EXECUTIVE DIRECTORS GUIDE

The Guide for Successful Nonprofit Management

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FINANCIAL MANAGEMENT

CHAPTER 11

This chapter focuses on one of the most critical elements of nonprofit management – managing the finances of your organization. Here we explain the importance of paying close attention to finances, describe the role and responsibilities of the executive director, and provide a primer on nonprofit financial management.

The Importance of Attention to Finances

Not every executive director will come to the job well equipped to manage finances. If you fall into the financially challenged category, don't despair. Help is available from peers, board members, service providers, and consultants. As executive director, however, you must have a sufficient knowledge base in financial management to enable you to make the best use of this outside help.

Financial management is the foundation of planning and managing every other aspect of the organization, including buildings, equipment, people, programs, fundraising, technology, printing, and insurance. Thinking strategically when managing money is essential because it is so interlinked with every other function.

A thorough understanding of your agency's finances will allow you to know if programs are cost-effective, if staffing patterns make sense, if the organization has a balanced budget, and if fund development can keep pace with the growth of the agency. Other common management questions that require a full understanding of agency finances include:

- How much revenue will our organization receive this year? Over the next three years? What portion has already been committed to the organization, and how much will we need to raise?
- What are our staffing needs, given our current and projected revenues?
- What will it cost to remain in this facility for the next five years?
- How much will it cost us to raise money this year? Over the next three years?
- What are the costs associated with operating core programs?
- What are the costs associated with developing a new initiative?
- How much will obtaining and maintaining new technology cost, including the cost of training staff in its use?
- What parts of the strategic plan are doable? Does the plan have to be revisited in light of financial analysis?
- What are the projections for health insurance costs over the next three years? Can we afford 100 percent coverage? 80 percent coverage? Can we cover family policies or only individual policies?
- Can we afford a retirement plan? If so, what type and what level of contribution can the agency support?
- Do our financial decisions reflect our organization's core values?

Be Prepared!

If you have recently taken over as executive director, be prepared for some unpleasant surprises regarding your agency's finances. In our experience, more often than not when a new executive director comes on board, she or he discovers that the financial management systems need shoring up. Even if you asked all the right questions and looked at the books and latest audit before taking the job, there is a good chance that you will find some holes that need to be patched – if not whole systems that need to be overhauled or replaced.

As soon as possible after settling into your job, we suggest that you set up a meeting with the board treasurer, your auditor or outside accountant, and your financial staff, if any. Such a meeting will help you improve your understanding of the organization's overall financial picture, including any hidden or looming financial crises, get a sense of the relative competence of the key financial players in the agency, and send a message to the entire organization that you consider financial management a high priority and will be paying close attention to it. Some of the questions for discussion at this meeting might be:

- What is your sense of the overall financial health of the organization?
- Do we have an organizational budget for the current year and projections for subsequent years?
- How is the annual budget put together?
- Do our systems produce the reports we need?
- Is there a Finance Committee and if so, who serves on it and how often does it meet? Do the members have a clear understanding of their duties?
- Is the strategic plan – assuming there is one – tightly integrated with the organization's budget?
- Are there any financial red flags out there that you should know about – revenues not collected, bills not paid, contracts not signed, lawsuits threatened or pending, accounting hardware or software issues?
- How would you rate the quality of our internal financial controls?
- Do we have the right numbers, types, and competency levels on our financial management staff?
- Has the organization ever received anything other than a clean audit? If so, when and why?

Money isn't just money. It is another lens through which we can view our organization's current reality and future potential. Money, along with mission and values, should be one of the primary screens for all organizational decisions. Executive directors and boards of directors who do not understand this – who see financial management as a necessary evil or enemy of mission and program – run the risk of jeopardizing the organization's future. Mission, money, and values are integrally connected as the core indicators for how, and at what level, programmatic actions can be taken.

Upholding fiduciary responsibility does not mean that an agency will remain forever solvent. Too many factors influence the financial health of a nonprofit organization for there to be any guarantees. Careful financial stewardship, however, will increase the likelihood of stability and will enhance the organization's credibility with all its constituents, both internal (board, staff, volunteers) and external (funders, vendors, colleagues, regulatory agencies). Confidence in the financial stability of an organization will increase the confidence of the staff to take on new challenges and make the organization a more valuable asset to the community.

