Secure and Resilient

A Financial Management Guide for Education Nonprofits

By Rebecca Gifford Goldberg, Carrie C. Irvin, Liz McNamee, Shruti Nagarajan, and Andrew J. Rotherham

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Bellwether city fund

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Introduction and Objectives

In recent years, unexpected bank failures, the COVID-19 pandemic, and fraud have threatened the financial stability of some in the nonprofit sector. As the landscape continues to shift, nonprofits can proactively prepare for the potential of reduced funding and implement financial management practices to navigate event-driven or funding-related challenges.

This guide defines effective financial management as a continuous process of implementing up-to-date policies and procedures, evaluating financial performance, and making data-informed decisions to achieve an organization's mission.

It introduces five key components of financial management to bolster the resilience of education nonprofits and the nonprofit sector: 1) tax and accounting, 2) financial planning, 3) risk management, 4) metrics and monitoring, and 5) board governance.

Nonprofit executives and board members who read this guide will be able to:

1. Gain insight into the five fundamental and interrelated components of successful nonprofit financial management.
2. Take actionable steps to implement and strengthen financial management practices within their organization.
3. Tell their organization's financial story effectively to key stakeholders.

__Note__: Bellwether's definition of financial management is adapted from Nonprofit Quarterly and Financial Management for Nonprofit Organizations (Zietlow, John; Hankin, Jo Ann; Seidner, Alan; O'Brien, Tim). ***Sources****: Association of Certified Fraud Examiners; The Chronicle of Philanthropy.*

How to Use This Guide

This guide provides a starting point for effective financial management for nonprofit executives and board members. We recommend that leaders:

Adapt the guidance to fit their needs. Pick and choose the resources and topic areas that best suit their organization's needs. Leaders know their nonprofit's context best.

Read the spotlight stories. Throughout the guide, spotlights ground the tactical guidance with reflections from 17 diverse leaders in the nonprofit sector who have grappled with financial management challenges and built thriving, resilient organizations.

Follow guidance related to specific roles. Each section of this guide provides guidance customized for specific roles: organization leaders, finance team leaders, and board members. However, depending on the organization's context, the responsibilities may apply to other individuals in different positions. The most important takeaway is executing the outlined responsibilities.

Click on the mouse icons throughout to learn more. Some sections will include the icon, indicating that you can click on it to find additional detail in the Appendix.

Financial Management Overview

This guide provides practical information on **five interrelated components** of financial management.

Tax and Accounting

Be familiar with relevant tax and accounting terms.

Align accounting to generally accepted accounting principles (GAAP) and train team members.

Implement accounting systems that support effective practice in other areas (e.g., tax).

Financial Planning

Begin financial planning by reviewing the organization's business model.

Create a financial plan that includes annual budgeting, cash flow projection, building a cash reserve, and financial forecasting. Use these tools in financial decision-making.

Risk Management

Develop an ongoing risk management process.

Create a risk action plan.

Set internal control policies to help protect an organization's financial resources from fraud and/or theft.

Protect and diversify cash holdings.

Metrics and Monitoring

Determine appropriate financial measures for the organization to regularly monitor.

Track and use metrics to tell a compelling financial story.

Engage leadership and the board in regular monitoring and oversight.

Board Governance

Provide oversight of the organization's financial health and risk management.

Lend board expertise in tax, accounting, financial planning, investments, and others as needed.

Overcome common board challenges.

Effective financial management is guided by an organization's strategic goals and implemented by a skilled team.

An organization's **strategy** drives how each financial management gear must function to meet key goals.

An organization's **skilled team** drives implementation of sound financial management practices with fidelity.

Why This Matters

Nonprofit leaders value support to practice effective financial management.

Financial Management Skill-Building

Many leaders do not receive formal training in financial management and build the skill on the job.

"I was hired because I'm from the community. I understand students' and families' needs. I'm good at organizing and running campaigns. That doesn't mean I had the skills to do all the things that are necessary for the long-term health of an organization. In those early days, there were a lot of tears. I was stretching as a leader, focusing on things that aren't my skill set. It made me question whether I was the right person to be leading this work. What I needed was training on the skills, like cash management. With a lot of encouragement and thoughtful investment in me as a leader, I started to think, 'I can figure this out!'"
—Founder/CEO

Funding for Internal Operations

Funding sources favor program-related spending, which limits an organization's ability to invest in internal functions, systems, and financial management capacity.

"There is underinvestment in the finance function and overall underinvestment in back-office functions. The sector has a history of funding programs versus internal infrastructure. This dynamic makes it tough to hire adequate operations and finance staff or compensate team members well. So there is a talent gap, but it's about compensation, role structure, and funding versus a fundamental lack of capacity to do the work well." —Nonprofit Finance Expert

"We had a robust internal control policy. It was a great document, but it wasn't used effectively because there wasn't internal capacity to do the work internally. That comes back to the pressure from keeping admin ratios low. You end up hiring more junior people, you have less expertise, and you have more risk." —Chief Operating Officer

Guidance in Moments of Crisis

Financial management challenges are often isolating experiences for many leaders who can benefit from support and guidance.

"It's isolating. You don't want to tell anyone when you're not doing well. I was worried about whether my leadership would be questioned. It is scary." —Founder/CEO

"There's information asymmetry. Information moves through networks, and certain people with less access get left out." —CEO

***Sources**: Bellwether interviews.*

"Nonprofit CEOs can be embarrassed to ask for support with financial management. As leaders, we should be willing to show humility and ask questions when we need help.

But there is also an equity component. *Organizations led by people of color that do complex, grassroots work often have the most to lose and may be the most afraid to ask for help."*

—CEO

Tax and Accounting

Financial Planning
Risk Management
Metrics and Monitoring
Board Governance

Tax: What are the key tax compliance matters for nonprofits?

Nonprofit tax exemption standards are governed by the IRS.

- Tax-exempt status is a classification recognized by the IRS to describe organizations that are allowed to make a profit but are prohibited from distributing profits or earnings to those in control of the organizations.
- The most common IRS status is the 501(c)(3). A 501(c)(3) status gives organizations tax exemptions, which means that the organization is not subject to federal income tax. It also enables donors to give tax-deductible donations to the organization.
- Other 501(c) organizations such as 501(c)(4) entities are tax-exempt, but donors may not deduct donations to these organizations from their federal income taxes.

