



Effective Financial Management Fundamentals for Nonprofits

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Introductions and Logistics

- ▶ Hartford Public Library – Daniel Alexandre
- ▶ Hartford Foundation for Public Giving – Lucas Codognolla
- ▶ Facilitator – Jen Hockenhill

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

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

Internal Controls – Key Principles cont.

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)
3. Statement of Cash Flows
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

STATEMENT OF ACTIVITIES
For the year ending December 31, 2019

	Without Donor Restrictions	With Donor Restrictions	Total
REVENUES AND OTHER SUPPORT			
Contributions	673,493	200,035	873,528
Government Contracts	167,754		167,754
Program Fees	15,841		15,841
Interest	87		87
Net assets released from restriction	214,693	(214,693)	0
Total Revenue and Other Support	1,071,868	(14,658)	1,057,210
EXPENSES			
Program	847,436		847,436
Management & General	111,056		111,056
Fundraising	78,230		78,230
Total Expenses	1,036,722		1,036,722
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

Cash-Basis vs. Accrual-Basis Accounting

	Cash Basis	Accrual Basis
Income recorded when...	Cash is received. (Deposit)	Income is earned or promised. (<u>Receivable</u>)
Expenses recorded when...	A check is written (Expenditure)	An obligation is incurred. (<u>Payable</u>)

Cash vs. Accrual?

	Advantages	Disadvantages
Cash Basis	Easy to understand Fewer transactions	Not GAAP compliant Incomplete picture
Accrual Basis	GAAP Compliant More meaningful data	Harder to understand More transactions
Modified Basis	Use easier method for internal interim reporting	Audit looks different from internal statements; may lead to surprises

2. Statement of Financial Position

- ▶ Lists all an organization's assets (what it owns), liabilities (what it owes), and resulting net assets
- ▶ $\text{Assets} - \text{Liabilities} = \text{Net Assets}$
- ▶ 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

	<u>2019</u>
ASSETS	
Cash and cash equivalents	358,953
Accounts Receivable	2,700
Contributions Receivable	77,500
Property and Equipment	8,855
Prepaid Insurance	10,756
Security Deposit	<u>1,460</u>
Total Assets	<u>460,224</u>
LIABILITIES	
Accounts payable	73,533
Refundable Advances	<u>62,000</u>
Total Liabilities	<u>135,533</u>
NET ASSETS	
Without donor restrictions	232,106
With donor restrictions	<u>92,585</u>
Total Net Assets	<u>324,691</u>
TOTAL LIABILITIES AND NET ASSETS	<u><u>460,224</u></u>

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.

3. Statement of Cash Flows

- ▶ 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	<u>55,183</u>

CASH FLOWS FROM INVESTING ACTIVITIES

Equipment purchases	(3,084)
NET CASH USED BY INVESTING ACTIVITIES	<u>(3,084)</u>

CASH FLOWS FROM FINANCING ACTIVITIES

Proceeds from (payment of) short-term debt	(75,000)
NET CASH PROVIDED BY (USED BY) FINANCING ACTIVITIES	<u>(75,000)</u>

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

STATEMENT OF FUNCTIONAL EXPENSES For the year ending December 31, 2019

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

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?

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

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?

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

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?

$$\text{Days Cash} = \frac{\text{Cash} + \text{Cash equivalents}}{\text{Operating Expenses}/365}$$

Management and General Expense Percentage

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

Management And General % =

$$\frac{\text{Mgmt. and General Expense}}{\text{Total Expenses}}$$

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:

	Form to File
Gross Receipts less than or equal to \$50,000	990-N (e-postcard)
Gross Receipts less than \$200,000 Total Assets less than \$500,000	990-EZ or 990
Gross Receipts greater than \$200,000 Total Assets greater than \$500,000	990

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?

Resources, Next Session and Wrap-Up

- ▶ 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 JenniferHockenhuillCPA@gmail.com
- ▶ Connect with me on LinkedIn!
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THANK
YOU!