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# Financial Management
# Talking Point

**INTRODUCTION**
The M. J. Murdock Charitable Trust believes that effective financial management is an important characteristic of a healthy nonprofit organization. Being a good steward of resources (fiscal responsibility, appropriate transparency and donor accountability) can also build community support for your organization. Most importantly, sound financial management is vital to achieving mission and sustaining the organization. There are several key elements and organizational characteristics, behaviors, and practices to consider regarding effective financial management. A partial list of these elements follows.

**MISSION, BOARD & PLANNING**
Effective financial management begins with a clear understanding and commitment to an organization's mission on the part of the board and senior staff, as well as a commitment to short and long-term planning and assessment. The board is responsible for the financial wellbeing of the nonprofit and must have financial expertise, develop an effective structure (treasure, finance, and audit committees, etc.), establish appropriate policies (financial controls, conflict of interest, etc.) and insure that all board members understand the organization's financial position. Understanding the value, effectiveness, and true cost of each current service/program will enhance the financial planning process.

**ANNUAL OPERATING BUDGET & INCOME**
Effective nonprofits strive to balance mission (programs and services) with resources (financial, human, and organizational infrastructure). Through the organization's annual operating plan and associated fundraising plan, the organization should realistically identify both contributed and earned income revenue sources needed to operate and sustain the organization. Reviewing financial trends may inform the budgeting process. Generally speaking, achieving a more diverse revenue stream may mitigate the potential loss of any one source. Careful attention should be paid to tracking income and expenses associated with new programs to ensure program viability and sustainability. While staff may develop the annual operating budget, the full board is responsible for ensuring it is attainable and adequate.

**EXPENSE**
Staff and board will want to understand the true costs associated with operating the nonprofit in order to assess organizational effectiveness. Projecting and tracking direct staff expenses, program delivery expenses, and indirect or overhead expenses are important to managing the organization's financials and contain costs. Accounting for overhead (administration, management, fund development, technology, finance, human resources, facility and occupancy expenses, etc.) is important because nonprofits need organizational infrastructure to deliver and enhance its programs and services. In general, smaller organizations may have higher overhead than larger organizations, and all organizations must acknowledge overhead as a cost of operating the nonprofit.

**RESTRICTED & UNRESTRICTED INCOME**
Unrestricted income, both earned and contributed, offers the organization flexibility and can be used for any purpose. Many institutional donors such as foundations, corporations, and public agencies support a specific program, project, or activity, thus restricting the funds for that use. Special care must be taken

to accurately track the use of restricted funds in accordance with donor intentions and accounting standards. Unrestricted income can also be the building blocks of reserve funds and pilot new programs.

**MONITORING, PRESENTING & RESPONDING TO FINANCIALS**

Timely, accurate, consistently presented and reviewed financial information should be an institutional priority and requires an investment of board and staff time and efficient financial systems. The best annual plan means nothing if the board and staff are not monitoring the organization's progress and making adjustments in expenses based on revenue shortfalls. An organization that continues to operate with a deficit cannot be sustained. While the staff is responsible for internal management and administrative functions of fiscal controls, all nonprofits must have financial policies and procedures in place that are developed, reviewed, and approved by the board. Board oversight should not be left to one or two board members; the full board must "own" and carefully monitor the organization's financials in partnership with staff. Annual audits are considered the gold standard, but smaller organizations may conduct a financial review in addition to its annual IRS 990 filing.

**SURPLUS & RESERVES**

The Trust is supportive of nonprofits' use of operating, equipment and facility reserve funds. Nonprofits can budget for a "surplus" to create an operating reserve, new program fund, facility fund, or other mission-focused priorities. Year-end surpluses can also be allocated to operating reserves or fund depreciation such as the replacement of equipment, vehicles, and facilities. Having even a modest reserve fund for equipment can provide cash for unexpected equipment breakdowns or the planed replacement of a roof. Operating reserves of two to six months are generally considered to be a best practice. The board must plan for and develop written policies regarding the purpose, funding level, management, and use of such reserve funds.

**ENDOWMENTS**

As an organization grows and matures, board-established quasi-endowments and donor-directed endowments can be established to provide investment income to the organization for a variety of purposes. Surplus funds or unrestricted bequests can also be allocated to quasi-endowments. Organizations should have written policies in place regarding the acceptance of funds; purpose, management, and use of bequests; board-restricted quasi-endowments; and donor-restricted endowments. Local community foundations may be of assistance to donors and nonprofits wishing to establish endowments.

**QUESTIONS**

- *What is the role of the board and staff in financial oversight of the organization?*
- *Do you have an annual fund development plan, business plan, or other plans that help shape your organization's financial position?*
- *How does program evaluation and assessment influence the deployment of organizational resources?*
- *Describe how your organization tracks, reports, and monitors its annual budget revenue and expenses. Who is involved in this process, and when does this take place?*
- *Do you have an operating reserve, endowment or quasi-endowment? Has your organization defined a goal or target for these funds?*
- *Do you have a capital expense budget? Do you fund depreciation? Do you have a schedule of major maintenance and replacement of equipment and facilities, and if so, how do you fund this work?*
- *Do you have an equipment replacement fund or equipment reserve fund in place, and if so, how is it funded?*