Nonprofits must file a federal form 990 with financial disclosures.

- The federal form 990 is the primary, annual financial disclosure made by nonprofits in the United States. Failure to file a federal form 990 for three consecutive years will result in the automatic revocation of tax-exempt status.
- The current federal form 990 is not required to follow accounting principles and is self-reported by organizations. The form asks for the organization's primary exempt purpose aligned with its 501(c) status, which is typically an overview of its mission and vision. The federal form 990 also asks for specific information about an organization's largest programs, including an overview of each program, total revenues, and total expenses.

Click here for more on public charities versus private foundations.

***Notes**: The Internal Revenue Service sets tax exemption requirements for nonprofits. Learn more about section 501(c)(3). 501(c)(4) organizations are also required to submit an annual information report by filing Form 990, 990-EZ, or 990-N with the IRS, unless an exception applies. The exempt purposes set forth in section 501(c)(3), for example, are charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition, and preventing cruelty to children or animals. Learn more about exempt purposes. **Sources**: IRS; Financial Management for Nonprofit Organizations (Zietlow, John; Hankin, Jo Ann; Seidner, Alan; O'Brien, Tim); Nonprofit Accounting Basics.*

Accounting: What are the accounting rules for nonprofits?

Nonprofit accounting **standards are set by the Financial Accounting Standards Board.**

Most nonprofit organizations must provide audited financial statements in accordance with GAAP to comply with requirements from government agencies, state authorities, and funders.

Statement of Financial Position *(Balance Sheet)*
Shows what resources the organization owns or has control of and how those are being financed at a certain point in time.

Statement of Activities *(Statement of Net Revenue or Income Statement)*
Indicates to what extent an organization's revenues exceeded its expenses in a given time period, resulting in a change in its net assets. Note: Net assets are not equal to cash. The amount of unrestricted cash and cash equivalents is how much the organization can spend.

Statement of Cash Flows
Shows how the cash and cash equivalents amount changed from one year (or quarter) to the next.

Audit
Examines an organization's accounting records and financial statements by an independent auditor, typically a certified public accountant (CPA). The auditor tests the organization's internal controls and the accuracy of its accounting records.

Click here for more on financial statements and reports.

Cash or accrual accounting?

It depends.

It is acceptable to use **cash accounting**, which records cash when it is received, for relatively small organizations. These smaller entities may not be required to present financial statements in accordance with GAAP.

This mismatch is especially challenging when the organization is large or complex. In such cases, **accrual accounting**, which records revenues when they are earned, should be used. Nonprofits with revenues greater than or equal to $3 million are typically required to provide audited financial statements prepared in accordance with GAAP.

Source: *Financial Management for Nonprofit Organizations (Zietlow, John; Hankin, Jo Ann; Seidner, Alan; O'Brien, Tim).*

Tax and Accounting are distinct but related functions.

Tax

Why It Matters
The federal form 990 is a marketing tool and regulatory compliance tool. It is the publicly available mechanism for oversight. The form is often subject to scrutiny, and many funders will review it to learn about an organization.

How It Relates to *Accounting*
Strong accounting processes can make the process of meeting ongoing tax compliance much easier.

How To Do It
Ensure strong internal recordkeeping and associated systems for:

- Financial records (money coming in, money going out, employment tax records, and asset records).
- Permanent records (e.g., bylaws and internal policies).
- Annual filings and records to prepare returns (e.g., board minutes and budgets).

Maintaining 501(c)(3) status involves:

- Required Filings: Federal form 990.
- Ongoing Compliance:
    - Accurately classifying the records noted above.
    - Limiting unrelated business income.
    - Not participating in political campaign activity.
    - Prohibiting board members, organization leaders, and others from receiving improper benefits (e.g., excessive compensation).

Accounting

Why It Matters
Smaller nonprofits are not required to audit financial statements and often use cash accounting instead of accrual accounting. However, to better gauge financial health and amid times of uncertainty, ongoing review of accurate financial statements that use accrual accounting is vital.

How It Relates to *Taxes*
Periodic audit reviews can help nonprofits improve the accuracy and credibility of financial reporting — a critical input for the public-facing federal form 990.

How To Do It

- Implement strong internal accounting procedures aligned with GAAP to mitigate potential compliance, tax, and/or legal compliance issues. Note that funders can require the organization to undergo an audit.
- Examine the organization's accounting records and financial statements through an audit by an independent CPA to comply with requirements from government agencies, state regulatory authorities, or grantmaking entities.
    - The auditor tests the organization's **internal controls** and the accuracy of its accounting records. If an organization does not go through with an audit, it must at least compile its financial statements in good form.

Sources: *The Standards for Excellence; Learn more from the IRS; Financial Management for Nonprofit Organizations (Zietlow, John; Hankin, Jo Ann; Seidner, Alan; O'Brien, Tim); Nonprofit Accounting Basics.*

Tax and Accounting: To make sound decisions, leaders must identify and dispel misconceptions about nonprofit finance.

Misconceptions	Reality
1. Nonprofits never pay taxes.	Nonprofits pay taxes on payroll and may be required to pay sales tax and taxes on unrelated business income. Real estate taxes are determined by state and local governments.
2. Nonprofit accounting is very different from for-profit accounting.	About 80% of the fundamentals of for-profit accounting are the same except in two cases: 1) revenue and 2) net assets.
3. Nonprofits cannot make a profit.	Nonprofits can have an operating surplus and hold those dollars in **reserve** as long as they have a plan for how they will use those resources for future 501(c)-aligned purposes.
4. Nonprofit accounting standards are the same as IRS tax standards.	GAAP alignment is reviewed by an organization's auditor and focuses on providing accurate financial information to external stakeholders. IRS tax standards are focused on compliance with the law.
5. Nonprofits have an owner.	There is no equity or individual ownership stake in the organization. Technically, nonprofits are owned by the public.
6. Nonprofit personnel cannot be liable for the nonprofit's debt.	Though there is no owner, the founder/CEO and/or board of directors could be held personally liable for a nonprofit's debt.

