Financial Questions Every Board Member Should Ask

Although board members typically do not manage the day-to-day activities of the nonprofit, they do act as stewards and have fiduciary financial responsibilities. As a board member, you must act in good faith and make informed decisions. Regulators have been raising the bar for the board's level of understanding of the financial health of its nonprofit.

As a board member, you should understand the following:

1 What is our current cash position? How many days of cash on hand do we have?

Cash on hand is good indicator of the solvency of the organization and represents the amount of cash readily available to the nonprofit - usually in the checking account. A benchmark to strive for is 3 to 6 months of operating expenses.

2 What are our key sources of revenue? What is the mix of unrestricted, temporarily restricted and permanently restricted net assets?

Understanding the makeup of revenue for the organization (e.g. government contracts, fee-for-service, donations, grants) helps you understand the key stakeholders and the stability or vulnerability of your revenue. Does the bulk of revenue come from a single donor or government agency? What if the donor passed away suddenly or there were a cut in government funding? Even though there may be funds on a balance sheet, if they are restricted, they are not available to fund operating expenses. Insufficient unrestricted assets limit the organization's ability to respond quickly to organizational needs required to meet its mission.

3 Do we have an operating reserve? If so, how many days (or weeks or months) of operations does it represent?

In addition to cash on hand, many nonprofits create an operating reserve fund that represents a "rainy day" fund – a source that could pay operating expenses in the event that expected revenue is not received. It is generally measured in how many days, weeks or months the organization could continue to operate with no new revenue. Many nonprofits strive for a 3 to 6 month operating reserve.

4 Do we currently have a line of credit? If so, for how much and what are the terms? Has it been recently activated?

A line of credit allows the organization to borrow money over a very short term, helping to bridge a revenue gap. Most banks require some type of collateral (i.e. future promise of state or federal funding or real estate) and frequently tie the interest rate to some national indicator (e.g. prime rate plus one percent). Best practice is for nonprofits to secure a line of credit <u>before</u> it is needed, so that it can be activated quickly to plug a revenue gap.

5 Do we have an endowment? If so, how is it managed?

If a nonprofit has an endowment, board members should understand how the fund is invested and managed and how much goes back into the general operations of the nonprofit. Is it invested in a broad range of securities with a trustworthy investment firm? Is it just the interest that goes into the operating fund or is the organization using funds from principal to support its operations? Does the board annually approve the spending policy from the fund?

6 Do we have financial policies such as requiring multiple signatures that safeguard us from fraud and embezzlement?

Fraud and embezzlement can be a very real threat to nonprofits large and small. Not only do they drain precious funds from your organization, but they can create a public relations nightmare, causing donors and others to question your ability to safeguard your funds. No one person in the organization should have complete and unchecked access to your funds. Is there a board committee tasked with overseeing policies related to fraud prevention? (See 12 Tips for Preventing Fraud on this website.)

7 Do we have a whistleblower policy that encourages employees to expose possible fraud?

The Sarbanes-Oxley Act of 2002 requires that every organization implement policies that encourage both employees and volunteers with the organization to report suspected fraudulent activities without fear of repercussion from the organization. In other words, an employee should feel free to report suspected fraudulent activity about his boss or another employee without fear of losing his job. The IRS Form 990 specifically asks you to report on your whistleblower policy.

8 Do we have a year-end financial review or audit? Are these documents shared with the full board?

Nonprofit boards of various sizes should assure the fiscal health of their organizations, and many chose to have either a financial review or audit done by an outside party. At certain thresholds, state and federal audits are required.

9 Are annual IRS filings (Form 990's) reviewed by the board prior to filing?

An annual IRS Filing is required of all nonprofits. Once these are filed, they become public documents and can be posted on websites. Guidestar.org is one of the most popular sites which lists the 990 forms of many nonprofits. While this is not a legal requirement, it is good practice for all board members to be aware of the information contained in this public filing. Organizations are asked how they handle this on the Form 990.

10 Are regular financial reports provided to the board in a timely manner (for example - one month after the close of the quarter)? Are the financial reports presented in way that is clear and useful for board members to make planning decisions?

One of a board member's key roles is to provide financial oversight to the organization, so regular review of recent financial information is vital. The key to doing this well is creating clear financial statements that communicate the overall picture and allow board members to raise questions and make informed decisions.

11 Does the board assist in developing and finally approving an operating budget for the coming year?

Board members should understand the financial position of the organization and review financial information at every meeting. As part of the board's oversight and planning role, the operating budget for the coming year should be approved by the full board prior to implementation. Is there clear disclosure of the "at-risk" assumptions in the proposed budget? Is there a link between resource allocations in the budget with the organization's strategic plan?

While asking financial questions may feel awkward, it will show that you take your fiduciary responsibilities as a board member seriously. With a fresh set of eyes focused on the finances, it may turn out that your fellow board members learn something in the process too.