Nonprofit Risk Management Center

IN is OUT, and OUT is IN Outsourcing the Finance or Accounting Function in a Nonprofit

By Alex Ricketts

Resource Type: Articles

Topic: Fraud and Financial Oversight

Fiscal Outsourcing

Outsourcing financial tasks has become a popular trend in the nonprofit sector. Common reasons nonprofit leaders outsource some or all of their financial management responsibilities include:

- to gain access to expertise the nonprofit doesn't require on a full-time basis,
- to reduce the cost of financial management activity, and
- to enable the efficient ramping up or scaling back of financial management based on the ebbs and flows of fiscal activity at the organization.

In addition to the benefits listed above, retaining an independent, qualified finance or accounting firm may enable a nonprofit to mitigate certain downside risks that arise in financial management, such as:

- fraud made possible by the practice of allowing one staff member to control some or all financial functions from start to finish,
- undesirable fiscal surprises or instability due to the lack of fiscal literacy on the board and the board's inability to spot red flags in periodic financial statements,
- untimely financial reporting or filing because the nonprofit staff must focus on other pressing business, and
- allegations of noncompliance with the terms of grants or contracts due to sloppy financial reporting.

Fiscal outsourcing can be helpful to a nonprofit that finds itself ill-equipped to manage these and other financial risks alone. But before outsourcing, nonprofit leaders must first prepare to mitigate risks that may arise from outsourcing.

Outsourcing Due Diligence

Before turning over access to any aspect of the financial management function to a third-party, it's important to take the time to choose a vendor whose expertise, business model and pricing suit your needs.

According to Ed Mulherin, CEO and Founder of eCratchit, a Boston-based accounting firm that offers "virtual" financial services, the key to successful fiscal outsourcing is finding the right match. "Collaborating with the

right firm is essential for a healthy partnership," Mulherin said. "Partnering with an inexperienced firm or one that is unfamiliar with your organization is the greatest potential downside risk."

Planning for a successful partnership begins by understanding your needs. Ask: What specific fiscal tasks should we outsource? What are the pros and cons of outsourcing a few specific financial tasks or activities, versus the entire finance function? Knowing the answers to these questions will help guide you in the search for a firm and enable you to reduce the risk of a costly match. Mulherin also urges nonprofits to seek out firms that carry professional liability insurance.

Once you identify potential partners, interview them as if you were hiring an employee. Some of the questions you might ask include:

- Have you worked with nonprofits before?
- What sizes and types of nonprofits do you currently serve?
- What is the range of services you provide? What specific services do you recommend for a nonprofit similar in size or structure to ours?
- How long will the transition take, and what is involved?
- Is there a startup fee to access your firm's services?
- How often will we be billed for services, and how is billing structured (e.g., monthly invoice based on number of hours devoted to the account, or flat weekly fee debited from the nonprofit's bank account)?
- How often will you provide financial statements or other reports, and can these reports be customized to meet our needs at no additional cost?
- What is your availability to meet with our finance committee, audit committee, and/or board, and are these meetings included in your fee?
- What training, if any, will our staff need in order to work in partnership with your firm? (e.g., training on accessing our accounts virtually)
- What challenges do you anticipate (e.g., based on our internal resources, current accounting software, etc.) and how do you propose to address them?
- Can you provide current and former client references?

The answers to these questions will be invaluable as you narrow down your options. You may discover, for example, that a well-respected firm isn't in position to assign a go-to account manager; instead, you'll be working with a different representative every time you call. Or you may learn that the affordable flat fee for services is a baseline only, and weekly or monthly bills are likely to include unpredictable costs, such as fees for work by senior accountants, or fees for custom reports.

Caution is Required

- Use a Written Service Agreement: In order to reduce the risk of confusion and disappointment, a well-structured service agreement is crucial. "A service agreement with a detailed scope of work is essential," Mulherin advised. "The segregation of duties is one of the greatest potential benefits of outsourcing, so it's important to formally establish the exact services that will be provided by the firm."
- Have Realistic Expectations: Though your nonprofit will have access to greater fiscal expertise, do not assume that your outside partner is perfect. The risk of human error and even fraud remains. Although professional liability insurance provides some peace of mind by potentially financing some losses, it remains the nonprofit's duty to guard the fiscal health of the organization. Outsourcing finance tasks doesn't mean forgetting about your legal responsibility for fiscal oversight.
- Ensure Accessibility: In order to discharge the responsibility for fiscal oversight, make certain you will be able to access your accounts and reports without delay. Ask: Will we be able to verify information provided by the firm by accessing our accounts directly? Does the firm have 24/7 support? Will the firm immediately notify us when a problem arises? Will the firm provide us with several communication options? What is the firm's commitment to respond promptly to our questions and concerns? These questions should be asked and answered prior to signing a service agreement.
- Formulate an Exit Strategy: To avoid the perils of a long-term commitment to an unhealthy partnership, formulate a way out long before you need it. Mulherin suggests that nonprofit leaders create åat-will service agreements' with their outsourced partners. If things don't work out or the firm's services are no longer needed, the relationship may be terminated, without penalty, by the nonprofit. Include in any exit strategy your expectations for support and assistance during a transition period.
- Be Selective: Think carefully about which financial functions you should outsource. Mulherin suggests that the easiest activities to outsource are transactional tasks: bill payments, financial report production, and

management of bank accounts and payroll. You may want to outsource some of these tasks before you hand everything over to the firm. Outsourcing transactional tasks for a time also provides an opportunity to get to know the firm and evaluate the firm's proficiency at managing finance tasks.
- Don't Lose Touch: It is essential that nonprofit leaders routinely review the performance of an outside accounting firm. Beware of losing interest and neglecting financial duties after outsourcing. You will still need to be fiscally literate and savvy to discharge your responsibility for fiscal oversight. Discus with your provider what protocols make sense for communication, such as regularly scheduled check-in calls or as-needed email exchanges and conversations.

As fiscal outsourcing becomes more common in the nonprofit sector, it may be tempting to jump on the bandwagon. Like any other trend, however, it is important to first identify, understand and manage the downside risks associated with any new approach before you can reap all of the benefits.

For information about the Nonprofit Risk Management Center, visit www.https://nonprofitrisk.org/ or call (703) 777-3504.