6 Ways CPAs Can Strengthen the Financial Outlook for Nonprofits

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Financial oversight is a key responsibility of nonprofit boards, but many members lack the understanding of finance or nonprofit accounting to effectively perform this duty. As their trusted advisor, a CPA is perfectly positioned to equip board members for this critical task and ensure that their nonprofit maintains strong governance. Here are six ways to get them there:

1. NONPROFIT ACCOUNTING 101

Financial terminology, such as restricted funds, functional expenses, net assets and nonprofit revenue recognition rules can be overwhelming and confusing for new board members. But training from a CPA in accounting concepts can quickly bring them up to speed.

Despite the critical information footnotes provide, they are often overlooked. In one scenario, a finance committee didn't read the footnotes and missed a large, underfunded pension obligation. An outside consultant raised the issue and now the organization is taking steps to address the problem.

2. MONITORING FINANCIAL PERFORMANCE

Boards monitor a nonprofit's financial health and make decisions throughout the year. But to do this effectively, the right information must be presented clearly and concisely. CPAs can work with the board to craft management reports tailored to the expertise of board members and their strategic objectives. Essential information includes liquidity (expressed in dollars and days of operating expenses), accounts payable aging, borrowings, debt covenant compliance, and investment performance and holdings. Since board members can be held personally liable for unpaid payroll taxes, a CPA can put processes in place to ensure they are paid each period.

3. LONG RANGE FINANCIAL PLANNING

In addition to evaluating past results and monitoring the present, boards create a vision for the future with a strategic planning process. By using their accounting and spreadsheet skills, CPAs are uniquely qualified to translate the board's vision into financial plans that set realistic targets for the future.

4. INVESTMENTS

Nonprofit boards in every state except Pennsylvania manage endowment investments and spending under the requirements of the Uniform Prudent Management of Institutional Funds Act (UPMIFA). Board members may be investment experts but have no familiarity with UPMIFA. This creates an opportunity for CPAs to help boards successfully perform their fiduciary responsibilities by advising them on the details of this endowment law.

UPMIFA directs boards to use modern portfolio theory by building portfolios with a diversified mix of asset classes and evaluating potential investments in the context of the entire portfolio and overall strategy. New Jersey did not adopt an optional provision that expenditures above 7 percent are considered imprudent, as was done by some states. Instead, board members are expected to set spending levels using seven factors: duration and preservation of the fund; purpose of the fund and institution; economic conditions; inflation and deflation; expected total return; other available resources; and the organization's investment policy.

5. SETTING INVESTMENT OBJECTIVES AND RISK TOLERANCE

While UPMIFA sets the regulatory framework for investment management, the board determines the organization's objectives, risk tolerance and operations. They decide how much to let the nonprofit's portfolio rise or fall in value (volatility), the amount and timing of redemptions, and the required investment return. The board also sets the credit ratings, maturities and instruments permitted for short-term investments used for working capital expenditures.

CPAs can help boards codify these requirements in a written Investment Policy Statement, which provides direction for investment managers and acts as the primary investment risk management tool.

6. INVESTMENT EXECUTION

One of the most important board investment decisions is determining who will manage investments. Some nonprofits hire an investment consultant to recommend changes to the endowment portfolio. Other nonprofits contract an outside investment company (called an outside chief investment officer or OCIO) to recommend endowment strategy and make day-to-day investment decisions. Nonprofits with the largest endowments build their own in-house investment team. Short-term funds are usually invested by staff in high-quality fixed income securities or by an external investment company. Each option has benefits and shortcomings, but as a financial expert, the CPA can lead the board through these important decisions.

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