



GOVERNANCE
SERIES

third edition



**financial
responsibilities**
of nonprofit boards

JOAN PAYNE, CPA

BoardSource®



third edition



financial responsibilities of nonprofit boards

JOAN PAYNE, CPA

Library of Congress Cataloging-in-Publication Data

Names: Payne, Joan, 1966- author. | Lang, Andrew S. Financial responsibilities of nonprofit boards.

Title: Financial responsibilities of nonprofit boards / by Joan Payne.

Description: Third Edition. | Washington, DC: BoardSource, [2018] | Revised edition of Financial responsibilities of nonprofit boards, c2003.

Identifiers: LCCN 2018037086 | ISBN 1586861506 (alk. paper)

Subjects: LCSH: Nonprofit organizations--Finance. | Directors of corporations.

Classification: LCC HG4027.65 .P39 2018 | DDC 658.15/9--dc23 LC record available at <https://lccn.loc.gov/2018037086>

©2018 BoardSource

Published by BoardSource
750 9th Street NW, Suite 650
Washington, DC 20001

This publication may not be reproduced without permission. Permission can be obtained by contacting permissions@boardsource.org. Revenue from publications sales ensures the capacity of BoardSource to produce resources, conduct research, and provide services to strengthen the governing boards of nonprofit organizations. Copies of this book and all other publications can be purchased or ordered at www.boardsource.org or by calling 800-883-6262. Discounts are available for bulk purchases.

The views in BoardSource publications do not represent official positions of BoardSource or its sponsoring organizations. Information and guidance in this book is provided with the understanding that BoardSource is not engaged in rendering professional opinions. If such opinions are required, the services of an attorney should be sought.

BoardSource®

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

BoardSource is a 501(c)(3) organization.

For more information, please visit our website at www.boardsource.org, e-mail us at mail@boardsource.org, or call us at 800-883-6262.

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.

Financial Responsibilities of Nonprofit Boards, Third Edition

About the BoardSource Governance Series	9
Introduction	12
Chapter 1 // Fiduciary Responsibilities of Board Members	13
An Overview	13
Importance of Financial Literacy	13
Financial Committee Roles	14
Finance Committee	15
Audit Committee	17
Investment Committee	18
Role of the Board Treasurer	18
The Board and the Financial Staff	19
<i>A Board Member's Primer on Nonprofit Status</i>	20
Chapter 2 // Budgets and Forecasts	21
Budget Process and Timeline	21
Budget Surplus and Deficits	22
Capital Budgets	22
Budget Revisions	23
The Board's Role in the Annual Operating Plan and Budget Committee and Board Approval	23
After Board Approval	24
Using Forecasts	24

Chapter 3 // Nonprofit Financial Statements	26
An Overview of Financial Statements	26
Statement of Financial Position (Balance Sheet)	28
Assets	28
Liabilities	28
Net Assets	29
Statement of Activities (Income Statement)	31
Revenue	31
<i>Types of Revenue Unique to Nonprofits</i>	33
Expenses	34
Change in Net Assets	35
Statement of Cash Flows	36
Statement of Functional Expenses	37
Notes to the Financial Statements	38
<i>Accounting Methods Defined</i>	40
Consolidated Financial Statements	40
Financial Dashboards	40
Chapter 4 // Audit and IRS Form 990 Oversight	42
Ensuring Effective Financial Statements	42
Overseeing the Independent Audit	43
What the Auditor Does	43
Other Audit Services	44
Auditors Are Not Hired to Discover Fraud	44
Audits in New or Small Organizations	45
Selecting an Audit Firm	45
Rotating the Auditor and Lead Partner	46
Communicating with the Audit Firm	47
Engagement Letter	47
Management Representation Letter	47
Internal Control Letter	47
Governance Letter	48
<i>Federal Funding, Expenditures, and Federal Audits</i>	
<i>(Single Audits)</i>	49
The Board’s Executive Session with the Auditors	50
Reviewing the Organization’s Form 990	51
Filing Requirements	52
Nonprofit-Centered Issues on the Form 990	52

