ARE YOU READY TO LEAD THE SMALL ASSOCIATION?

Dollars & Cents: Sound Financial Management

Sound financial management

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Goals

- Feel more confident in basic areas of association finance
- Identify when and where an outside expert is needed

We will explore

- ED financial role
- Budgeting
- Financial software
- Financial controls
- Safeguarding financial position
- Investments
- Tax issues

The executive director’s areas of financial responsibility:

- Budget
- Controls
- Audit
- Investment
- Disclosure
- Tax laws
- Conflicts of interest

Clues to financial trouble:

- Running a deficit
- Reserves below target level
- Conference attendance declining
- Net profit from an activity significantly below planned

Clues to financial trouble:

- Must defer paying bills
- Data is unclear or delayed
- Auditors have reported weaknesses
- Convinced situation needs attention

BUDGETING

The budget is:

- A plan for receiving and spending money in specific categories to accomplish programs and projects within a set period of time and using monitoring mechanisms.

Budgeting

- Prioritize programs, products and services
- Ensures all know goals, work to be done, needed resources, time table
- Consulted, monitored, modified
- Ongoing process

The budget is not:

- Meant to hold you captive!

The budget:

- Assists in integrating administrative and operating activities
- Helps assess your organization's immediate and long-term financial situation
- Serves as a tool against which actual income and expense results may be compared so adjustments can be made
- Useful as one measure of your performance as executive director

Types of budgets

- Operating: income and expense for all functions
- Cash: when revenue to be received and expenditures to be made
- Capital: Additions, replacements or improvements in assets

To prepare an operating budget, do you:

- Take current year budget and add a percentage for inflation?
- Estimate expenses and then assume income to cover?
- Make a realistic estimate of income, then build expense budget?

Steps to building a budget

- Review mission & core programs
- Set program goals
- ID sources/amount of income
- Prepare work plan
- ID needed resources
- Determine resource costs
- Prepare budget

To trim the budget:

- Competitive vendor bids
- Service agreements
- Economies of scale
- Delay new activities or expansion of existing ones

Budget format

- Present new budget along with a comparison of budgeted and actual revenues and expenses for previous fiscal year
- Include current fiscal year revenues and expenses to date
- Budget narrative
- For board packet: program descriptions, goals, budget policies, summary of assumptions

Reserves

- Security for unexpected expenses or opportunities
- Set goal of creating reserve over 2 or 3 years
- Designate certain income categories

The board’s role in budgeting

- Mission statement and specific activities
- General policies
- Reviews and approves
- Plans for corrective action

Monitoring

- Monthly report of actual versus budgeted income and expenses
- ID emerging problems
- Develop action plan for corrections

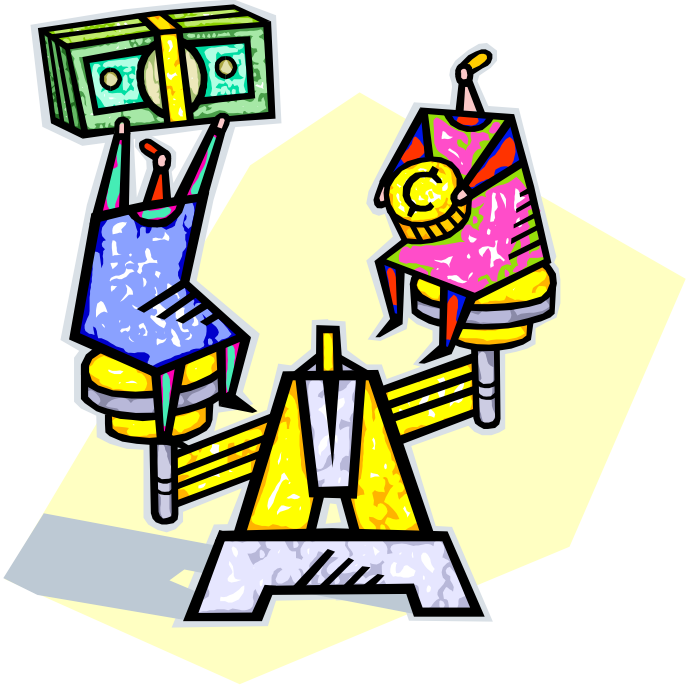
Cash flow budget

- Amount of cash in a given period versus amount of bills due
- Needs ongoing attention
- Forecast 13 weeks into the future