Roles and Responsibilities

Financial accountability is a shared responsibility of the board of directors and the executive director. In small organizations, the board or the board and executive director may do all of the financial management. As organizations grow, their roles and responsibilities become more defined, as outlined below.

The Board of Directors

The primary role of the board is oversight. As the legally accountable entity for the entire organization, the board has overall responsibility for its financial health.

The treasurer's job is to review the organization's finances at least monthly. Some treasurers rely on monthly statements and analysis provided by the executive director, bookkeeper, or controller. Others will "open the books" once a month and do their own analysis.

Other key financial responsibilities of the board (which each individual director takes on when he or she agrees to be a member of the board), include:

- *Approving the annual budget* (and helping to design it in small organizations). The annual budget should use realistic (conservative) projections for revenue to help ensure that the organization does not end up with an unexpected deficit.

  The budget should include expense line items that set the parameters within which the executive director can operate. We recommend a board-established policy that allows for a modest variance (generally 5 percent to 10 percent) for each line item, so that the executive director does not have to alert the board to minor variances, as long as the bottom line does not change. *If the organization is being managed within these parameters, the board's financial oversight responsibility should be limited to monitoring.* Unless there are serious problems or the executive director or treasurer requests help, micromanagement of finances by the board is usually counterproductive and not in best interests of the organization.

The board's fiduciary responsibility and its role in approving or setting the annual budget carries with it the responsibility to provide fair and equitable salaries, benefits, working conditions, facilities, and resources. Typically, the board sets the parameters for these matters and hires an executive director to manage and implement them.

- *Ensuring that the agency has adequate funds* to operate on an annual basis.
- *Ensuring that all financial reports, taxes, and other government requirements are met by the agency.*
- *Establishing policies and procedures designed to assure overall accountability* for programs and finances and adequate systems to implement them.
- *Choosing and contracting with a CPA to conduct an audit on an annual basis.* While we believe it is good practice to conduct an annual audit, check with your state attorney general's office to find out if you are required to have one. In Massachusetts, for example, you are required to have an annual audit if your annual budget is over $250,000 and a financial review if your annual budget is between $100,000 and $250,000. The board's decision regarding the auditor should be duly recorded each year in the minutes. It is generally a good idea to put your audit out to bid every few years to make sure you are getting the best price and also to have the benefit of a different perspective on your financial operations.
- *Ensuring ongoing fiscal monitoring.* This role is extremely important because of the liability associated with a failure to exercise appropriate financial oversight. As stated above, the treasurer should carefully review the books monthly and report to the board at its regular meetings. A regular treasurer's report to the board of directors is the foundation of the checks and balances system that guarantees full financial disclosure and accountability. In the event of a financial crisis or serious irregularity, the treasurer should inform the president and, if necessary, request a special board meeting.

  If a board of directors does nothing else, it should convene to hear the treasurer's report and approve it if it makes sense. (The legal test is that it must make sense to the mind of any ordinary, prudent person.) If the report does not make sense in some way, it should be questioned. Any corrective actions should be put in the notes and minutes. The treasurer and/or finance committee should monitor the executive director's management of corrective action.

  While the board holds ultimate fiduciary responsibility, it is the responsibility of both the board and the executive director to ensure the organization's viability and fiscal accountability.

The Executive Director

The primary responsibility of the executive director is to understand the organization's finances, interpret them for other stakeholders, and, together with the board, see that the agency remains financial accountable to its community.

Typically, the board delegates responsibility for managing the functions that fulfill its role in meeting legal requirements to the executive director, who handles the actual contracting with auditors and the filing of legal forms, such as annual reports, tax returns, etc. The executive director, in turn, often delegates these functions to staff and consultants, depending on the size of the organization. The executive director must have a basic understanding of bookkeeping and nonprofit financial management. She or he should be able to read a budget, monthly financial statements, and audit reports and be able to understand, and sometimes develop, internal financial management systems and controls. In addition, the executive director should know how to project the agency's financial needs against its fundraising capacity.

In smaller organizations, where the budget does not support a separate financial management staff, the executive director typically takes on all the work of the financial manager as well.

Be honest with yourself. If you are not skilled at financial projections, monitoring, building meaningful budgets (operating, capital, and fundraising), and creating sound financial management systems, *and* you don't have other staff who can do these things, get support from the board or community and meet monthly with people who can help you with your overall financial management responsibilities. *No executive director will have every skill required for the range of nonprofit management functions.* If your strengths lie elsewhere, find partners to help with financial management. Take a course from a nonprofit training center or local college.

