Fiscal Health & Fiduciary Responsibility
Making Sense out of the Dollars & Cents

I. What is fiscal health?

a. The quick ratio ([current assets – inventories]/current liabilities) indicates your organization's ability to meet short-term obligations. As a general guideline, a quick ratio of 1 or more is good.
b. The debt ratio (total debt/total assets) indicates the proportion of debt relative to assets. A high value can suggest liquidity problems and, just as it would for an individual, may be perceived as a risk by creditors. A debt ratio of 1 or less is good.
c. The defensive interval ratio ([cash + marketable securities]/[operational expenses/365]) measures the number of days an organization can operate without having to tap into long-term (fixed) assets. This lets you know how long your cash reserves will last. Strongly advised to have enough cash on hand to cover three to six months of operating expenses.
d. Income Statement Indicators:
    i. Revenue reliability.
        1. An organization's track-record of bringing in recurring dollars, on an <u>unrestricted</u> operating basis on an ongoing annual basis.
        2. Reliable revenue doesn't always come from the same sources providing the same amounts of money. However, it does suggest an ability to predict a level of income with a fair amount of certainty, based on historical performance and an understanding of market dynamics. Numbers of gifts and gift amounts may vary – but it is the consistency of the total that is important.
    ii. Consistent surpluses.
        1. A healthy nonprofit has reliable revenue (above) that covers operating expenses and is sufficient to create surpluses – all in the service of mission. <u>Nonprofit is a tax status, not a way of operating</u>:
        2. Positive operating results (unrestricted revenue consistently exceeding expenses) are an indicator of strong financial management.
        3. Aiming for breakeven doesn't allow for flexibility when things don't go according to plan. *(Many nonprofits are satisfied if they break even. Since 2008, the percentage of nonprofits reporting a surplus never surpassed 40% This is not healthy.)*
    iii. Full cost coverage.
        1. Set revenue targets to cover not just operating expenses but also the *full* costs of doing business. Anticipate replacement costs of FF&E and loss of any *in-kind* support. Surpluses provide resource if needed.
        2. Covering the full costs ensures longer-term sustainability and vibrancy.

3.

e. Balance Sheet Indicators:
   i. Ability to manage debt.
      1. Debt is a critical financial tool that can help organizations manage the ebbs and flows of cash for operations, facility purchases and upgrades, and more. But as liabilities bump up against an organization's ability to pay off those obligations, they can become a real problem.
      2. If debt ratio nears 50%, it can raise concerns about the organization's ability to manage debt, which, in turn, could jeopardize the delivery of programs and services to its users/constituency.
   ii. Ability to manage and maintain facilities.
      1. If an organization owns property and equipment, it must maintain and replace these assets over time.
      2. Reserves should be established for FF&E, facility improvements and replacements.
   iii. Appropriate liquidity.
      1. There are a number of ways to measure liquidity, the resources available to absorb risk and respond to new opportunities.
      2. As a general guideline, a minimum of 3 months cash and liquid assets is recommended held in reserve but it depends on several elements, including strategic priorities, funding, and general economic environment.

II. Responsibilities – Who does what?

a. How far does a Board go – what is its responsibility?
   i. <u>Not</u> day to day bookkeeping or financial management – that is the role of ED and staff
   ii. Board members exercise overall responsibility for the fiscal wellbeing of their organization and should:
      1. Have a keen interest in the fiscal affairs of the nonprofit, including its overall, current financial position, the reliability of the reports the board receives, and the effectiveness of the nonprofit's management of incoming and outgoing funds.
      2. Require regular, timely and complete financial reports from internal finance staff or contract staff and expect the board to hold staff accountable for meeting the standards of timely reporting (for example, providing financial statements no later than three weeks after the close of the prior accounting period).
      3. Ask critical questions about the financial reports the board receives, including budgets, periodic financial statements, the annual Form 990 and annual, sometimes audited, financial statements.
   iii. Board Practices
      1. <u>Board Composition</u>: In many cases the board will include several people who are comfortable reviewing nonprofit financial statements. (If you don't have anybody on your board that doesn't understand finances

and financial statements, you must – doesn't have to be an investment professional or accountant – many folks have the skill but it is a gap a successful board can't have.