Addressing cash flow problems

- Postpone purchases
- Send out dues invoices earlier
- Transfer funds from reserve account
- Short-term borrowing
- Begin accepting credit card payments via Internet
- On-line bill payment

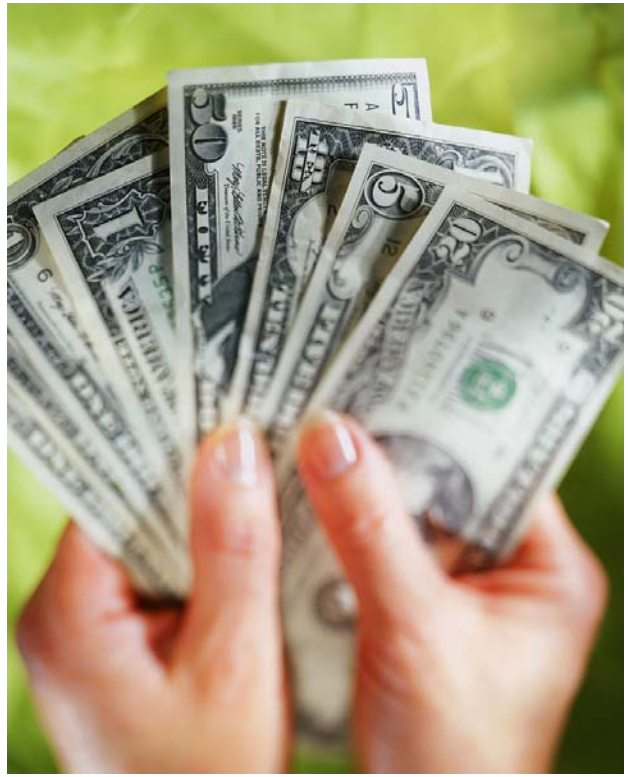
Budget concepts



- Truthful & accurate
- Based on good information
- Adhered to, but modifiable
- Basis for better cooperation
- Not easy, but crucial for success

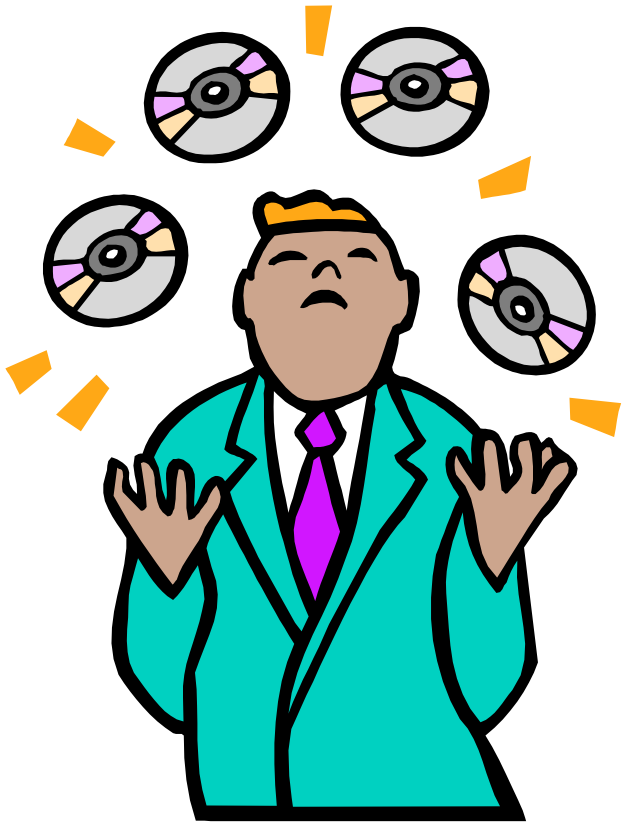
Enrichment break!

- By sharing, we all get richer!