In very small nonprofits the executive director or a board member is often also the bookkeeper. Note, however, that this is not a good situation – primarily for ethical reasons. If you find yourself in this situation, ask a local auditor (even if your organization is too small to require an audit) to give some pro bono time to analyze your financial management system and recommend appropriate checks and balances.

The Financial Manager

Some organizations have a large enough or flexible enough budget to employ a financial manager or controller. A financial manager can handle many tasks that would otherwise fall to the executive director, treasurer, and finance committee. A financial manager maintains the general ledger and can prepare budget drafts, develop financial management and monitoring systems, and assist with the financial details of human resource issues, such as retirement funds, health benefits, Section 125 plans, and cost of living projections and salary increases. The financial manager can shop for better buys, research accounting software, monitor monthly expenses by line item, generate financial reports at the level required by the board of directors, monitor cash flow, assist with the budgets of funding contracts, and prepare reports to funders as required. In some cases, the financial manager will also do all the basic bookkeeping.

The Bookkeeper

Many organizations have dedicated and highly skilled bookkeepers who do many of the tasks described above. The basic responsibilities of the bookkeeper, however, are to record income and expenses according to generally accepted accounting methods, create and maintain simple financial systems that enable the accurate recording of income and expenses on a monthly basis, prepare billings to funders and other customers, produce clear reports to the executive director and board of directors, typically on a monthly basis, and produce needed documents for the auditor on an annual basis.

Staffing Considerations

The way financial management tasks are handled in an organization often depends on the size of the budget and, especially in smaller organizations, on the competencies of the staff. An executive director who is a generalist and doing many other things should dedicate on average one to one-and-a-half days every two weeks to all the tasks related to financial management. Keep in mind, however, this will only cover the basics.

With the widespread use of computers, the time needed by nonprofits for bookkeeping has been slashed dramatically. An experienced bookkeeper working with an organization that has sound financial systems, a modest number of government contracts, and a budget under $1 million should be able to fulfill basic bookkeeping responsibilities in 8 to 10 hours per week. However, even a $1 million organization might need considerably more bookkeeping time, up to a full-time position, if it has multiple funding streams and/or government contracts that include strict budget and reporting requirements.

A growing, mid-sized nonprofit should consider hiring a full-time financial manager or experienced bookkeeper who can handle all the details. Such an action can free the executive director to provide general management of this function and to position the organization for a more mature pattern of growth through sound financial practice. By the time an organization has reached the $2+ million level, a full-time accounting position is usually justified, especially if the organization's finances are fairly complex (multiple state and federal contracts, ongoing fundraising campaigns that involve pledging, multiple sites or management of multiple facilities). Organizations of this size often need a half-time bookkeeping position as well. Larger nonprofits (over $5 million) typically require a finance department that includes a controller, staff accountant, and bookkeeper.

Beware of the tendency to overstaff. Agencies with flexibility in their budgets, an executive director with little or no financial experience, and a board that is not as engaged in its fiduciary responsibilities as it should be often find themselves hiring paid staff instead of reengaging the board or providing training for the executive director. Keep in mind that an organization is not well served if its leadership is allowed to abdicate its responsibility for financial management. A good auditor or financial consultant can review your agency's financial needs and give you and the board a sense of what present and future staffing patterns should be.

The Basics

Cash or Accrual Accounting?

Your organization will need to choose between cash and accrual accounting. Cash basis accounting and reporting reflects only transactions involving cash. Accrual basis accounting reflects cash transactions, but also includes revenues earned but not yet received and expenses incurred but not yet paid. Under the cash method, an organization's fund balance can be significantly overstated or understated, since it does not account for amounts owed to or from others. We recommend the accrual method for most organizations because it provides a more accurate view of the organization's financial position for a specific accounting period.

Developing an Operating Budget – More Left Brain than You Think!

