What Nonprofit Board Members Should Know About Nonprofit Accounting

7 min read

Being selected to serve on a nonprofit board is not just an honor, a networking opportunity, and another line item on your resumé- it's a real responsibility.

Key Takeaways

- **Understand the Importance of Financial Management for Nonprofits:** The accounting process in a nonprofit organization needs to be run with the exact same precision as in a…
- **Remember That You're Personally Liable:** As a nonprofit board member, it's paramount that you understand you have personal liability for the custody of the nonprofit's assets. To protect yourself from the liability…
- **Measuring Your Nonprofit's Success:** To track your nonprofit's success, you'll want to track the metrics that help you measure the impact and the ROI of your programs and…

In addition to caring greatly about the mission that you'll be working hard with the organization's executive director to achieve, serving on a nonprofit board will also require you to have some knowledge about nonprofit financial management. Without understanding the basics of operating a nonprofit organization and reading nonprofit financial reports, you won't be very helpful in making strategic decisions on behalf of the organization you're hoping to serve and help lead to an increasingly successful future.

7 Nonprofit Best Practices for Nonprofit Board Members

1. Understand the Importance of Financial Management for Nonprofits

Being part of a nonprofit board means you must be just as vigilant with the organization's financials as you are in doing great work and fulfilling your mission.

For-profit and nonprofit organizations run differently, and in terms of which KPIs the back office should be organized to track, they focus on different drivers. However, the accounting process in a nonprofit organization needs to be run with the exact same precision as in a for-profit business. The only difference between accounting for nonprofits and accounting for for-profits is that in a nonprofit, you must have higher standards of reporting and internal controls.

Why? Because with a nonprofit, you're using others people's money, and thus, it is imperative that all funds have a traceable origin.

2. Read Your NPO's Financial Reports

As a nonprofit board member, you might not be responsible for carrying out all of the bookkeeping and accounting functions, but you need to know enough about nonprofit financial management to be able to read and understand the organization's financial reports. The information available in these reports will be invaluable when it comes to making data-driven decisions to maximize the nonprofit mission's impact.

The basic financial reports you'll need to have a handle on include:

- Statement of financial position
- Statement of activities
- Statement of cash flows
- Unit economics reports
- Cash flow forecast
- Budget vs. actuals

These reports will provide you with all the information you need, as a board member, to participate responsibly in decision-making activities for the organization. Learn how to read these reports, understand the information they contain, and interpret it to identify trends, changes, and the organization's drivers.

3. Recognize That Passion Can't Run The System

Of course, passion and expertise are important qualities for nonprofit board members to have. Passion and knowledge give them the ability to motivate and drive your mission. Be wary, however, of overly focusing on the presence of these qualities.

Many nonprofit board members don't have a financial background; in fact, a large majority are hired for their dedication to the cause, their network, and their ability to raise funds or volunteer efforts. However, passion for a cause can't run the finance department, and expertise in your cause can't make sound or strategic financial decisions on behalf of the organization.

Imagine if your nonprofit had a board of investors that you had to keep up-to-date on the status of their investments. If this were the case, you would be held accountable for any discrepancies or issues that could arise in the event of an audit.

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For example, a community service organization's Executive Director may be a social worker who has never taken an accounting class or has no accounting experience. If they're also tasked with reviewing the check register, bank reconciliations, and detailed accounting reports, then they are hindered from doing their job, which is to raise money, set policy, and provide governance.

Plus, they are spending their valuable time on tasks that they are not truly trained to do. These tasks should belong to the nonprofit's finance committee, accounting department, and board members. If a nonprofit board is stuck micromanaging, then its primary function cannot be achieved. This is why nonprofit organizations must have a good system of internal controls, so the board (and the executive director) doesn't spend valuable time on anything other than their mission-critical tasks.

4. Remember That You’re Personally Liable

As a nonprofit board member, it’s paramount that you understand you have personal liability for the custody of the nonprofit’s assets. To protect yourself from the liability of being on a nonprofit's board of directors, it is first essential to always be sure your errors and omissions (E&O) insurance policy is always paid current. We recommend getting in the habit of confirming your E&O policy when you receive your audit financial statement.

5. Protect Yourself and the Organization With Thorough Compliance

Next, you must ensure the nonprofit is always in compliance with the rules and regulations of the governing bodies that are relevant to your organization. Your nonprofit must be both audit-ready and tax-ready. While specific requirements vary from state to state, many require you to get audited if you have a million dollars of revenue, or even $500,000.

Plus, the 990 tax return – the one needed for nonprofits – is considered the most difficult tax return for small and medium-sized organizations. Why? Because the IRS wants to ensure nonprofit organizations are not actually for-profit organizations in disguise trying to cheat on their taxes. This is exactly why you must be more stringent on your financial records; you must separate your programmatic expenses from fundraising expenses, general and administrative (G&A), and other administrative costs.

6. Accurately Report Costs With Joint Cost Allocation

Your nonprofit is allowed to allocate the cost of things that are done jointly for program and fundraising and administrative purposes.

To understand how joint cost allocation works, consider an executive director's pay based time. If they spend ⅓ of their time on fundraising, ⅓ of their time on the program itself, and ⅓ of their time on administrative work, then putting this entire cost under administrative work would make the nonprofit look bad because you would be reporting more cost than is actually spent on administration.

Joint cost allocation should be used to separate all costs like these to achieve the most accurate and attractive accounting metrics.

7. Be Smart About Resource Allocation

At the end of the day, money is money, and nonprofits need to be run the same as for-profit businesses in terms of making money. You want to be sure the efforts you put in match or exceed what you get out of fundraising and other initiatives. In other words, you want to maximize your ROI.

Smart resource allocation means knowing where to allocate funding for the best possible outcome/output. When making these decisions on a nonprofit board, you have to start with the drivers.

For example, in a community service organization, you could examine unit economics, such as the cost to serve a client. You can then look at the costs of serving someone in various programs. Say, a vocational training program costs $100 per person, and a day habilitation program costs $50 a person. After considering all of your programs, you can rank or prioritize your programs based on the ROI garnered from your limited resources. If both programs, in this example, are equally important initiatives, and you only have limited resources, then you must ascertain whether serving two people in your day habilitation program is better or whether serving one in the vocational training program is.

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This isn't an easy call to make, but that's the board's job – to figure out the policy and governance, a means of allocating resources. To maximize impact, your budget must be based on the resource allocation that's going to result in the biggest bang for your nonprofit buck.

Measuring Your Nonprofit's Success

In a nonprofit, success isn't measured in dollar signs; success is based on the fulfillment of your organization's mission. To track your nonprofit's success, you'll want to track the metrics that help you measure the impact and the ROI of your programs and fundraising efforts.

As a nonprofit board, you can help your nonprofit maximize its impact by bolstering your knowledge of nonprofit accounting and enlisting experts who can help establish nonprofit accounting systems that streamline with QuickBooks in addition to functioning in an advisatory role with regard to the nonprofit's financial management along the way.

In nonprofit work, true motivation lies in helping others in need and raising money to continue doing so. In order to propel your nonprofit's initiatives, you need to be diligent about maintaining profits in the most actionable way and letting the board do its central job.