Selecting financial software

Before you begin to evaluate



- Define reporting requirements
- Consider types of transactions
- Any required interfaces
- Security needs
- Cost limitations
- Base decision on value, not price

Advantages of accounting software

- May improve cash flow
- Saves time and money
- Flag problems
- Used to prepare timely and accurate reports

Features to consider:

- Security
- Chart of accounts
- Electronic transmission capabilities
- Ability to manage multiple entities

Financial reports

Association financial records

- Accrual, rather than cash, accounting
- Links income and expense for each activity
- Can tell exactly how profitable an activity is

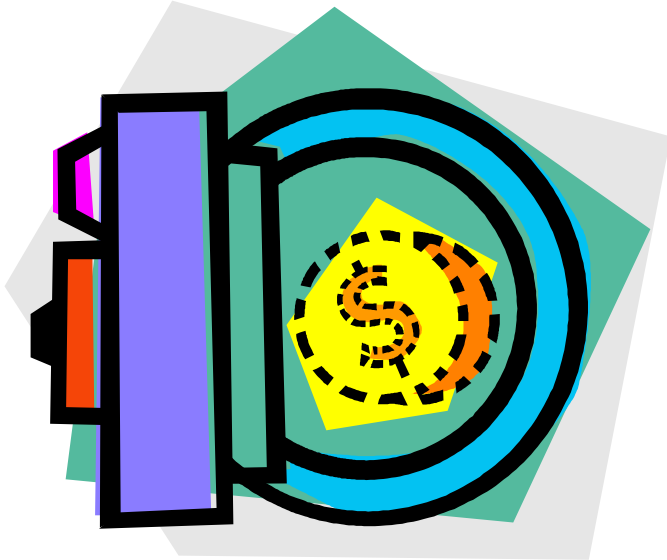
Types of financial reports

- Balance sheet: assets, liabilities, and equity
- Income statement: changes in net assets over fiscal period
- Statement of change in financial position: change in cash over fiscal period

Financial controls

Internal control

- Control cues
- Policy communication
- Segregation of duties
- Record keeping

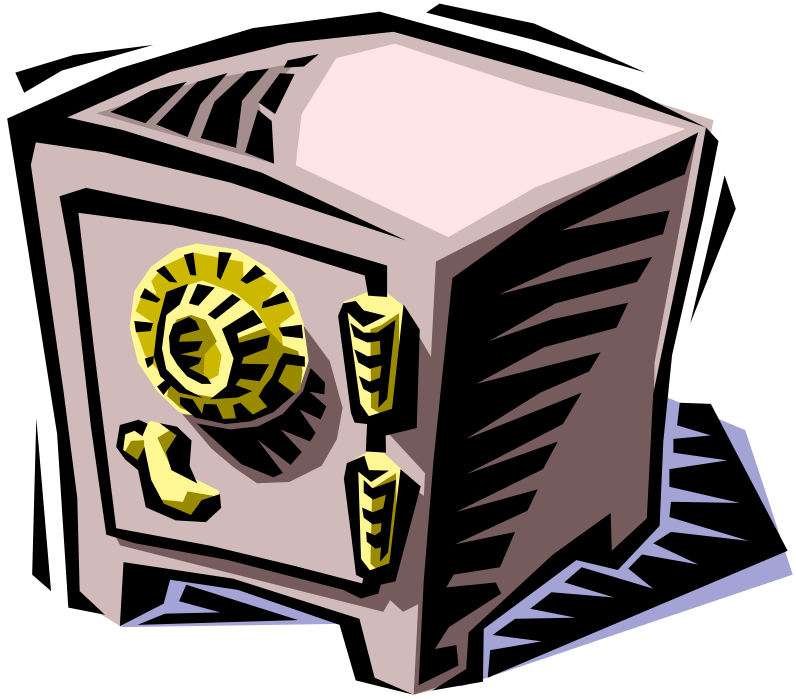


List of internal control procedures

- Plan for segregation of duties
- Checks endorsed on receipt
- Checks deposited same day received
- Invoices approved before payment
- Only original invoices paid

List of internal control procedures

- Invoices marked “paid” when check cut
- Checks have documentation
- Two signatures for large checks
- Proper security
- Supporting documentation



External audits

Benefits of audits

- Enhanced credibility
- Professional assistance
- Advice on internal control
- Help with tax reporting and compliance requirements

