



GOVERNANCE  
**SERIES 3**

second edition

# **financial responsibilities** of nonprofit boards

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BoardSource®

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Empowering Boards. Inspiring Leadership.

BoardSource envisions a world where every social sector organization has the leadership it needs to fulfill its mission and advance the public good. Our mission is to inspire and support excellence in nonprofit governance and board and staff leadership.

Established in 1988, BoardSource's work is grounded in the fundamental belief that boards are critical to organizational success. With decades of hands-on experience working with and supporting nonprofit boards, BoardSource is the recognized leader in nonprofit governance and leadership, and a go-to resource for nonprofit board and executive leaders. BoardSource supports a broad and diverse cross-section of social sector organizations with

- leadership initiatives addressing key opportunities and issues within the nonprofit sector
- research and benchmarking of board composition, practices, and performance
- membership and board support programs
- customized diagnostics and performance assessment tools
- a comprehensive library of topic papers, publications, and downloadable infographics, tools, templates and more
- live and virtual education and training
- governance consultants who work directly with nonprofit leaders to design specialized solutions to meet an organization's needs
- a biennial conference that brings together approximately 800 board leaders for two days of learning and sharing

A note to our global readers:

The need for effective board leadership and governance knows no geographic boundaries, and BoardSource is committed to strong social sector board leadership and governance around the globe. While BoardSource uses United States laws and policies as the legal framework for our resources and recommendations, most of our resources do not focus on legal matters but rather on good governance practices, making them relevant to organizations working outside of the United States. We do suggest, however, that you refer to applicable laws in your country regarding financial reporting and other legal and transparency issues.

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## **ABOUT THE BOARDSOURCE GOVERNANCE SERIES**

As BoardSource celebrated its 20th anniversary in 2008, we introduced updated editions of the books in the Governance Series, BoardSource's flagship series created to help nonprofit board members understand their primary roles and responsibilities. BoardSource believes that board members and chief executives who know and understand their mutual responsibilities are better equipped to advance their organizations' missions and, in turn, strengthen their communities.

### **WHY IS A STRONG BOARD IMPORTANT?**

There's no denying that the 1.6 million nonprofit organizations in the United States play a vital role in society, from assisting victims of natural disasters to beautifying our neighborhoods, from educating our children to healing the sick. To ensure that their organizations have the resources, leadership, and oversight necessary to carry out these and other vital activities, nonprofit boards must understand and fulfill their governance responsibilities.

Although there have been headline-worthy scandals by a few nonprofits and their boards, the vast majority try hard every day to be worthy of the public's trust. Nevertheless, BoardSource frequently hears from nonprofit board members and chief executives who say that they are not always sure what the basic components of good governance are or how to educate every board member in them so they can serve their organizations and the public in the best possible manner. The revised Governance Series helps bridge this gap in knowledge.

Within the board's broad roles of setting the organization's direction, ensuring necessary resources, and providing oversight,

board members wear many hats. They are guardians of the mission; they ensure compliance with legal and financial requirements; and they enforce ethical guidelines for their organization. They are policymakers, fundraisers, ambassadors, partners with the chief executive, and strategic thinkers. They monitor progress, evaluate the performance of the organization and the chief executive, and demonstrate integrity in everything they do on behalf of the organization. Because of their many roles, board members need more than enthusiasm for a cause, passion for a mission, or just “good intentions.” They need to understand all of their stewardship responsibilities and perform all of their duties.

## **WHAT WILL BOARD MEMBERS FIND IN THE BOOKS?**

The six books address all of the fundamental elements of service common to most boards, including board member responsibilities, how to structure the board in the most efficient manner, and how to accomplish governance work in the spirit of the mission of the organization.

1. *Ten Basic Responsibilities of Nonprofit Boards, Second Edition* (Book 1) by Richard T. Ingram describes the 10 core areas of board responsibility.
2. *Legal Responsibilities of Nonprofit Boards, Second Edition* (Book 2) by Bruce R. Hopkins, JD, LL.M., elaborates on the board’s legal responsibilities, liabilities, and the oversight it should provide to protect the organization.
3. *Financial Responsibilities of Nonprofit Boards, Second Edition* (Book 3) by Andrew S. Lang, CPA, explains board fiduciary responsibilities in the areas of financial oversight and risk management.
4. *Fundraising Responsibilities of Nonprofit Boards, Second Edition* (Book 4) by James M. Greenfield, ACFRE, FAHP, helps board members understand why they should be actively engaged in ensuring adequate resources for the organization — and how to get involved in fundraising.

5. *The Nonprofit Board's Role in Mission, Planning, and Evaluation, Second Edition* (Book 5) by Kay Sprinkel Grace, MA, Amy McClellan, MNO, and John A. Yankey, PhD, shows how to define and communicate the organization's mission and link strategic planning and evaluation to achieve organizational success.
6. *Structures and Practices of Nonprofit Boards, Second Edition* (Book 6) by Charles F. Dambach, MBA, Melissa Davis, and Robert L. Gale offers guidance on how to build and structure the board (size, committees, term limits) and enhance leadership roles and the partnership between the chair and the chief executive.

Each book focuses on one topic, breaking information into manageable amounts that are easy to digest. Readers will find real-world examples that provide insight from effective boards, statistics from BoardSource's *Nonprofit Governance Index 2007* survey of nonprofit organizations, tips and pitfalls, lists of the most important things to remember, end-of-chapter questions, glossaries, and resource lists for further reading. The authors of the books are subject matter experts with years of experience in the nonprofit sector.