Developing budgets is actually fairly easy. Most organizations will build off actual costs from the previous year. Start by taking all of the line items from the previous year and adding any new costs. Salary and benefit changes are usually the most complex to project. Keep in mind that there will likely be changes during the year – unexpected turnover, new funding that allows a long-dreamed-for position to be filled, or budget cuts – but projections must be as realistic as possible. All other line items can be built by factoring in estimated inflation and any substantial changes in programming, facilities, staffing, or equipment. If, for instance, you have purchased 10 new computers, include the effect on the office supplies line item, possibly on utilities (more electricity consumed) and on staff training.

Follow the same procedure with the income side of the budget sheet. *Your fund development plan for the next budget year should be in place before you develop the operating budget.* Link income and expense projections. The capacity to raise funds comes first, however. (See Chapter 7, **Fund Development**.) The organization's operating budget *should never exceed* the fund development goal.

The safest method for developing an operating budget is to use conservative figures for fundraising totals and slightly inflated figures for expense totals. *Do not fall into the trap* of picking a wishful revenue figure and assuming the agency will somehow raise it all.

If managers or team leaders are involved in developing department or team budgets, give them the previous year's expenses to build from and include some financial parameters; otherwise, they may include unrealistic costs. Encouraging them to create the income side of the balance sheet as well will help them understand that the agency cannot spend money it does not raise.

Who should develop the operating budget? While the board should set the budget parameters, having staff and board representatives involved in developing the budget will increase buy-in at different levels. When the staff and board understand the true cost of doing business, they tend to be more understanding of budget constraints (such as smaller raises) and more inclined to assist in fund development. If your organization is so small that its managers cannot take time to participate in the budget process, try to include at least one other person in addition to the executive director and the finance committee in developing the budget.

Sample Operating Budget	FY 2001	FY 2002	FY 2003
Line Items	Amounts		
Revenues			
State contracts	625,000	656,250	689,063
Membership dues	25,000	27,500	30,250
Contributions	80,000	88,000	98,000
Service fees	170,000	178,500	187,425
Foundation grants	300,000	325,000	350,000
Other	0	0	0
Total Revenues	**1,200,000**	**1,275,250**	**1,354,738**
Expenses			
Salaries & wages	760,000	798,000	837,900
Employee benefits	152,000	159,600	167,580
Consultants	110,000	110,000	110,000
Rent	60,000	75,000	75,000
Utilities	3,600	3,780	3,969
Equipment maintenance	4,200	4,410	4,631
Insurance	20,000	21,000	22,050
Travel	7,000	7,350	7,718
Telephone	4,000	4,200	4,410
Postage	7,000	7,350	7,718
Office supplies	4,200	4,410	4,631
Printing	12,500	13,125	13,781
Staff recruitment	6,000	6,300	6,615
Professional fees	14,000	14,700	15,435
Training and development	6,000	6,300	6,615
Miscellaneous	6,000	6,000	6,000
Other	0	0	0
Total Expenses	**1,176,500**	**1,241,525**	**1,294,051**
Surplus/Deficit (-)	**23,500**	**33,725**	**60,686**

Indirect Cost Calculations

The basic formula looks like this:

A. $\dfrac{\textbf{Total agency indirect costs}}{\textbf{Total agency direct program costs}}$ **= Indirect cost rate**

B. Indirect cost rate x Individual program direct costs = Program indirect costs

C. Program direct costs + Program indirect costs = Total program expenses

Calculating and Covering Indirect Costs

Indirect costs are costs that benefit all programs but cannot be easily identified as relating to a specific program. Indirect costs might include the salaries and benefits of administrative staff such as the executive director, accountant, and receptionist, as well as payroll service costs, insurance, rent, and other costs related to the administrative function of the organization.

Indirect costs are generally pooled into one cost center and then assigned proportionately to specific programs. Start by adding up all of your indirect costs. Then, add up all of your direct program costs. Direct program costs include program salaries, fringe benefits, and consulting fees, as well as printing, travel, or other identifiable, line-item costs attributable to specific programs. Next, divide the total of all indirect costs by the total of all program direct costs. This will give you an indirect cost rate. You can then multiply this percentage by the total direct cost for each individual program to get the amount of indirect costs to be added to direct costs in order to get a total program expense budget.

A grant or contract that covers only direct costs such as staff, consultants, and travel but none, or only part, of the indirect costs borne by the program can be a loss leader. Sometimes, to meet the mission of the organization, it is important to accept a loss leader type of grant. Many agencies do. There must, however, be a plan for covering in some other way the indirect costs related to the grant and the program it is supporting. Make sure you include these costs in your fund development budget. If your organization receives direct federal funding, you should apply for a negotiated rate in order to receive reimbursement for indirect costs. Contact the federal awarding agency for information on establishing indirect cost rates.

