Accounting Spoken Here

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Not all board members have to be financial wizards, but they should understand the basics of nonprofit accounting – in good times and bad.

Are you financially fluent? Do you read and speak basic accounting? There's no reason to be embarrassed if you don't. But there's no more hiding behind those board members who do, either. Now, due to the impact of the economic crisis on the nonprofit sector, it's absolutely essential for all nonprofit board members to know how to read and understand their organization's financial information. When the discussion turns to finances, too much is at stake to not have everyone's voice heard at the board table.

Fortunately, many nonprofit organizations have staff members with expertise in finance who are happy to teach their language to you. So, here are a few questions that you can ask your organization's chief financial officer to start your education.

What are the basic mechanics of nonprofit financial statements?

Before you can understand "what" a financial statement says, you need to know "how" it works. All nonprofit organizations should have a Statement of Financial Position (a balance sheet showing the assets and liabilities of the organization at a given point in time), a Statement of Activities (showing revenue and expenses for a specified period of time), and a Statement of Cash Flows (showing where cash came from and how it was used). Ask your CFO to explain the basics of these statements and how they link to one another.

As for the details of the statements, make sure your CFO explains basic accrual accounting terms like "prepaid expense" and "deferred revenue."* Often, questions about accounting will derail a board's more important discussions of financial issues. You shouldn't be spending time in the boardroom talking about why deferred dues are on the statement of financial position but instead about how to increase non-dues revenue. Also ask your CFO to present financial reports to your board in a simple, one-page format. Complicated reports that change in format from one meeting to the next are confusing.

What are the financial highlights?

Not surprisingly, there are a lot of numbers on a financial statement. Fortunately, just a few of them will give you a quick feel for what's going on in your organization. Ask your CFO to point out these numbers. You don't need to spend time trying to figure out why the supplies expense is $342 over budget. You want to stay out of the weeds and look at the big picture.

When I talk to my board, I always address the following four financial highlights. Ask your CFO to do the same.

1. *Did gross revenue grow over last year's results?* I care more about the growth over last year than the budget because budgeting revenue is really difficult. Growth in revenue shows movement in the right direction; no growth or worse, negative growth, are, of course, undesirable.
2. *Are we monitoring expenses to maintain the budgeted bottom line?* Expenses need to be kept in check. If revenue doesn't meet budget, the board needs to make sure that expenses are adjusted to meet the budgeted bottom line.
3. *Are investment gains/losses in line with the benchmark?* If you have a 10 percent loss on investments and the benchmark is a 15 percent loss, that is actually good! Monitor investments compared to a benchmark, not in and of themselves.
4. *What are the trends or future implications?* Today's numbers have more value if you understand what has been happening with them or what is predicted to happen in the future. Spend some time discussing trends and future commitments.

What is new in the world of nonprofit finance?

In this post-Enron world, the roles of both for-profit and nonprofit board members have changed from a fiduciary point of view. When the treasurer or CFO presents financial data to the board, ask him or her to update the board on what is new in the world of nonprofit finance. Whether it is changes to the Form 990, changes in auditing standards, or new disclosure requirements, board members need to be up to speed on these issues.

Will you take on the role of educator at every board meeting?

Having the treasurer or CFO just read the level of assets and the amount of the net loss at a board meeting does not help in your education. Ask your board to set aside 15 minutes on every board meeting agenda for the CFO to educate board members about accounting specifics. Ask the CFO to develop a curriculum for the year. For example, she could discuss revenue diversification in September and the different types of restricted net assets in October. Suggest she occasionally treat the board to an industry expert or consultant and invite your organization's investment advisor and auditor to attend a meeting to share a bit of their knowledge.

While decisions made by a nonprofit board are not based solely on finances, they have financial impact. It is important for the board to discuss this impact and for every member to be a part of the discussion. That includes you!

*Some very small nonprofits use a cash method of accounting (as opposed to accrual accounting) that records revenues when they are received instead of earned and expenses when they are disbursed instead of incurred. Thus, revenues are not matched with expenses.

KEY FINANCIAL TERMS YOU SHOULD UNDERSTAND

- Deferred revenue. Cash that has come in the door but is not yet earned because your organization has not yet delivered the goods or service paid for. Deferred revenue is recorded as a liability on the Statement of Financial Position and then moved to the Statement of Activities when earned.

- Prepaid expenses. Cash that has been paid for services or goods prior to your organization receiving the services or goods. Prepaid expenses are recorded as an asset on the Statement of Financial Position and then moved to the Statement of Activities when the services or goods are received.

- Operating margin. The excess or deficit of revenues over expenses.

- Net assets. The difference between your organization's assets (what it owns) and its liabilities (what it owes). Net assets are categorized as unrestricted, temporarily restricted, or permanently restricted.

- Reserves. The amount of resources currently available to your organization to use in any way it chooses. Because reserves should be available to spend in time of need, the figure should not include fixed assets, such as land and buildings, nor be reduced for such long-term debts as mortgages.

- Unrealized gains and losses. Changes in value of investments that would result if the investment were sold. These changes are accounted for as revenue or expenses.

- Designated funds. Unrestricted resources that the board has voted to set aside for a period of time or for a specific use.

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