## **WHO SHOULD READ THE BOOKS?**

Board members and senior staff, especially chief executives, in nonprofits of all types and sizes will find the information contained in the Governance Series relevant. They can use it to set standards, to develop their own approaches to board work and interacting with board members, and to modify practices as the organization evolves.

There's something in the Governance Series for everyone associated with the board. A board chair, for example, might share Book 5 (*The Nonprofit Board's Role in Mission, Planning, and Evaluation*) with board members before starting a strategic planning process or give Book 4 (*Fundraising Responsibilities of Nonprofit Boards*) to the development committee. Chief executives will find it beneficial to give Book 3 (*Financial Responsibilities of Nonprofit Boards*) to the board treasurer and to review Book 1 (*Ten Basic Responsibilities of Nonprofit Boards*) and



give it, along with Book 6 (*Structures and Practices of Nonprofit Boards*), to senior staff and the board chair to clarify board–chief executive roles and strengthen the partnership with the board. All board members will want to read Book 2 (*Legal Responsibilities of Nonprofit Boards*) so they understand how to protect themselves and the organization. The chair of the governance committee might give new board members all six books. This sharing helps ensure that everyone associated with the board is “on the same page” and has a common understanding of the board’s responsibilities, expectations, and activities.

Board service entails serious obligations, to be sure, but it can also deliver immense satisfaction. A board that knows what is expected of it and performs at the highest level is a strategic resource for its organization and chief executive. And ultimately, this commitment by dedicated board members translates into mission impact in our communities.

**The Governance Series was made possible in part through the support of MetLife Foundation.**

# INTRODUCTION

## ***A GREAT TRUST***

Board members may think of their responsibilities in terms of how much money they should give to the nonprofit organization or what committees they will serve on. They may not realize that their responsibilities encompass far more. Ultimately, board members are responsible for the financial viability, the program success, and the very survival of the organization. Most important, for purposes of this book, they have a fiduciary responsibility.

The concept of fiduciary responsibility — a trust held for the greater community — goes back before modern times. Throughout history, from ancient Athens to the American frontier, communities have selected people to protect the common good — to make and enforce laws, spend public funds, or care for the sick.

Today's board members, as custodians of something of value to the community, have a similar role. For them, to invoke that often-quoted presidential phrase, “the buck stops here.” The governing board has the ultimate responsibility for the organization's success, which includes every aspect of what happens with the organization — including the financial aspect. The board can delegate some details to a finance committee and some to an audit committee, but the full board always retains the final responsibility.

Dealing with financial matters requires board members (and staff, too) to communicate in another language. Accounting has its own vocabulary, grammar, and rules of construction. Unless you've already been trained in it, this language takes some effort to learn to speak and understand well. This book will help board members become more fluent in various aspects of accounting and thus overcome the normal “fear factor” felt by those entering this largely unfamiliar territory.

## EDUCATION DISPELS FEARS

Board members must understand the issues important to financial integrity and solvency, safeguards and procedures to protect the organization, and signs of financial trouble. That means knowing how to read and understand the financial information — such as distinguishing the important numbers and relationships — and, most important, making decisions based on the information. Developing this knowledge enables board members to recognize impending problems and tell the difference between minor ripples and major crises.

Of course, a board shouldn't expect every one of its members to become a financial expert. Board members, inevitably, will have differing levels of expertise. But, at a minimum, a board should have an expert provide training so every member can attain at least a basic understanding of nonprofit accounting and the organization's financial side. In addition, all board members need to feel comfortable asking questions when they don't understand something and be able to make sense of the answers (and realize when the answer doesn't make sense). Simply put, there are no dumb questions.

Financial information is, of course, not the only type of information used in decision making. But it plays an essential part in all important decisions, even those that may, at first glance, appear non-financial in nature (for example, should we keep our clinic open an extra hour in the evening so people can get there after work?). Armed with this knowledge, decision makers can better protect and enhance the nonprofit organization's capacity to serve the community.

In 2002, after several high-profile instances of corporate financial mismanagement, the U.S. Congress passed the Sarbanes-Oxley Act. For the most part, the Sarbanes-Oxley Act does not impose legal requirements on nonprofits (two parts of it do; see pages 25-26 for more information). Its provisions (other than the report on internal controls, known as the Section 404 Report) are generally practices that nonprofit organizations should follow anyway, because doing so enhances an organization's ability to serve its constituents. Also, these good practices cost little to implement.

This book discusses these practices and other issues of importance to nonprofit organizations. For example, Chapter 1 covers general and specific financial responsibilities of boards and includes a brief discussion of the Sarbanes-Oxley Act. Chapter 2 tells who's who and defines the roles of the main players. Chapter 3 goes into more detail about internal controls and procedures, while Chapter 4 offers a primer on financial statements and audits. In Chapter 5 you'll find suggestions for dealing with outsiders who assist the organization in its financial operations, and the Conclusion provides a list of the top 10 things to remember.

Discussion questions at the end of each chapter are designed to prompt board dialogue, whether at regular times set aside on the board meeting agenda or during a special board education session on finances. Each chapter also includes several quiz questions for testing your financial literacy. Appendix I presents samples of an auditor's opinions, while Appendix II and Appendix III summarize the federal and state schedules for filing various tax and information forms. The glossary provides definitions of financial terms that nonprofit boards often encounter as they fulfill their fiduciary duty.