Capital Budgets

A capital budget consists of items that an organization has purchased or plans to purchase that will have a useful life of longer than one year and a cost greater than a threshold established by the organization. Items in the capital budget – typically buildings and costly equipment – are listed as assets in the organization's financial records and are depreciated, or capitalized, over a predetermined "useful" life. This means that a portion of the cost is listed as an expense in each year of its useful life. For example, suppose you buy a piece of equipment with a useful life of four years. Every year, for four years, you would record one-fourth of the original cost as a depreciation expense. At the end of four years, the piece of equipment would be fully depreciated and would not be considered an asset on your books, even though you might still be using it. The useful life of most equipment has been predetermined by tax law or accounting convention, so if you are in doubt, check with an accountant or the IRS.

Most organizations set a threshold for items that will appear on the capital budget so that they don't have to go through the trouble of depreciating the cost of numerous small items. Common thresholds are \$3,000 to \$5,000 for a piece of equipment. Items that fall below the threshold are listed as one-time expenses in the annual operating budget.

Capital budget items usually will need to be replaced when they have worn out or become obsolete, so be sure to budget for the replacement cost. The use of a capital budget and depreciation schedule can serve to remind you to set aside an amount in reserve – perhaps equal to the amount being depreciated – so that you will have the resources available when it is time to replace old equipment.

Budgets in the Board Room

Although the treasurer should review the more detailed working budgets that the executive director, bookkeeper, and financial manager work with on a day-to-day basis, the full board should review only the aggregate totals for various line items on a monthly or regular basis. For example, if $500 per month is set aside for printing, the treasurer may want to know how those funds were spent in the last quarter. The full board, however, needs to know only that the treasurer has reviewed the books for the month (or quarter) and that no line items are substantially off target.

The Art of Cash Flow

Cash flow has become an increasingly large problem for nonprofit organizations that receive a significant percentage of their income from cost-reimbursement contracts. Payments from public agencies may lag behind expenses by three to six months.

If your agency is eligible for a federal letter of credit or up-front payments from state agencies (called "ready pay" in Massachusetts), you can eliminate a great deal of your cash flow problems. If not, you may need to seek a line of credit from a bank, which of course carries a cost in the form of interest. For this reason, *it is very important to examine the financial implications of cost-reimbursement contracts before accepting them.*

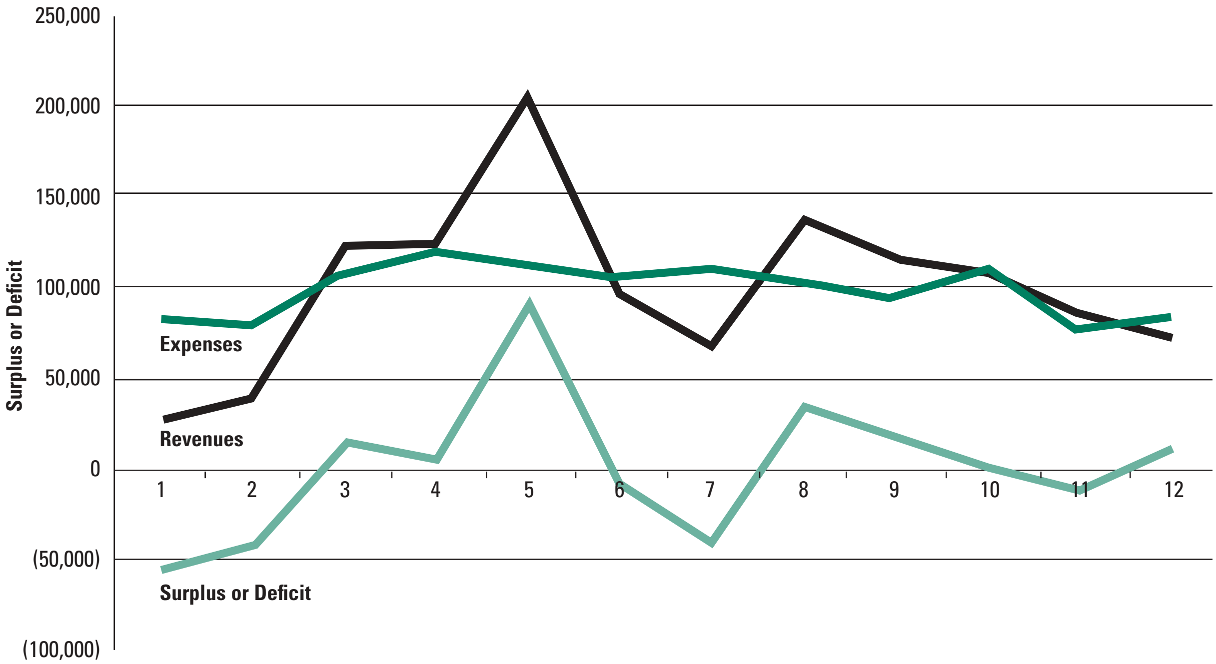
A cash flow budget is a useful tool for organizations without large cash reserves because it enables you to predict your monthly cash needs over the course of the year and plan ahead for the dry periods.