Role of auditor

- Verify information in financial reports
- Issue an opinion
- Will not examine each financial transaction
- The tighter the internal controls, the fewer transactions the auditor will need to examine

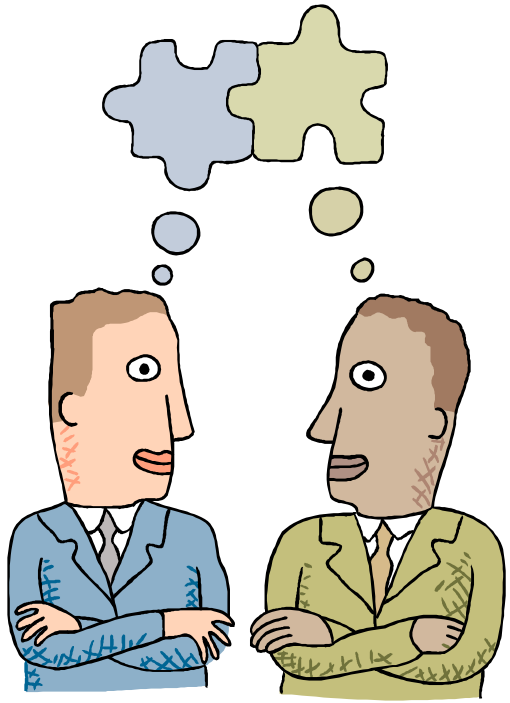
Audits

- Review vs. full audit
- CPAs
- RFP
  - Your mission
  - Your tax status
  - Programs
  - Financial information
  - Decision timetable, process and selection criteria

Factors in selecting audit firms

- Industry knowledge
- Tax expertise
- Price
- Name recognition
- Staff continuity
- Size and location
- Range of resources
- Technology

Two schools of thought



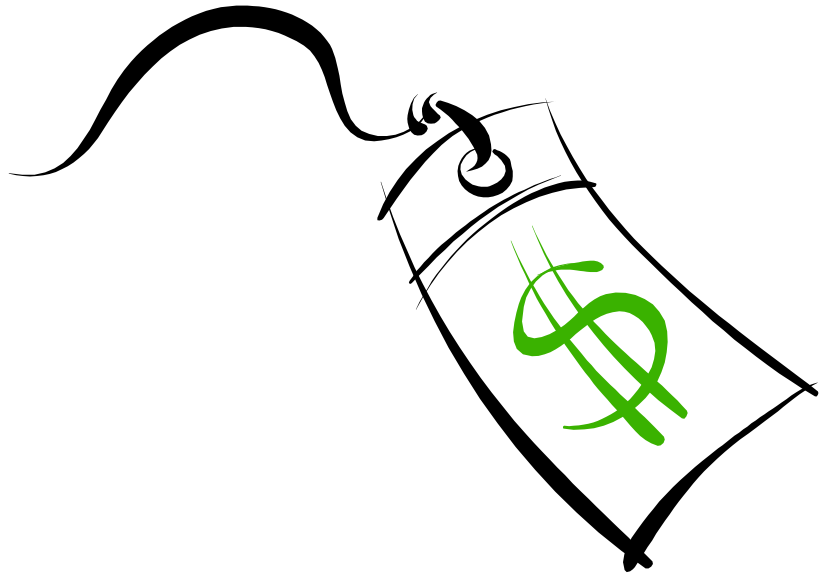
- Develop long-term relationship with one audit firm
- Value to changing audit firms every 3 to 5 years

Audit meetings

- Pre-audit
  - Planning, ID areas of focus, process discussion
- Post-audit
  - Review financial statement drafts and related reports, discuss recommendations and implementation methods

Keep audit costs low

- Make sure you do your part
- Adequate internal controls and verification procedures
- If auditors must act as your bookkeepers, will add to time