2. Finance Committee: Made up of folks who might have a range of understandings is critical BUT it is not an abdication for other board members.
3. Board Training: Periodic training for all board members on some aspect of organizational finance. Goal is to get board members basic understanding.
    a. Use how-to-read guide to nonprofit financial statements for each member of your board i.e. Andrew Lang's booklet titled, *How to Read Nonprofit Financial Statements*;
    b. Scheduling a training program on nonprofit financial statements as part of the board's agenda — perhaps the first meeting of your fiscal year or board retreat; and
    c. Have a CPA whose practice focuses on nonprofits brief the board and potentially serve as a resource should members have questions during the year.
4. Board Questions: Board shouldn't be afraid to ask questions and ED or staff should anticipate these questions to the best of their ability. The only dumb question is the one not asked.
    a. How are our finances aligned with our organizational goals/mission statement?
    b. Is our spending in line with our budget?
    c. What accounts for the differences or variances if any, particularly those of significance?
    d. Do we anticipate any significant variances from budget and if so why?
    e. Where does the majority of our funding come from and how strong or vulnerable is that funding source?
        i. Is this addressed in our SWOT or Strategic Plan?????
        ii. Ex. Govt funding can be reliable but can also go away – strength and a weakness!
    f. What are our most significant expenses and do we expect them to grow or not – is it something we can control.
        i. Ex. Rent
5. Board Tools: Dashboard – financial statements can be dreary and hard to read –
    a. Well thought out dashboard should answer the questions above.
    b. Include actual to budget, variances and exceptions with notes, key organizational dates et
    c. Easy to read – often using pictographs. Different folks have different learning and interpretive skills – no one set format is best. Work with your board to see what is most effective for them.

b. What are the ED's/Treasurer's responsibilities for the financial health of the organization?
    i. Ensure that the budget, staff and priorities are aligned with mission/strategic plan
    ii. Oversee the financial status of the organization including developing long and short range financial plans, monitoring the budget and ensuring sound financial controls are in place; set financial priorities accurately to ensure the organization is operating in a manner that supports the needs of the program and staff
    iii. Put the tools in place to provide the board with financial information they need i.e. *dashboard.*
    iv. Make sure that resources/infrastructure are in place for the organization to be fiscally sound.
        1. Bookkeeping software ie Quickbooks and Peachtree – spreadsheets in this day and age aren't enough
        2. Policies and procedures
            a. Operations manual including
                i. Accounts payable and receivable procedures
                ii. Expense reimbursement procedures
                iii. Delegation of authority
                1. Threshold for dual signatures
                iv. Fund reporting
                1. Grant tracking
                2. Restricted Gifts
            b. Reserve Policy *(min 3 months preferably 6 months operating expenses – should include in-kind – what happens if in kind goes away…)*
            c. Cash Management Policy *(flexibility – look at current cash needs – time investments accordingly – but don't let it just sit there when it could be working for the organization)*
            d. Investment Policy *(longer term investments)*
            e. Gift Acceptance Policy *(Do you really want a house or a horse – or do you just want cash – stay away from more complicated gifts unless your organization has the expertise to manage them – policy more typically would convert asset to cash immediately.)*
            f. Records Retention Policy
            g. Conflict of Interest Policy (*should state that the employees and directors have a duty to act in the best interests of the nonprofit and not in their own self-interests. Best practice, once a year you should have your directors detail their relationships and financial interests in writing in order to document and avoid potential conflicts of interest. .It may seem invasive but provides transparency.*)

    h. Whistleblower Policy *(Whistleblower Protection Policy should include a statement that organization will not retaliate against an employee who reports violations of law or public policy. Each employee should be required to read and sign this statement in order to ensure that they understand the terms of the policy.)*
    i. Endowment Policy – if applicable
3. Multi-year budgeting
    a. Aligned with strategic plan
    b. Provides interim guidance on programming, fundraising, expense management
    c. Year 1 is current year budget for board approval years 2 and beyond are measured approximations and used for guidance
4. Audit
    a. If an audit was performed, did the management letter indicate that the organization was well managed or were there any issues which need to be addressed
    b. Audit vs Review – what do <u>your</u> funders want to see
    c. Audit review committee if necessary
5. Taxes
    a. 990 tax return as a tool for selling the good works of the organization. (Answer the questionnaire with a marketing mind - The tax return is a public document and it is used by individuals and organizations in reviewing potential recipients.)
    b. Form 990-N (e-Postcard): This is the simplest version of the Form 990, used by the smallest nonprofits (Gross Receipts normally less than or equal to $25,000).
    c. Form 990-EZ: This is the short-form version of the regular Form 990 that is required for smaller and mid-size nonprofits (Gross Receipts less than $500,000 and Total Assets less than $1.25 Million). It does not include all of the governance and management questions required by the regular Form 990. It essentially requires basic financial information about your nonprofit and its assets as well as the names and compensation of your directors, officers, and key employees.
    d. Form 990: This is the most common version of the Form 990 and it is required of mid-size and larger nonprofits (Gross Receipts greater than or equal to $500,000, or Total Assets greater than or equal to $1.25 million). This version includes the financial questions required of the 990-EZ, but it also has additional questions related to the governance and management of the nonprofit. The questions about governance and management seem to have presented the most difficulty for nonprofits.