Chapter 5 // Risk Management Oversight	56
Risk Management Policy	56
Insurance Coverage	57
Board Members and Personal Liability	57
Business Continuity Plan	58
Risk Areas to Consider	58
Financial Risk	59
Human Capital Risk	61
Operational Risk	63
Reputational Risk	65
Other Risks Specific to Your Organization	65
Crisis Communications	65
Chapter 6 // Policies and Procedures	67
Whistleblower Policy	67
Document Retention and Destruction Policy	68
Investment Policy	69
Related-Party Transactions	70
Reserve and Endowment Policies	71
<i>Endowment Types</i>	72
Liquidity Policy	72
Gift Acceptance Policy	72
Loans Policy	73
Risk Management Policy	73
Signing Authorities	74
Organization Credit Card Policy	74
Personnel Guidelines	74
Accounting Policies and Procedures Manual	75
Internal Controls	76
Segregation of Duties	77
Fraud	77
Accounting Systems and Technology	78
Financial Transparency	78
Public Documents	79
Private Information and Documents	79

Case Studies	81
Glossary of Financial Terms	91
Appendix // The Board’s Role in Reviewing Form 990: A Checklist	105
Recommended Resources	111
About the Author	114

ABOUT THE BOARDSOURCE GOVERNANCE SERIES

BoardSource created the Governance Series, its flagship series, 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 approximately 1.5 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, most nonprofits 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 so they can serve their organizations and the public in the best possible manner. The 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, while remembering that it is the governing board that holds legal authority rather than individual board members. The chief executive is accountable and reports to *the board only*.

WHAT WILL BOARD MEMBERS FIND IN THE GOVERNANCE SERIES?

The Governance Series addresses 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.

Ten Basic Responsibilities of Nonprofit Boards describes the ten core areas of board responsibility.

Legal Responsibilities of Nonprofit Boards elaborates on the board's legal responsibilities, liabilities, and the oversight it should provide to protect the organization.

Financial Responsibilities of Nonprofit Boards explains board fiduciary responsibilities in the areas of financial oversight and risk management.

Fundraising Responsibilities of Nonprofit Boards helps board members understand why they should be actively engaged in ensuring adequate resources for the organization — and how to get involved in fundraising.

The Nonprofit Board's Role in Mission, Planning, and Evaluation provides guidance on how to define and communicate the organization's mission and link strategic planning and evaluation to achieve organizational success.

Structures and Practices of Nonprofit Boards focuses 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, data from BoardSource research, 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. You can use it to set standards, to develop your 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 *The Nonprofit Board's Role in Mission, Planning, and Evaluation* with board members before starting a strategic planning process or give *Fundraising Responsibilities of Nonprofit Boards* to the development committee. Chief executives will find it beneficial to give *Financial Responsibilities of Nonprofit Boards* to the board treasurer and to review *Ten Basic Responsibilities of Nonprofit Boards* and give it, along with *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 *Legal Responsibilities of Nonprofit Boards* so they understand how to protect themselves and their 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. Ultimately, this commitment by dedicated board members translates into greater mission impact in the communities they serve.

INTRODUCTION

You've accepted the invitation to serve on a board for a nonprofit organization dedicated to advancing a cause you're passionate about. Now what?

Board service comes with a host of responsibilities, including helping oversee the organization's financial situation. This can be intimidating for those who do not have a strong financial background. *Financial Responsibilities of Nonprofit Boards* will help you navigate through and prepare for the fiduciary and financial responsibilities that come with being a nonprofit board member.

We recommend you read the book before — or in conjunction with — joining a nonprofit board. Reading it before participating in board member orientation will allow you, along with your fellow board members and management, to dig deeper into the concepts in this book that relate specifically to your organization.

Chapter 1 introduces you to your overall fiduciary responsibilities, the importance of financial literacy, the three most common financial committees, the role of the board treasurer, and the nature of the board's relationship with staff when it comes to financial oversight.

In Chapter 2, you'll learn of the board's role in budgeting and forecasting.

Chapter 3 introduces you to nonprofit financial statements and generally accepted accounting principles for nonprofits.

Chapter 4 focuses on the board's role in overseeing an independent audit and reviewing your organization's Form 990.

Chapter 5 delves into risk management.

Chapter 6 addresses the board policies and procedures that relate to financial oversight.

Each chapter includes red flags to look for when exercising your financial responsibilities. We end the book with case studies, a glossary of financial terms, and a checklist to use when reviewing your organization's Form 990.

While financial information is not the only type of information used when making decisions for your nonprofit, it plays an important part in all important decisions, including those that may, at first glance, appear non-financial in nature. Armed with the knowledge presented in *Financial Responsibilities of Nonprofit Boards*, you, a decision maker, can better protect and enhance your organization's capacity to serve your community.