintenance</td>
<td>255</td>
<td>22</td>
<td>23</td>
<td>300</td>
</tr>
<tr>
<td>Telephone</td>
<td>5,537</td>
<td>454</td>
<td>509</td>
<td>6,500</td>
</tr>
<tr>
<td>Travel and transportation</td>
<td>3,538</td>
<td>222</td>
<td>248</td>
<td>4,008</td>
</tr>
<tr>
<td><strong>TOTAL EXPENSES</strong></td>
<td><strong>847,436</strong></td>
<td><strong>111,056</strong></td>
<td><strong>78,230</strong></td>
<td><strong>1,036,722</strong></td>
</tr>
</tbody>
</table>
Using Your Financial Statements: Key Financial Indicators

- Variance (or trend) analysis
- Ratio analysis
  -- Current Ratio
  -- Quick Ratio
  -- Day’s Cash
  -- Management & General %
Current Ratio

Do I have enough CURRENT ASSETS to cover my CURRENT LIABILITIES?

Current Ratio = \frac{\text{Current Assets}}{\text{Current Liabilities}}

Hint: A current ratio of less than 1.0 indicates that the organization may not have sufficient current assets to meet current payment obligations.
Quick Ratio

Do I have enough cash to pay my bills?

Quick Ratio = \( \frac{\text{Cash} + \text{Cash Equivalents}}{\text{Current Liabilities}} \)

Hint: A quick ratio of less than 1.0 indicates that the organization may not have sufficient current assets to meet current payment obligations.
Days Cash on Hand

If not another penny of income was received, how many days could the organization continue to pay its’ bills?

Days Cash = \( \frac{\text{Cash} + \text{Cash equivalents}}{\text{Operating Expenses}/365} \)
Management and General Expense Percentage

How much of the total expenses of the organization are spent on administrative activities?

Management And General % =

\[
\text{Mgmt. and General Expense} \div \text{Total Expenses}
\]

Hint: Appropriate range is often stated as no more than 35% of total expenses. Also fundraising costs should be 15% or less, as a best practice.
5. IRS Form 990

Filing guidelines:

<table>
<thead>
<tr>
<th>Gross Receipts less than or equal to $50,000</th>
<th>990-N (e-postcard)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Receipts less than $200,000 Total Assets less than $500,000</td>
<td>990-EZ or 990</td>
</tr>
<tr>
<td>Gross Receipts greater than $200,000 Total Assets greater than $500,000</td>
<td>990</td>
</tr>
</tbody>
</table>
6. Audits

- An “audit” refers to a set of financial statements that have been audited by a Certified Public Accountant.
- The purpose is generally to provide assurance to third parties (funder, regulator, etc.)
- The objective is the expression of an opinion on the accuracy of financial statements and their conformity with GAAP
Audit cont.

- Examines and tests supporting documentation
- Tests adherence to internal control policies
- Verifies asset and liability balances
- Includes a management letter
What triggers an audit?

Legal requirements

- State of Connecticut
  - Department of Consumer Protection - $500,000 in gross revenue (specific definition)
  - State Single Audit Act - $300,000 of state money expended
- Federal
  - $750,000 in federal contract dollars expended
What triggers an audit?
Cont.

Best practice guidelines

- Wise Giving Alliance - $1 million in gross income
- Standards of Excellence Institute - $500,000 in gross income
- Independent Sector - $1 million in gross income

Funder Requirements
Alternatives to an audit

**Review** – Similar to an audit, but only provides limited assurance by the auditor, limited internal control testing and no verification of balances

**Compilation** – presents the financial statements in GAAP format, but provides no assurance for accuracy, etc. (basic restatement of organization produced numbers)
Any questions so far?

Are we doing ok?
Planning
Direct vs. Indirect

- **Direct costs** are those easily identifiable as costs associated with a program and are often variable (if a program doesn’t happen, neither do the costs)
  - Supplies for a program
  - Salary for a Program Manager
  - Rent for a daycare center

- **Indirect costs** are those that are not directly related to a program and are typically fixed
  - Accountant Costs
  - IT Costs
Cost Allocation

- Common (or shared) costs are expenses that are not easily identifiable with a single function.
- Cost allocation is the process of assigning the cost among two or more activities/programs.
- A cost allocation plan is written documentation of methods used to allocate costs.
Common Cost Allocation: Step 1
Categorize Expenses

**Program**: Program staff, program materials

**Administrative**: finance staff, audit expense, board meeting expenses

**Fundraising**: development staff, event expenses

**Common Costs**: rent and utilities, computers, office supplies, receptionist
Common Cost Allocation: Step 2
Choose Allocation Method

Frequently used cost allocation rates:
1. FTE
2. Payroll
3. Square Footage
Common Cost Allocation: Step 3
Allocate Shared Costs

1. Line by Line Method
   -- a different rate of usage for each line item, or groups of line items

2. Bottom Line Method
   -- all shared costs are grouped together and one allocation rate is used
**Capitalization and Depreciation**

**Capitalization** means that:
- an item has a useful life of more than one year
- the item is recorded as an asset when purchased rather than expense

**Depreciation** is the process by which the cost of a capitalized item is recorded over the useful life of the item. The value of the asset is reduced each year due to wear and tear, age or obsolescence.
Budgeting

The budget is an organization’s annual financial plan that translates organizational goals and objectives into dollars.

Two purposes:
1. Project income and expenses
2. Monitor actual results against projections

ROAD MAP
Types of Budgets

- Line item
- Program-based Budget
- Capital Budget
10 Step Budgeting Checklist
(from Propel Nonprofits (formerly Nonprofits Assistance Fund))

1. Determine timeline
2. Agree on goals
3. Understand current financial status
4. Agree on budget approach
5. Develop draft expense budget
6. Develop draft income budget
7. Review draft budget
8. Approve budget
9. Document budget decisions
10. Implement budget
Budgeting Strategies

- Budgeting for a surplus
- Surplus vs. reserves
- Funding depreciation
- Methods? Zero-based? Income? Last Year Comparison?
Monitoring the Budget

- Monthly budget comparisons
- YTD budget comparison
- Budget revisions/mid-course corrections
Managing Cash Flow

- Appropriate use
- How to think about it
- Credit cards – can’t be used to fill gaps
- Loans/Line of Credit
Final Questions?
What Every Board Member Should Know About Financial Management…. And Probably Doesn’t

- Webinar held May 14th

Resources– please refer to the bottom of the agenda for additional resources

Please complete the survey that will be sent to you after this event

Any follow up questions, please reach out to JenniferHockenhullCPA@gmail.com

Connect with me on LinkedIn! www.linkedin.com/in/jennifer-hockenhull-8a6bbb92
THANK YOU!