__Notes__: Total revenue can differ on the audit and 990 because 990s exclude in-kind services. 1) Nonprofits must track restricted dollars. The timing of revenue recognition varies for nonprofits, with most funders preferring to see it on an accrual basis, which involves recording revenue when it is pledged. This is a statement of activities line item. 2) For-profits use "equity" to describe their financial position, while nonprofits have "net assets," which is the accumulation of surpluses and deficits since inception. Nonprofits must track restricted donations as part of their net assets because they have a specific purpose as designated by the donor. This is a statement of financial position line item. __Sources__: Nonprofit Accounting Basics; IRS.

Tax and Accounting: 501(c)(4) Nonprofits

Key Differences Between 501(c)(3) and 501(c)(4) Nonprofits

	501(c)(3) Nonprofits	501(c)(4) Nonprofits
IRS Stated Purpose	Charitable organizations	Operate to promote social welfare or a local association of employees
Examples	Direct services for students	Homeowners associations, advocacy groups
Tax Exemption	Donations are tax-deductible	Donations are generally not tax-deductible
Partisan Activity *(Relates to Elections)*	Must only engage in nonpartisan activity	Can engage in limited partisan activity; are prohibited from engaging primarily in political activity
Lobbying *(Relates to Legislation)*	Limits on lobbying activity	No limits on lobbying activity
Disclosure	Generally, not required to disclose donors in most states	Depends

How To Do It

1. **Be clear on the strategic rationale** for starting a 501(c)(4), especially because it is harder to raise dollars that are not tax-exempt.

2. **Consider operating separate 501(c)(3) and 501(c)(4) entities.** The 501(c)(3) entity can provide direct services in line with its charitable purpose while the 501(c)(4) entity can engage directly in the political arena. Operating as two separate entities allows the 501(c)(3) to employ staff and charge time spent on political and/or lobbying activities to the 501(c)(4). The 501(c)(3) can also contribute approximately 10% of its revenue to the 501(c)(4). These strategies can help sustain the 501(c)(4) entity through long revenue cycles driven by periodic elections, but this approach requires strategic accounting practices.

3. **Consult legal and finance experts** with 501(c)(4)-specific expertise.

4. **Comply with the law** prohibiting coordination of activities and all local laws.

__Sources__: Skadden; AJF; Nonprofit Accounting Basics; IRS; Donorbox. Learn more about social welfare organizations and local association of employees.

Tax and Accounting: Spotlight

Strategic accounting matters when operating both a 501(c)(3) and a 501(c)(4).

City-Based Advocacy Organization

An organization focused on access to excellent schools for all kids created a 501(c)(4) to exert political influence in the community through school board campaigns and other electoral support and legislative advocacy. The organization also runs a 501(c)(3). It made key decisions about how it would employ its team, comply with the law, ensure robust accounting, and design revenue sustainability for the long term.

"We thought about the parts of our work that are allowable within a 501(c)(3), which set us up for longer-term sustainability with a broader set of donors and resources to do the work that is mission-aligned and allowed under a 501(c)(3). We had amazing attorneys and finance experts helping us. You can only spend a certain amount of your annual budget on political activities, but our school board races are every four years. In election years, we have to spend more on other things to offset the spending on our 501(c)(4) work. You need experienced bookkeepers who understand those intricacies and who present the financials so you can make real-time decisions about spending in different categories."

—Founder/CEO

 ***Source**: Bellwether interviews.*

Tax and Accounting: Team Responsibilities

Organization Leader

Reviews organizational financial statements in consultation with the finance team lead and the board finance committee (at least quarterly).

Hires the board-approved independent auditor and supports information flow in the audit process.

Updates the board about audits and tax compliance.

Finance Team Leader

Prepares and shares financial statements with the organization leader and the board finance committee.

Manages external auditors and accountants.

Organization's Board

Approves the federal form 990.

Reviews and approves the board finance committee's recommendation of an independent auditor.

Ensures timely compliance in financial statement reporting for audit and tax purposes.

Conducts quarterly review of key financial data, including GAAP-aligned budget versus actual revenue, grant expenses to date versus budget, operations expense to date versus budget, and unrestricted and restricted revenue commitments to date.

Sources: *Bellwether interviews.*

Tax and Accounting

Financial Planning

Risk Management

Metrics and Monitoring

Board Governance

Financial Planning: What is it and how do you do it?

Organizations use five financial planning tools to drive decision-making.

Assess the Business Model	Annual Budgeting	Projecting Cash Flow	Building a Cash Reserve	Financial Forecasting
Pre-Work	*Short Term*	*Short Term*	*Medium Term*	*Medium to Long Term*
A business model is the strategy behind a nonprofit's revenue mix and spending. Developing a business model is a critical first step to financial planning.	A budget is a guide that can help a nonprofit plan for the future as well as assess its current financial health. It is good practice to periodically review the budget and compare it to actuals.	Cash flow projection encompasses identifying cash needs, accessing cash effectively, and borrowing cash if appropriate. Note: the budget alone cannot identify cash flow challenges that may occur during the fiscal year.	An operating reserve is an unrestricted fund balance set aside to stabilize a nonprofit's finances by providing an accessible savings account for unexpected cash flow shortages, expenses, or losses.	Nonprofits use financial models to forecast revenues and expenses for future years, providing a big-picture view that aids in organizational planning. While financial forecasts are essential, they should complement rather than replace annual budgeting. *(Though financial forecasting is critical for financial planning, this guide does not go into detail about financial forecasting.)*

Sources: *Council of Nonprofits; Nonprofit Finance Fund; Understanding Nonprofit Business Models by Bridgespan; Business Planning for Nonprofits.*

Financial Planning: Assess the Business Model

Before financial planning, assess the business model by reviewing each of the following:

Need

Assess the needs of the beneficiaries the organization seeks to serve through its program and activities. Continuously reflect on what has worked and what may change moving forward to increase the organization's impact.