It is fairly simple to put together a cash flow budget. Start with the unrestricted cash available at the beginning of the fiscal year. Next, list all the income anticipated each month against all anticipated payments. Typically, contract-dependent agencies will have dry periods with no cash coming in. During these months, it is necessary to dip into reserves (borrow from the reserve account to pay current operating expenses) or borrow against a line of credit.

If possible, do not carry an ongoing line of credit. Always pay it off as soon as possible. Nonprofit organizations too often find themselves in situations (much like individuals with credit cards) in which they cannot get ahead enough to pay off the line of credit, and then begin having to budget for ever-increasing interest costs.

Cash Flow Forecast - 12 Months

Month	Cash on Hand	1	2	3	4	5	6	7	8	9	10	11	12	Totals
Revenues														
State contracts		0	25,000	75,000	60,000	100,000	40,000	30,000	60,000	80,000	55,000	40,000	60,000	625,000
Membership dues		1,000	0	0	0	0	2,500	10,000	6,000	3,000	1,500	1,000	0	25,000
Contributions		2,000	2,000	5,000	6,000	10,000	30,000	10,000	5,000	4,000	3,000	2,000	1,000	80,000
Service fees		10,000	12,000	18,000	18,000	18,000	8,000	8,000	15,000	18,000	15,000	18,000	12,000	170,000
Foundation grants		15,000	0	25,000	40,000	75,000	15,000	10,000	50,000	10,000	35,000	15,000	10,000	300,000
Other		0	0	0	0	0	0	0	0	0	0	0	0	0
Total Revenues	**25,000**	**28,000**	**39,000**	**123,000**	**124,000**	**203,000**	**95,500**	**68,000**	**136,000**	**115,000**	**109,500**	**76,000**	**83,000**	**1,200,000**
Expenses														
Salaries & wages		55,000	55,000	65,000	75,000	75,000	75,000	75,000	65,000	60,000	60,000	50,000	50,000	760,000
Employee benefits		11,000	11,000	13,000	15,000	15,000	15,000	15,000	13,000	12,000	12,000	10,000	10,000	152,000
Consultants		5,000	5,000	5,000	10,000	10,000	5,000	5,000	15,000	10,000	20,000	15,000	5,000	110,000
Rent		5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	60,000
Utilities		300	300	300	300	300	300	300	300	300	300	300	300	3,600
Equipment maintenance		350	350	350	350	350	350	350	350	350	350	350	350	4,200
Insurance		5,000	0	0	5,000	0	0	5,000	0	0	5,000	0	0	20,000
Travel		250	250	500	1,500	1,500	250	500	500	500	500	500	250	7,000
Telephone		250	250	500	500	500	250	250	250	250	250	250	500	4,000
Postage		150	150	1,200	750	250	1,500	150	300	1,500	750	150	150	7,000
Office supplies		350	350	350	350	350	350	350	350	350	350	350	350	4,200
Printing		0	0	6,000	2,000	0	0	0	0	3,000	1,000	500	0	12,500
Staff recruitment		0	0	1,500	0	0	1,500	0	0	1,500	0	1,500	0	6,000
Professional fees		0	2,000	8,000	1,000	0	0	0	1,000	1,000	1,000	0	0	14,000
Training and development		0	0	0	1,200	1,200	0	1,200	0	0	1,200	1,200	0	6,000
Miscellaneous		500	500	500	500	500	500	500	500	500	500	500	500	6,000
Other		0	0	0	0	0	0	0	0	0	0	0	0	0
Total expenses	**0**	**83,150**	**80,150**	**107,200**	**118,450**	**109,950**	**105,000**	**108,600**	**101,550**	**96,250**	**108,200**	**85,600**	**72,400**	**1,176,500**
Cashflow Surplus/Deficit (-)	**25,000**	**-55,150**	**-41,150**	**15,800**	**5,550**	**93,050**	**-9,500**	**-40,600**	**34,450**	**18,750**	**1,300**	**-9,600**	**10,600**	**23,500**
Opening Cash Balance	**0**	**25,000**	**-30,150**	**-71,300**	**-55,500**	**-49,950**	**43,100**	**33,600**	**-7,000**	**27,450**	**46,200**	**47,500**	**37,900**	
Closing Cash Balance	**25,000**	**-30,150**	**-71,300**	**-55,500**	**-49,950**	**43,100**	**33,600**	**-7,000**	**27,450**	**46,200**	**47,500**	**37,900**	**48,500**	