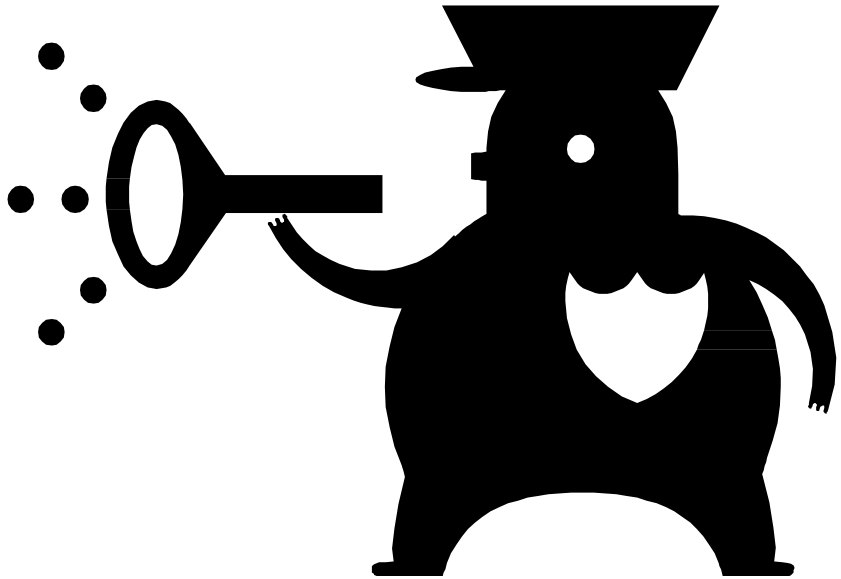
Reading audit reports

- Opinion letter
- Notes
- Current ratio
- Cash flow to total debt
- Long term liabilities divided by net assets
- Total margin

Safeguarding your financial position

Operating reserves

- How much is enough?
- The smaller the budget, the larger the percentage
- Median target is 50% of annual operating budget
- Pay attention to liquidity



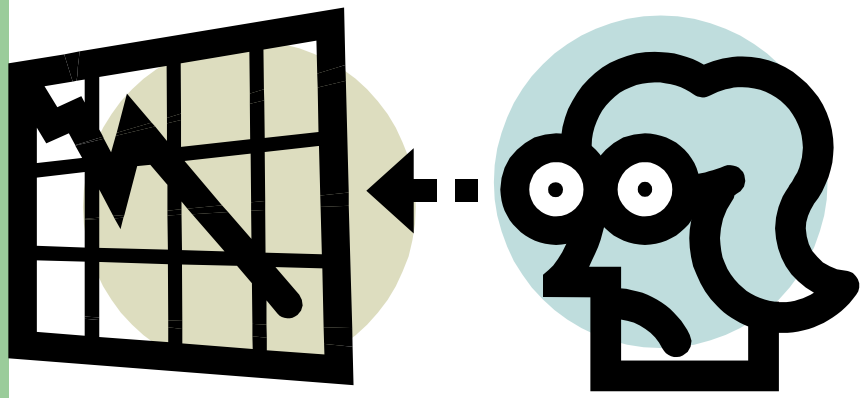
Managing your reserves

- Set goal
- Invest conservatively
- Pay attention to liquidity

Mix of funding sources

- Watch trends within each source of funds
- The smaller the association, the more it relies on dues

To make up for declines in one area:



- Cut expense budget
- Reach new markets w/existing products
- Develop new products
- Reevaluate current product offerings

Investments

Drawing

- *The Practical Guide to Managing Nonprofit Assets*
- Donated by DiMeo & Schneider

Building an investment program

- Purpose
- Oversight
- Spending goals/limitations
- Socially responsible screens
- Time horizon
- Asset classes or investment types