Guiding Questions

- ❏ Does the current program offering meet the needs of the community and beneficiaries the organization seeks to serve?
- ❏ What are the strengths, challenges, and opportunities for growth in the organization's programmatic scope, geographic reach, and/or beneficiaries served?
- ❏ With these reflections in mind, what might need to change about the current program offering and activities?

Expenses

Determine necessary expenses to support the scope of program activities, hire an effective team, and invest in internal infrastructure and systems.

Guiding Questions

- ❏ What are the key expenses and expense drivers for the organization (e.g., personnel, supplies and materials, technology, rent or occupancy, and professional fees)?
- ❏ What personnel and salary expense is necessary to staff the program and internal operations effectively?
- ❏ What are the internal systems and infrastructure expenses that are necessary to support effective financial management and guard against risks?

Revenue

Determine the overall revenue and aligned sources (e.g., donor, funder, government) to cover expenses and generate surplus to contribute to the reserve fund.

Guiding Questions

- ❏ How do the organization's revenue sources align with its use of funds? For example, is advocacy work funded by philanthropy while program costs are covered by fees for service?
- ❏ What is the overall revenue mix and diversity of sources?
- ❏ How much of a surplus can the organization consistently generate to build cash reserves?

__Sources__: Bellwether adapted from La Piana, David; Gowdy, Heather; Olmstead-Rose, Lester; Copen, Brent. The Nonprofit Business Plan: A Leader's Guide to Creating a Successful Business Model (Chapter 3), Turner Publishing Company. Learn more about need at Nonprofit Quarterly.

Financial Planning: Annual Budgeting

A lever to adjust ongoing spending.

A budget is a guide that can help a nonprofit plan for the future as well as assess its current financial health. It answers the questions: What are we planning to do in the next year, what will it cost, and how will we fund those costs?

Why It Matters

- Budgets transform annual priorities into resource-allocation decisions.
- Budgets enable progress tracking, accountability, and real-time financial decision-making.
- Budgets help leaders monitor overall financial health.

How To Do It: Budgets Should Be ...

- **Informed by data**: Build a budget (where an organization is planning to go) using an income statement (where the organization has been) and balance sheet (where the organization is today).
- **Focused on the short term**: Develop an annual budget that summarizes revenue and expenses, with a monthly forecast.
- **Predictable and representative of diverse voices**: Stakeholders can anticipate deadlines far in advance and plan accordingly.
- **Transparent**: Implement budget system(s) that are easy to follow, with clear deadlines and decision points.

Strong processes are key to budgeting success.

City-Based Grantmaking Nonprofit

After 10 years, the nonprofit made the shift from an outsourced, part-time accountant to internal full-time capacity. The new chief operating officer implemented an annual budget and monthly spending review process that was accessible for organization leaders. As a result, leaders developed insight into how money flows through the organization, began to make more informed spending decisions, and built capacity to articulate the organization's financial status to key stakeholders.

"Previously, there was this unscalable wall between the finance people and the rest of the team. We streamlined the 'strategic chart of accounts' to be more accessible and meaningful to program leaders and decision-makers, who were able to consume the information without having to talk with me or the finance team. This streamlined the budget and spending approvals process and helped budget managers understand how money was flowing through the organization."

—Chief Operating Officer

***Sources**: Adapted from Nonprofit Finance Fund; Bellwether Strategic Financial Planning.*

Financial Planning: Projecting Cash Flow

A tool to plan for cash needs.

Cash flow is the money that comes in and out of an organization. Cash flow projection forecasts the timing of cash in and cash out. Unlike a budget — which summarizes revenue and expenses for a time period — cash flow projections plot total cash received and spent on a monthly or weekly basis.

A sample cash flow tool including step-by-step instructions can be found in the sources below.

Why It Matters
The budget alone cannot identify cash flow challenges that may occur during the year. With proper planning, several tools are available to ensure sufficient cash flow even when there are predictable periods of negative cash flow (e.g., due to timing of revenue).

How To Do It

- Create a cash flow projection tool and use the tool to identify cash needs.
- If cash flow is an issue, select a strategy that meets the specific need. For example, leaders can:
  - Access cash reserves that will be replenished when revenue is received.
  - Hold off on excess spending until revenue is received.
  - Approach funders for an advanced payment to cover a temporary shortfall.
  - Establish a line of credit.

Questions to keep in mind about an organization's cash flow:

- ❏ To what extent are the organization's revenue streams and/or expenses steady throughout the year versus variable or cyclical?
- ❏ How do revenue or expense spikes affect when the organization will have cash versus when it will need to spend cash? Does the organization need to adjust the timing of expenditures to smooth cash flow?
- ❏ What is the organization's plan for unforeseen periods of time when cash expenditures exceed cash receipts?
- ❏ What expectations has leadership set with its customers, vendors, or grantees for timing of payment relative to timing of when services are delivered?
- ❏ Does the organization have any big or one-time investments planned for an upcoming fiscal year? If so, what sources of revenue will cover those investments? What is the corresponding timing leadership has planned for receipt of revenue versus expenditure?

__Sources__: Adapted from Nonprofit Finance Fund; Bellwether Strategic Financial Planning; Cash flow projection template from NFF.

Financial Planning: Building a Cash Reserve

A source for emergency funding.

It is good practice to have at least three to six months of cash or liquid assets to cover unforeseen expenses or to absorb other shocks.

Why It Matters
Nonprofit cash reserves provide a financial safety net during crises or cash flow shortages and promote stability by preventing hasty staff reductions or programmatic cuts.

How To Do It

- **Set a target**: Cash reserve targets can vary a lot within and beyond the three to six month guideline, based on an organization's stage of growth, sources and degree of cyclicality of revenue, and types of assets.

- **Operate at a surplus**: Budget for a surplus and communicate about the importance of this approach with funders and the board. How much of an operating surplus to budget for can vary; organizations with earned revenue may have greater operating margin targets than government-funded or grant-funded organizations.

- **Set and follow a policy for how to deploy reserves**: A good practice is to use cash reserves to cover unexpected operating expenses and build a separate reserve for strategic investments when an organization surpasses its operating reserve target. Organization leaders should discuss and document priorities for spending cash reserves with board and leadership team.