The Auditor as Friend

As we stated at the beginning of this chapter, one of the first meetings a new executive director should have is with the auditor. Inexperienced executives moan and groan about audits, but experienced ones use the audit to their advantage. *A good auditor is one of your organization's best friends.*

While the IRS does not require an annual certified audit, many states do. Most funders will ask for copies of the audit. It should also be part of the packet you give to prospective board members.

How to find an auditor. An auditor is a certified public accountant. Make sure yours has experience with nonprofit organizations since many accounting rules apply only to nonprofits. Experience in your field of work is even better. Check with your state's association of nonprofits, or ask other executive directors for recommendations.

What to ask your auditor. The auditor's job is to express an opinion on the organization's statement of financial position in accordance with generally accepted auditing standards and any applicable government standards. Ask how your organization can design its financial systems in order to meet those standards and regulations. Usually, money spent to put appropriate systems in place will save money down the line.

During the audit, keep an eye out for the coming year. Ask the auditor what the agency is doing right and wrong. Can you improve your system of internal controls? What work can be done internally to better prepare your organization for the audit and to reduce its cost?

How to prepare for the audit. Before scheduling the audit, your auditor will send you a list of items to assemble. These will include copies of financial statements, trial balances, supporting schedules, board minutes, leases, loan agreements, depreciation schedules, accounting policies and procedures, grant awards, and contracts. Auditors will also need access to all documents supporting the organization's financial transactions. Collect all reports to government agencies and have all financial files easily accessible. Make sure time sheets and other payroll records are complete and in order. Prepare a list of assets, including equipment, property, inventory, and money that is owed to you, and a list of liabilities. Pull together all bank statements, checkbooks, and canceled checks. Make a list of all donations and donors.

What to expect from your auditor. If an organization has done what it is contracted to do, maintained good financial systems with appropriate checks and balances, kept orderly books, submitted its reports to the attorney general, the IRS, funders, and any regulatory bodies in a timely manner, maintained ethical standards in fundraising, and expended funds as approved by the board for the defined mission and program, then it should have no problems with the audit. During the audit, your auditor will:

- review internal controls for the approval of expenditures and safeguarding of assets;
- test entries in the general ledger and verify their authenticity by inspection of vouchers, bills, checks, invoices, and other documents;
- test fulfillment of service contracts by reviewing time sheets to ensure staff were assigned to programs as required by the project, invoices, travel requests, and financial and narrative reports;
- verify asset and liability balances by sending confirmation letters to bank and investment firms; and
- review proper compliance with tax law, annual reporting, and maintenance of tax-exempt status.

If federally funded program expenses exceed $300,000, the auditor may also be required to conduct a compliance audit (an “A-133” audit) of federally funded programs administered by your organization.

The Art of Financial Management

Accounting is not as black and white as it might appear on the surface. There is always room for interpretation – within, however, highly prescriptive accounting parameters. What is sometimes called creative accounting is actually strategic use of financial management – as long as it stays within the boundaries of good practice. When in doubt, interpret narrowly. Recognize your auditor as an important resource in developing the strategic dimension of your financial skills. The rules of accounting change often, and your auditor can help you work through the changing world.