

Why Financial Management of a Nonprofit is Harder than a For-Profit

7 min read



Key Takeaways

- Nonprofits require a high-level financial oversight, such as creating a budget, checking the actual financial results against the budget, and asking the executive director about any variances.
- Nonprofits have to live up to donor expectations. People and corporations donate money because they believe in the nonprofit's cause. It's implicit that the funds need to be spent the way the donors intend them to be spent: on effective programs that advance the mission.
- Cash flow is often a problem for both nonprofits and for-profits, but unlike a for-profit, a nonprofit can't offer discounts to increase sales when times get tough. Make sure to improve the budgeting and planning process, improve cash flow forecasting, and stay current with government grant conditions and policy changes.

Compared to other types of organizations, nonprofit financials are often more difficult to manage.

NonProfits Have Unique Needs and Face Unique Challenges...

Watchdogs

Because nonprofits are subject to audits, and are required to submit IRS form 990– it's easy to find issues.

Failing to disclose financials can quickly raise red flags. Watchdog groups dig into the details of organizations, share reports on their findings, and rate nonprofits based on their accountability and transparency.

[Charity Navigator](#) is considered a watchdog group that evaluates nonprofit organizations financial health.

Board Oversight

The board of directors is responsible for ensuring that operations advance the organization's mission. This involves high-level financial oversight, such as creating a budget, checking the actual financial results against the budget, and asking the executive director about any variances. It also involves making sure the organization puts financial policies and procedures—such as internal controls—in place and making sure they function as designed.

What to do:

Prepare a great board packet with useful reports.

[Five Tips for Better Board Packets](#)

Nonprofit Sample Reports:

- Monthly narrative of budget performance showing [budget vs. actual](#)
- Restricted vs. unrestricted net assets
- Projected cash position by program, grant, development/events, service centers

- Customized reporting packages for your Board of Directors and Committees
- Grant compliance, depreciation schedules, budget analysis

Financial Inexperience

Even though board members are usually accomplished professionals in their own right and bring many skills to the organization, few come from a financial background. As a result, a higher degree of financial transparency is required in order to provide them with the information they need to make decisions. It's important that the board members understand the financial aspects of the organization and the financial role of the board so they stay focused on the high-level view instead of getting lost in the minute.

What to do:

[Don't let your mission get derailed by bad financial management](#). Outsource bookkeeping and accounting to an experienced team of professionals. Find a service that specializes in helping nonprofit organizations keep their finger on the financial pulse, so they can focus on what really matters – serving the mission and achieving their greatest potential.

Donor Expectations

Nonprofits have to live up to donor expectations. People and corporations donate money because they believe in the nonprofit's cause. It's implicit that the funds need to be spent the way the donors intend them to be spent: on effective programs that advance the mission—without overspending on fundraisers, administration, or expenses.

What to do:

Create a development package (a P&L by class & sub-class) to be able to give a donor a report on exactly how you spent their money.

[Using Classes and locations in QuickBooks Online](#)

Stringent Audit Requirements

Nonprofits face more stringent audit requirements. They have to adhere to higher standards of reporting and internal controls than the majority of small businesses. In some states, nonprofits with just five hundred thousand in revenue must get audited. The only small businesses that get audited are those that receive a big outside investment. The reason for this is that nonprofits are using donated money—funding from the public—and all funds must be traceable. Moreover, nonprofits are accountable for the correct use of their funds to further their missions.

What to do:

Reconcile every balance sheet's accounts & update your audit work-papers every single month.

[State Law Nonprofit Audit Requirements](#)

Tax Reporting

Tax reporting for nonprofits is extremely complex. The non-profit tax code is one of the most difficult ones, especially for small organizations, designed to reduce the risk of fraud and ensure transparency. The IRS needs to make sure the tax exempt status is not abused so there are additional reporting requirements. Note that nonprofit's tax returns are public record, as the public has a right to see how the funds are being used.

What to do:

Set up your chart of accounts and your classes and sub-classes to create the reports needed for the tax return. If you keep your books audit ready – they will be tax ready.

[Federal Filing Requirements for NonProfits](#)

Public Trust

Nonprofits have the burden of public trust. The public expects nonprofits to operate efficiently and effectively, and they hold nonprofits to higher standards than for-profits.

There are watchdog organizations that monitor the financial activities of nonprofits throughout the country to ensure their funds are being allocated correctly.

What to do:

Implement time tracking using a service like [TSheets](#) to make it simple to track every hour worked on programs, including your volunteers. If there is a fair market value for services, you can record donated services as income and expense. Implement joint cost allocation and track staff time so you can allocate as much as you can to programs.

Limited Funds for Back Office Operations

Nonprofit income and accounting is different. Fundraising and government funding is the way most nonprofit organizations acquire money to operate—and any profit must be reinvested into their programs. That means there’s no room for error and no “rainy-day fund.” It also means there usually isn’t a budget to hire an experienced in-house accountant, which can limit the organization’s ability to optimize its finances.

The executive director’s core competency is usually not in accounting or bookkeeping. While the executive director will almost certainly be passionate about the organization’s mission, he or she can often come from a varied background, depending on the organization and the person. However, since accounting is a critical aspect of operations, the executive director ends up overseeing a function he or she doesn’t always understand. The truth is that financial literacy can make or break a nonprofit, so if the leadership doesn’t possess the right qualifications, the organization needs to find a way to acquire them.

Nonprofits often feel they can’t pay market value for professional staff and many times have to rely on volunteers for critical functions. One of the biggest problems nonprofits face is not having the professional experience in critical back office functions to run the organization. Unfortunately, this tends to result in higher spend to get the books done, prepare reports, and handle financial management and planning.

What to do:

[Outsourcing the bookkeeping and accounting function](#) can save the organization 30-40%.

Cash Flow Management

Cash flow is often a problem for both nonprofits and for-profits, but unlike a for-profit, a nonprofit can't offer discounts to increase sales when times get tough. Nonprofits can't go out and sell more or offer discounts. If the government grant doesn't cover the unit economic, a nonprofit organization needs to have a development plan to compensate.

What to do:

- 1) Improve the budgeting and planning process.
- 2) Improve cash flow forecasting. Invest the time, energy and cost in creating detailed operating budgets and cash flow forecasts. When you can properly plan and monitor cash flow, the organization is able to anticipate possible issues and take action more quickly to address the problem.
- 3) Stay current with government grant conditions and policy changes to prepare for the possibility of unexpected loss of grants due to a shift in sources. Have a financial management system in place for performing accounting functions, and to provide timely and accurate reporting and analysis.

From partial to full outsourcing options, GrowthForce offers customizable services to help your organization gain control of cash flow and manage reporting requirements. We do that by reducing manual efforts and improving operational efficiencies. Our Team, Technology & Processes approach means our nonprofit clients get timely, accurate financial intelligence, without blowing the budget on salary, training, software, hardware, and office space that come with hiring more in-house staff.