__Sources__: Adapted from Nonprofit Finance Fund; Bellwether interviews; GrantThornton.

While three to six months of cash in reserve is a general guideline, organizations can increase and/or tailor their cash reserve target to reflect specific circumstances:

❏ Organizations with cyclical revenues (e.g., large donations at the end of the calendar year) or expenses (e.g., seasonal) may need a higher cash reserve target.

❏ Organizations that spend and receive resources on different timelines may need more cash on hand to bridge time lags between revenues and expenditures.

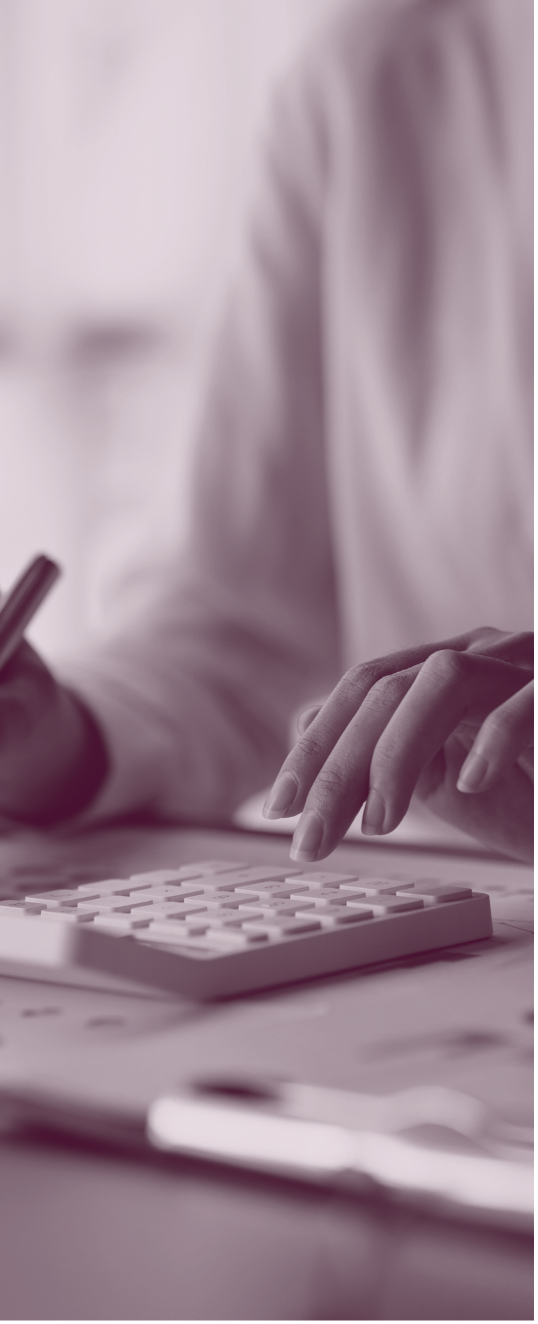
❏ If an organization's revenues and/or expenses are unpredictable, consider a higher cash reserve target to mitigate risk of delayed payment or loss of funding.

❏ If an organization's funding is highly concentrated in type (e.g., government or philanthropy) or a single source (e.g., a specific grant program or funder), consider a higher cash reserve target.

❏ Organizations that own buildings and other fixed assets may need to keep additional cash on hand for unexpected maintenance expenses.

❏ If the board or leadership has a low risk tolerance, the organization may need a higher cash reserve target.

❏ Loan terms or other contractual requirements may require the organization to hold certain levels of cash in reserve.



Financial Planning: Spotlight

Accurately projecting cash flows is essential to avoid running out of money.

National Education Nonprofit

After more than 15 years in operation, a national nonprofit with a staff of nearly 70 faced a cash crisis. In her first month on the job, the new CEO discovered there was only about four weeks of cash on hand. The organization reduced its head count by 70% and did an emergency round of fundraising to survive. It instituted new cash forecasting methods, which incorporate more nuance about the certainty of revenues and the timing of cash inflows and outflows.

"There were financial statements, but no forward-looking financial planning. One challenge was that we had included potential revenue in the cash flow projections, even though some of it was unlikely to come in. I instituted new criteria about what we count in our cash forecast. It's only counted if it's committed revenue, the contract is signed, and you know a date when it will be in the bank. With that, we could see more clearly what we needed to raise, and by when, to avoid insolvency. The timing element matters. If I need $800,000 by Dec. 1 and another $500,000 by Feb. 1, it doesn't matter if I raise $1 million in January, because we would have run out of cash in December."

—CEO

***Source**: Bellwether interviews.*

Financial Planning: Spotlight

Grantmaking nonprofits must build cash reserves, understand cash flows, and have clear financial policies in place.

City-Based Grantmaking Nonprofit

This city-based nonprofit raises money to fund grants to local organizations. As both a fundraising organization and a grantmaker, the organization's leadership is focused on building and strategically managing cash reserves. A key strategy has been to diversify its revenue beyond philanthropy.

"When I started as CEO, we only had a couple months of cash reserves. Such a small reserve meant we were one non-renewed grant away from needing to make significant cuts. My guess is that many well-funded organizations are in a similar situation. To build our reserves, we defined multiple 'tiers' of funds, each with a distinct and clear purpose.

The first tier is our annual operating budget — money we've budgeted to spend during the current fiscal year. This tier includes the timebound and restricted grant funds that we've raised and plan to distribute. We raise and distribute tens of millions of dollars annually, so we keep a close tab on cash flow and try to have as much of our budget as possible in accounts that bear meaningful interest but have little risk, such as short term certificates of deposit and treasuries. The second tier is a three-month operating reserve that we don't want to touch unless there is a cash flow issue. This tier is invested primarily in low-risk money market accounts that can be immediately liquidated. The third tier is a multimillion-dollar fund of unrestricted money that we aggressively invest, primarily in equities. We set goals each year around how much additional unrestricted money we want to deposit into tier three. We are now in the early stages of considering whether to build an endowment, which would allow us even more flexibility to support and sustain our mission in the years to come. To do this, we've focused on raising flexible revenue, which allows us to direct our resources with more discretion and an eye toward long-term sustainability."

