BOARDSOURCE®

201 KEY ISSUES

AVOIDING FINANCIAL RISKS

To avoid or diminish financial and accounting risks that might threaten the organization's existence or decrease its effectiveness, the board needs to be aware of proper financial processes and practices.

The fiduciary role

Functioning as a fiduciary means that your board is responsible for the well being and financial health of the organization. The board's decisions must not place the organization in financial jeopardy. As individual fiduciaries, your board members must understand that they may be considered personally liable for their actions and inaction. Even if they are not all financial wizards, they must be "financially literate" enough to ask the right questions when things are unclear.

Role clarity

The biggest risk factor occurs when board members misunderstand their duties or willfully disregard them. If your board does not realize that one of its duties is to monitor the organization's financial matters and management activities, it has already abdicated its oversight role. You can begin to reverse this situation by drafting clear job descriptions that outline duties and define individual responsibilities. Clearly state what fiduciary duty means.

Legal requirements

Ignoring legal requirements poses serious risks. Even if your board is not physically filing papers and paying the necessary taxes, it must make sure that these tasks are carried out. The easiest way to do that is to have an annual calendar of must-do tasks and to make sure that required statements and supporting documents are included in board packets for review and verification; they can then be voted on in a consent agenda and the vote is recorded in meeting minutes. Items to be verified include payment of payroll taxes, filing of Form 990, filing of state registrations and possible fundraising permits, and any applicable certification documents.

Internal controls

Without internal controls, there are opportunities for misappropriation of funds. The board needs reassurance that money is handled properly — from opening mail that contains checks to approving financial statements. The best way to do this is by segregating duties. The chief executive sets the system in place and is responsible for eliminating loopholes. But, because the chief executive reports to the board, the board must ultimately feel comfortable that the information it receives is accurate and timely.

Budget approval

If the board is not involved in approving the annual budget, it is neglecting a major aspect of its fiscal responsibility. The finance committee should work closely with the chief executive — or the chief financial officer — to reach a mutual understanding of the year's financial objectives as well as to create a physical document to guide the staff when making decisions. The budget is the most important financial document for the staff. If serious deviations from the budget are planned, the board needs to be consulted beforehand.

Regular, unbalanced budgets are a major red flag. If the board approves budgets that reflect dreams rather than reality, the organization is courting danger. Occasionally, it may be acceptable to go ahead with a deficit because of unusual circumstances — exceptional opportunities, catching up after hardship — but you must be able to justify it and have a clear plan for getting back in financial balance.

Reserves

Planning for the future without building any reserves is not smart financial planning. Even tight fiscal forecasts should include saving for the future. Operational reserves are a safety net for both unforeseen circumstances and promising opportunities that turn up unexpectedly. Just as for individuals it is risky to live from paycheck to paycheck, it is risky for organizations to have no savings.

Policies

Policies serve as guides for decisions, assure fairness when properly enforced, and serve as protection if anyone questions outcomes or wants to know the basis of your decisions. The board's financial policies should address oversight duties, not daily operational processes, which are the domain of the chief executive and the financial staff.

Audits

The board should engage an independent auditor to verify the soundness of your financial structure and processes. And, remember: The auditor reports to the board, not the staff. Posting audited financial statements on your organization's Web site is a sign of transparency.

Training

Because board members are not necessarily financial experts, it is wise to provide regular education on financial matters that affect the organization. This should include instruction on how to interpret the reports and where to focus attention so that potential pitfalls can be avoided before they endanger the organization.

Resources

Financial Responsibilities of Nonprofit Boards, Second Edition
Availabe at www.boardsource.org or by calling 202-349-2500.
