Is Financial Oversight Your Weakest Link?



By Melanie Lockwood Herman

Executive Director

Resource Type: Risk eNews

Topic: Fraud and Financial Oversight

Several years ago I read *Money Matters for Nonprofits: How Board Members Can Harness the Power of Financial Statements by Understanding Basic Accounting,* by Melisa F. Galasso. Melisa kindly sent me a copy after learning about NRMC from a friend, who spoke at an NRMC *Risk Summit*.

Did you know that:

- The members of a nonprofit board share responsibility for financial oversight?
- No one on your board gets a 'pass' on this responsibility?
- Financial literacy—a keen understanding of nonprofit financial statements—is often presumed, but rarely taught to the members of a governing board?

If you've been around a nonprofit board in any capacity—as the CEO reporting to a board, as a member of a board, or as a staff member sitting in the cheap seats while the board deliberates—you've probably witnessed weak financial oversight. Perhaps it was a comment or question that suggested a lack of understanding about the nonprofit's financial model. Or a comment about getting the 'boring, routine financial stuff' out of the way to make room for a conversation about the upcoming fundraising event. Many years ago, I was part of a local board that accepted financial statements that we never saw. The volunteer Treasurer assured us everything was in order. In 30 seconds, a motion to approve the statements was made, seconded, and passed.

The final words in Galasso's subtitle,"…by Understanding Basic Accounting," may be off-putting to many nonprofit leaders who want to improve their financial literacy and be better financial stewards. I was initially skeptical that 'basic accounting' was the secret sauce to better oversight. But my skepticism was quickly countered by the author's plain language explanation of basic accounting and financial reporting concepts that are absolutely key to understanding a nonprofit's financial health.

Galasso reminds the reader that: "The oversight function ensures that all resources are used to achieve the mission," while pointing out that "…the oversight and presentation of the financials cannot be delegated to the independent accountant." Too often, board members give themselves a 'pass' on fiscal oversight because they believe that:

- The completion of an annual, independent financial statement audit indicates that the financial house is in order, or
- Having a Finance Committee with fiscally literate members is sufficient.

Galasso offers concise explanations of concepts that stymie board members across the mission spectrum. Some of my favorite examples include:

Revenue recognition:

- "Nonprofits have a variety of revenue streams. Some may come from *exchange transactions*, where each party receives approximately what they pay for. This is also referred to as *commensurate value*. Some revenue can come from contributions. These are often referred to as *voluntary nonexchange transactions*. Each stream has different recognition and measurement rules."

Restricted donations:

- "Some restrictions are temporary and expire after a period of time…Some restrictions are *perpetual* in nature."
- "When a donor's restrictions have been met (i.e., the funds are used for the correct purpose or the time restriction has expired), the statement of activities shows this as a reduction of the net assets with donor restrictions and an addition to the net assets without donor-imposed restrictions."

Deferred revenue:

- "Deferred or unearned revenue is when a nonprofit is paid in an exchange transaction before the good or service has been delivered…When the good or service is delivered, then the deferred revenue account is reversed, and revenue is recognized."

Have you heard the expression "no money, no mission"? It's often uttered to remind an audience that without financial resources, the programs and services of a nonprofit cannot be delivered. I encourage boards to go beyond the simple idea that 'we can't deliver our mission if we don't have financial resources.' As leaders and stewards of nonprofit missions, we should call out poor financial oversight as an existential threat and unacceptable risk. By the time many boards realize their beloved organization is in poor financial health, the options available have dwindled. Multiple years of 'clean' audits won't help you when you're eliminating programs and notifying staff about impending layoffs.

I appreciated the content and structure of the book as well as the clear examples. Chapters cover each financial statement, refer to the variances in names for those statements, and Galasso provides actual examples of financial statements! Over the years I've consulted a number of sources to create NRMC workshops and webinars on financial oversight. This is the first source I've encountered that uses actual—versus hypothetical—financial statements. The actual examples—of both large and small organizations—show how different organizations choose to present financial information. They also demonstrate that—contrary to the common perception that the rules are always rigid—GAAP accounting and the rules of the Financial Accounting Standards Board (FASB) allow variation.

We've all seen slick promotions about quick and painless methods to lose weight. While we might wonder "what if…" for a minute or more, our logical brains remind us that regardless of the potions and pills promising results without effort, losing weight is about eating less and moving more. The same concept applies to providing the financial oversight that every nonprofit mission deserves. While I'd love to be able to share a checklist or infographic with everything you need to know, I'd be a charlatan if I suggested that was possible. Don't let the subtitle of Galasso's book dissuade you from learning basic concepts that will serve you well in a management, executive, or volunteer role in a nonprofit whose mission matters to you.

In addition to Galasso's book, I encourage you to check out these additional resources from NRMC:

- "Why Fortified Fiscal Oversight is Key to Financial Well-Being"
- "Set the Story Straight with a Financial Dashboard"

Melanie Lockwood Herman is Executive Director of the Nonprofit Risk Management Center. Over the years, she has taught numerous workshops and webinars on the topics of financial oversight and managing financial risk. She welcomes your ideas about how to do that effectively, including resources you use to convey financial concepts using words non-financial leaders understand. Reach Melanie at Melanie@nonprofitrisk.org or 703.777.3504.