—CEO

Sources: *Adapted from Nonprofit Finance Fund; Bellwether; Bellwether interviews.*

Financial Planning: Team Responsibilities

Organization Leader

Deeply understands the organization's financials, including how organizational strategy drives financial decision-making and how financial realities and risks could impact the organization's mission.

Hires finance team to ensure the organization has sufficient finance capacity, recognizing where those skills need to be complemented and supported with internal and external resources.

Proposes annual budget to the board.

Engages deeply with the finance team (and the board finance committee) to make meaning of financial reporting, including cash flow projections, budget to actuals, and key organizational health metrics.

Escalates financial risks to the board promptly and transparently.

Recruits board members with financial expertise, including specific expertise in nonprofit financial management.

Finance Team Leader

Prepares financial reports for the organization leader and board, including cash flow projections, budget to actuals, and key organizational health metrics.

Supports the interpretation of financial reporting and provides actionable guidance to inform board and leadership decision-making.

Proactively identifies financial risks (e.g., cash shortages) for the organization's leader and board.

May approve releases from the cash reserve, and ensures that budgets are based in reality.

Organization's Board

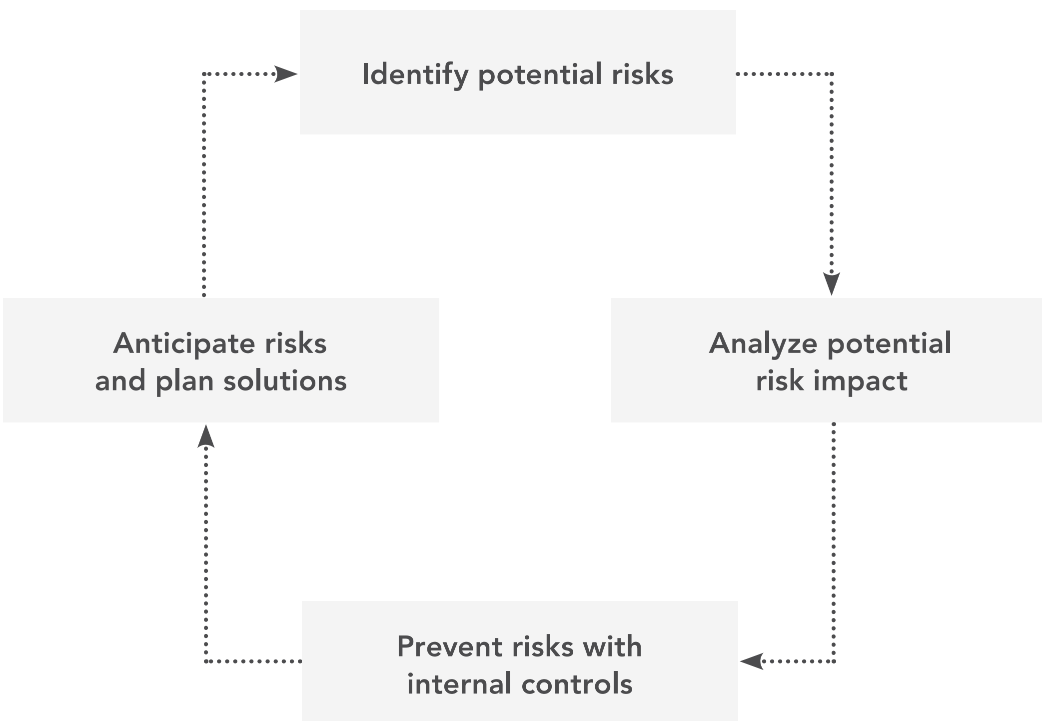
Provides oversight of financial reporting and interpretation functions by regularly reviewing financial reports and asking strategic questions on financial health.

Guides the organization leader to make thoughtful decisions that ground financial trade-offs in the organization's strategy and mission.

Tax and Accounting
Financial Planning
Risk Management
Metrics and Monitoring
Board Governance

Risk Management: What is it and why is it important?

Risk management is a proactive, ongoing process to:



Risk management can prevent crises — and prepare an organization to face them.

National Education Nonprofit

A national education nonprofit startup invested in financial management, human resource systems, and strong governance practices. An internal audit of its systems surfaced a need to strengthen its online security and information technology systems. It was in the process of addressing its vulnerabilities when a cybersecurity breach occurred, resulting in financial theft. The board sprang into action and the leader worked closely with key internal and external stakeholders to stabilize the organization.

"One of the biggest challenges as a startup is catching up your systems to the pace of growth. You know what you have to do, but things can fall through the cracks because you can't make it all happen quickly enough. We have so much that I'm proud of in our leadership and systems, and we still had this security breach. The strength of our board mattered a lot in that moment. My network and credibility as a leader mattered. Most of our stakeholders understood that this breach was a sophisticated attack. As an organization, we have emerged stronger with a better sense of the risks and the value of investing in proactive mitigation strategies."

—Founder/CEO

 Sources: *OR DOJ; Nonprofit Risk Management Center; Jitasa Group.*

Risk Management: Set Internal Control Policies

Internal controls are policies and practices designed to prevent illegal activity and fraud.

Financial controls, also known as internal controls, are policies and practices that protect an organization's assets (including financial assets) from theft and fraud and ensure compliance with applicable laws.

Why It Matters
Nonprofits can avoid financial losses if organizations implement basic financial controls.

How To Do It

- **Designate different people to have the authority** to deposit cash, keep transaction records, and approve expenditures; this is called "segregation of duties" and ensures that no one person is solely in control of finances, which can prevent fraud and reduce errors.
- **Use budgets** to reconcile and examine bank statements monthly.
- **Document internal control procedures** and regularly test whether they are being consistently practiced.
- **Adopt conflict of interest policies**.
- **Communicate** that policies are in place to build a culture of compliance among the broader team.

A culture of risk management can help avert crises.

National Education Nonprofit

Several years into its operation, an education nonprofit witnessed wire fraud when an invoice it sent to a client organization was forwarded with falsified wire instructions. The payment was never received, which raised questions and, ultimately, led to discovery of the fraud — someone at the client had changed the wire information using software that intercepted invoice emails. The client services nonprofit updated its internal controls policy to confirm wire information verbally, and it no longer relies solely on emailed wire instructions.