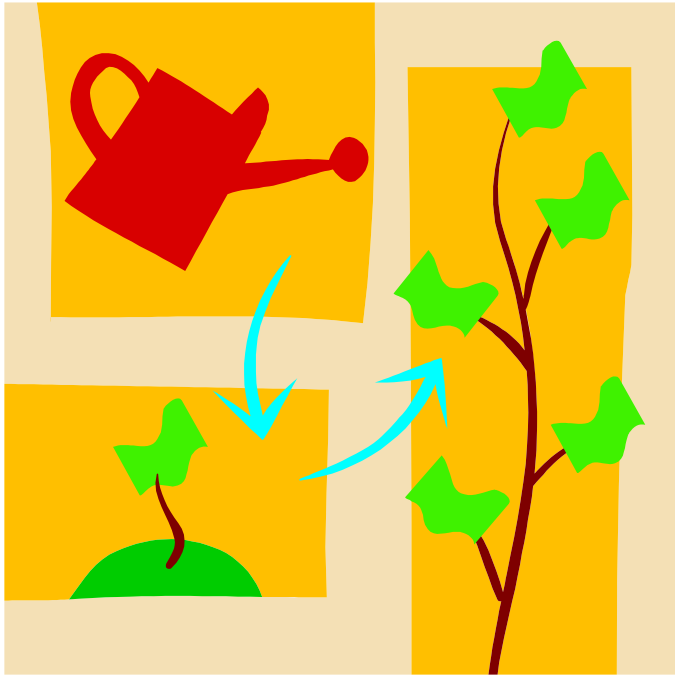
Investment policy development

- Percentages for fixed income, cash, equities
- Acceptable and unacceptable investments
- Limits on stock purchases of one company
- Minimum bond ratings
- Frequency of rebalancing
- Other criteria of importance to association

Types of investment strategies

- No-load mutual or common stock fund
- Retain professional to provide advice
- Retain pro to advise and to buy and sell investments

Investment considerations



- Safety of principal
- Yield
- Risk
- Stability of income
- Marketability and liquidity
- Maturity

Questions in developing strategy

- How much money available to invest? For how long?
- What portion should be safe and liquid? Can some be invested more aggressively?
- What should be the diversification mix?
- Investigate vehicles, determine yields, and assess differences in risk.

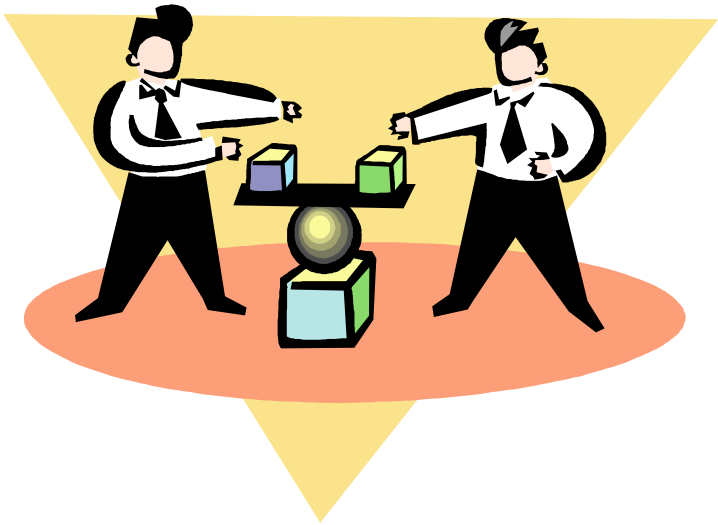
Investment manager selection

- Recommendations
- Stable organization, minimum turnover
- Exclude those with above-average expenses
- Arrange personal interviews with finalists

Interviewing investment managers

- Assess history and stability of organization
- Subject of litigation or censure?
- Credentials of team members
- Succession plan?
- Well-defined investment process
- Performance over market cycles
- Active or passive?
- Accessibility
- Fee schedule

Portfolio rebalancing



- Time-dependent method
- Percentage method
- Seek to minimize frequency while minimizing drift

Performance monitoring

- Choose appropriate index as benchmark
- Broad-based or narrow index
- Quarterly evaluations against benchmarks

Do you need a consultant?

- Growing portfolio
- Investment committee:
  - No experience in capital markets
  - No objective perspective
  - Hard to negotiate favorable terms
  - Not understand legal fiduciary duties
  - Not able to commit required time

An investment consultant can:

- Improve performance
- Help board satisfy fiduciary responsibilities
- Reduce expenses
- Provide continuity
- Help develop well-founded policies

Ask potential consultants:

- Why do you want to work with us?
- What sets you apart?
- Greatest shortcoming?
- How do you foresee helping us?
- How many clients lost?
- Why?
- Conflict of interest?
- Fees?
  - Project, fixed retainer, asset-based retainer

Communicating with the board

- Keep apprised of financial status
- If unexpected losses, inform board on extent of variance
- Be honest and direct

Tax issues

What tax-exempt means

- Subject to UBIT
- Exempt-status preservation
- Federal and state reporting requirements