"It's common to get an email that seems like it's from someone you know, and you have to bring a level of scrutiny to the table. When someone who I know understands our policies asks me to do something that is not in compliance, that's always the tip-off. It's not just about having the policy, but it's about the culture of knowing that everyone knows and practices the policy."

—Bookkeeper

Sources: *Adapted from OR DOJ; Nonprofit Risk Management Center; Jitasa Group; The Bridgespan Group.*

Risk Management: Conduct Risk Action Planning

Prepare for uncertainties on the horizon.

A risk action plan can help an organization prepare for an external shock (e.g., an economic downturn or increase in inflation) or an unexpected event (e.g., an unforeseen expense, the loss of a major funder, or a cybersecurity breach). This is often called scenario planning.

Why It Matters
A well-crafted risk action plan will better prepare an organization to respond to challenges in creative ways, weigh real-time resource decisions, and be well equipped to respond to uncertainty in the future.

How To Do It

- Set up an annual risk planning cycle that includes an organization's finance, operations, and program teams.
- Document the risk action plan, including the following key elements at right.

Click here for an example risk action plan.

Risk Action Plan Element	Questions Organizations Can Ask
Risk Event	What are the one to three key uncertainties on the horizon?
Level and Likelihood	How likely is the event (e.g., 1%, 20%, 50%) and what would the impact be (e.g., high impact — loss of major revenue source)?
Management Controls	What controls or policies would be appropriate to mitigate risk?
Thresholds for Action	What indicators can be tracked to drive decision-making timing?
Portfolio of Possible Actions	What can the team and board do if this risk event occurs?
Accountable Team Member	Who will make the decision? Who will perform key tasks?

 Sources*: Adapted from OR DOJ; Nonprofit Risk Management Center; Jitasa Group; The Bridgespan Group.*

Risk Management: Diversify and Protect Cash Holdings

Know where cash is held and consider options for insuring cash and accessing cash when needed.

Organizational leaders can diversify and protect cash holdings — by understanding where cash is held, banking with more than one FDIC-insured entity, and establishing a line of credit — to safeguard against bank failure and/or fraud.

Why It Matters
Nonprofits are advised to keep about three to six months of operating funds on hand as cash reserves; it is important to ensure the organization has access to this cash when it is needed. Click here for details on cash reserves.

How To Do It

- **Obtain insurance**: Be aware of accounts in excess of $250,000, the amount typically covered by the FDIC. Check BankFind Suite to make sure accounts are FDIC insured.
- **Consider trade-offs**: It may not be realistic for every dollar to be FDIC insured, but it is important to understand the risks involved.
- **Bank with more than one entity**: This ensures that even if a bank experiences a disruption or failure, a leader's organization will still have access to funds and the ability to make transactions.
- **Establish a line of credit**: Having access to credit can be a useful tool to diversify access to cash.

Recent bank failures underscore the importance of protecting cash — and having backup options.

City-Based Charter Management Organization

A charter management organization runs multiple schools serving grades pre-K through grade 12. When Silicon Valley Bank failed in March 2023, the terms for the organization's facilities loans required all cash reserves for those loans to be held by Silicon Valley Bank. All of those funds were at risk and the organization's cash was inaccessible for transactions.

"Luckily, payroll had just gone out. There was a scramble to open a new account at a different bank, but the next state government payment was not due to come for weeks. It turned out that the federal government backstopped the bank, and there was only uncertainty for a few days. A lot of charters bank locally. If you're just in one city, you want to have a relationship with your banker and that makes sense. But it's so important to have two banks, including one that is national that the government won't let fail, and to get more FDIC coverage on your deposits by negotiating with your bank."

—Board Chair

__Note__: Deposits in credit union accounts are also insured by the National Credit Union Administration (NCUA) up to the same threshold. __Sources__: Adapted from OR DOJ; Nonprofit Risk Management Center; Jitasa Group; The Bridgespan Group.

Risk Management: Team Responsibilities

Organization Leader

Sets and updates internal controls policy, in consultation with the finance team lead and the board.

Maintains culture of compliance and ensures sufficient training and role clarity internally to effectively implement the internal controls policy.

Leads and facilitates communication within the organization and with the board about high-risk events on the horizon.

Recommends a path forward about actions to take from the risk action plan.

Identifies and recommends safeguards for the organization (e.g., insurance).

Approves bank selection(s), including a backup or secondary bank.

Finance Team Leader

Sets and updates internal controls policy, in consultation with and approval from the organization leader and board.

Regularly monitors internal controls practices, especially those related to access to the organization's accounting systems and records.

Supports risk action planning, particularly from a financial data and analysis standpoint.

Leads and facilitates with the organization's leader and board about strategies for protecting and/or investing cash reserves, in accordance with the organization's risk tolerance levels.

Reviews banking partner options and recommends bank selection(s), including a backup or secondary bank.

Organization's Board

Approves internal controls policy.

Approves path forward and actions to take from the risk action plan.

Approves cash diversification practices.

Ensures safeguards for the organization are in place (e.g., insurance).

Depending on the size of the organization, the board may serve a role in internal controls (e.g., being a signatory on accounts).

 ***Sources**: Adapted from OR DOJ; The Bridgespan Group.*

Tax and Accounting
Financial Planning
Risk Management

Metrics and Monitoring

Board Governance

Metrics and Monitoring: What is it and how can it help?

Metrics

How will an organization collect and analyze data to measure progress *(quantitative)*?

Monitoring

How will an organization regularly evaluate metrics to assess its financial health *(qualitative)*?

Strong metrics and monitoring can better tell an organization's story.

Financial stories are not only about numbers. They are about how an organization uses financial resources to do its work. Here are examples of how to tell a compelling financial story to key stakeholders:

Story 1: Past Trends

What did the organization do in the past? How did it spend its money?

Data to inform the story: Past income statements and past balance sheets.

Story 2: Current Model

What are the primary sources of revenue that fund the organization's work? Does the funding model cover costs to serve stakeholders?