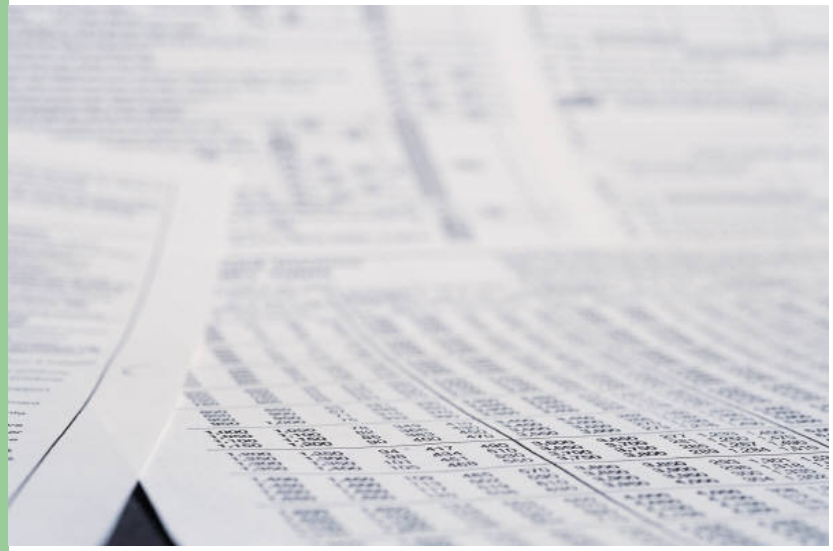
For 501(c)6 status:

- Organized for a common business interest
- Not organized for profit
- Meaningful extent of membership support
- No inurement to private individuals
- Activities directed to improvement of business interests
- Primarily engaged in activities for which it received exemption

Significant threats to tax status:

- Too much unrelated business income
- Provision of too many services too individuals
- Inurement of net earnings to any private individual

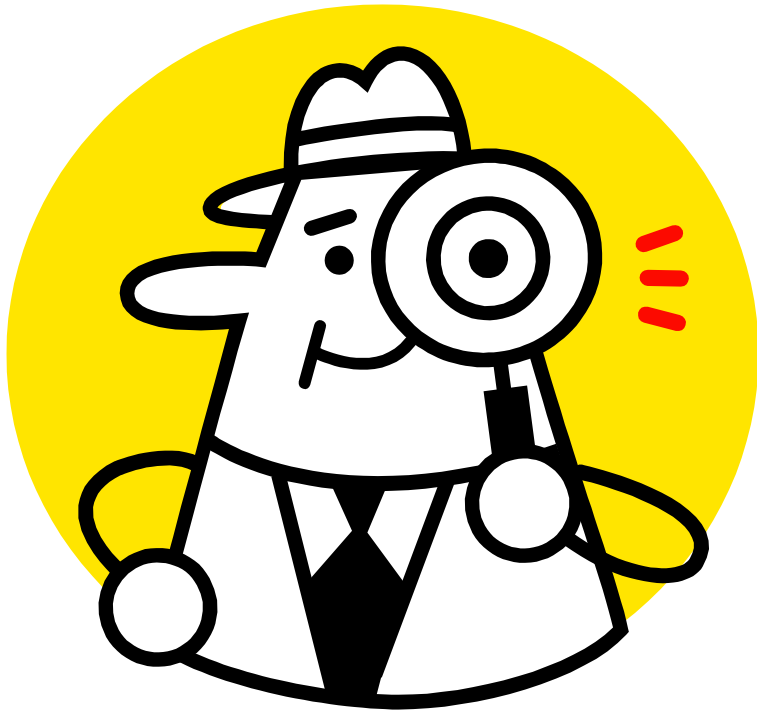
Form 990



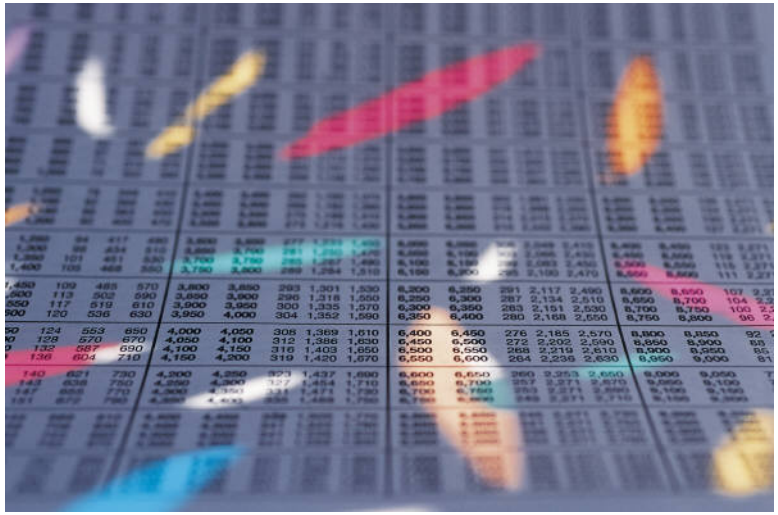
- List of officers, directors and trustees
- Balances at beginning and end of year
- Itemization of revenue and expenses
- 990 EZ
  - Gross receipts $100,000 or less
  - Total assets less than $250,000

Available for public inspection:

- 3 most recent annual returns
- Articles of incorporation
- Bylaws
- IRS determination letter



UBIT results when:



- Income is from a business
- Business is carried on regularly by association
- Business not substantially related to tax-exempt functions

Specific exemptions include:

- Interest income
- Rents from real property
- Royalties

Royalties

- Payments for use of trademarks, copyrights, photos, member names
- If you market product in affinity arrangement, payment PROBABLY IS NOT royalty

To lower risk of UBIT, structure so:

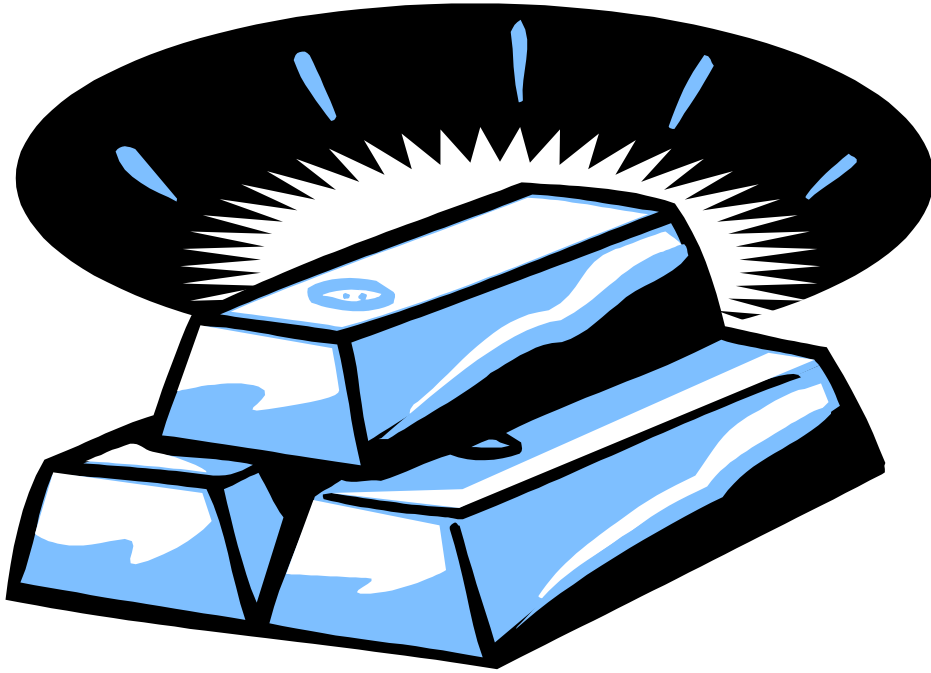
- Association
  - Licenses name/logo/mailing list
  - Exercises quality control of use of its intangible property by vendor
  - And not much else
- Expressly state that it is not a joint venture or partnership

Other areas with UBIT implications:

- Insurance services
- Trade show exhibit income
- Volunteer-run activities
- Advertising
- Corporate sponsorship

As executive director

- In charge of preserving and using the assets on behalf of the members
- Must discharge these responsibilities effectively and efficiently



A chance

- To throw away your association’s financial problems and concerns!

Go forth

- And prosper!