Data to inform the story: Current and/or revised budget(s), cash flow projections, and the most recent balance sheet.

Story 3: Evolution

How is the business model evolving? What does the organization need to realize the future vision?

Data to inform the story: Financial forecasting and future-projected budgets.

 ***Sources**: Adapted from Telling Your Financial Story, NFF.*

Metrics and Monitoring: How to calculate metrics and determine if an organization is financially healthy.

First, understand how to read accounting statements. Then, calculate key indicators of organizational health.

Indicators	What It Shows	Source of Data	How It Is Calculated
Operating Surplus or Deficit *(Business Model Performance)*	An organization's ability to cover operating expenses with revenue from its core business model.	Income Statement *Audit, IRS Filing, Internal Statements, Budgets*	Operation Revenue - Operation Expenses
Months of Cash *(Liquidity)*	How long an organization can cover short-term obligations and day-to-day expenses — the best measure of solvency.	Balance Sheet *Profit & Loss ("P&L") for Expenses, Audit, 990, Internal Financials, Bank Statements*	$\dfrac{\text{Total Cash}}{\text{(Total Expenses / 12)}}$
Months of Available Net Assets *(Availability)*	How much of net assets are truly available for use (less restricted cash and outstanding obligations) — a better measure of accessible resources.	Balance Sheet *P&L for expenses, Audit, 990, Internal Financials*	$\dfrac{\text{Total Net Assets Without Restrictions - (Equity in Property and Equipment)}}{\text{(Total Expenses / 12)}}$

Click here for more on accounting statements.

Click here for more on additional metrics to monitor.

__Note__: For months of cash liquidity the denominator can change by organization but broadly could be total expenses/12 or average monthly expenses based on a year lookback. __Sources__: Adapted from Telling Your Financial Story, NFF.

Metrics and Monitoring: Team Responsibilities

Organization Leader

Reviews and monitors financial reporting, in consultation with finance team and board.

Analyzes key financial performance metrics, in consultation with finance team and board.

Translates the story of the organization's financial health to key external stakeholders, including funders and donors.

Finance Team Leader

Collects and shares financial performance metrics with the organization leader; supports analysis and interpretation of financial performance metrics by the organization leader and board.

Understands all reporting requirements across stakeholders (including funders and donors) and creates financial reports and summaries tailored to purpose and audience.

Organization's Board

Regularly reviews financial reports from the finance committee and organization leader.

Asks strategic questions on financial health.

Approves the organization's budget.

Metrics and Monitoring: Spotlights

Interpreting financial data matters for decision-making *and* storytelling.

National Education Nonprofit

"When I became CEO, I tried to understand the financial data better than anyone who would ask about it. I spent a lot of time early in my tenure immersed in our books. I wanted to ask the toughest questions my finance team would receive. I'd rather be the one to discover something we need to fix or improve (versus funders or the board)." —CEO

Nonprofit

"To get access to working capital, as a leader, you have to be equipped to explain to funders, donors, and lenders how money flows through your organization to drive mission and impact. It's not just about the tracking and public disclosure, but there is also a storytelling component." —Nonprofit Finance Expert

National Education Nonprofit

"It's scary when you have to tell your funders that you experienced fraud or that you're running out of cash. Whatever the situation is, how do you communicate with your funders, the board, your team … and not plant a seed of doubt in you as a leader? When we experienced fraud, we crafted a narrative about what we had done proactively, what happened, and what we were doing about it. For the most part, the response we got was, 'OK, how can we support you?'" —Founder/CEO

 Sources*: Bellwether interviews.*

Tax and Accounting
Financial Planning
Risk Management
Metrics and Monitoring

Board Governance

Board Governance: Boards are primarily responsible for oversight.

Mission Oversight

Maintain ambitious goals for impact; consistently track key data and monitor results closely.

Nonprofit boards provide critical oversight to meet the mission and use three key levers to do so:

1. Leadership	2. Resources	3. Engagement
Support organization leadership and hold them accountable for organizational performance.	Steward and align financials and fundraising to meet organization's mission.	Engage and elevate voices to advocate for, with, and within the community.

How Nonprofit Boards Should Organize Themselves to Support Success:

Composition
Diversify board membership across demographics and experience.

Structure
Commit to strategic board and committee meetings, set clear board expectations, and establish sound practices and processes.

Accountability
Insist on board member engagement, ensure compliance, and act with courage on behalf of people served by the mission.

 Sources: *Adapted from Bellwether's governance framework.*

Board Governance: Full Board Responsibilities

The board as a whole is responsible for oversight of the organization's financial health and stewardship of the organization's resources.

Key Financial Responsibilities

- Review quarterly financial reports from financial committee.
- At least once each year, review and approve organization budget, multiyear financial forecast, audited management letter, financial policies, and federal form 990.
- Approve finance committee recommendation of independent auditor(s).

Additional Responsibilities to Manage Risk

- Ensure board minutes are complete and accurate.
- Adopt conflict-of-interest policy.
- Add and/or recruit new board members with specific expertise that may be missing on the board (e.g., legal, accounting, insurance, nonprofit finance).
- Bring in outside experts for board training, as needed.

Examples of questions for board members to ask about the organization's financials:

- ❑ What is the budget for this year, and how is it aligned to the organization's mission, vision, and strategy?
    - ❑ Is this year's budget aligned with our longer-term strategic financial plan?
    - ❑ If we are projecting a deficit, what is the rationale?
- ❑ Is cash flow projected to cover our projected expenses? If cash flow is below projections …
    - ❑ Do we know why?
    - ❑ How are we planning to cover expenses this month? Next quarter?
    - ❑ What steps is the organization taking to mitigate/address the situation?
- ❑ Are revenues on track for the next month/quarter/year? If not, what steps are being taken?
- ❑ Are our key sources of revenue increasing (or decreasing)? How will that affect our revenue mix? What do you see as the underlying causes of any revenue trends, and how might these affect our future sustainability as an organization?
- ❑ Are our key expenses close to what was budgeted? What accounts for significant variations in planned expenses?
- ❑ Do we have sufficient operating reserves? How many months of cash on hand do we have compared to our cash on hand goal/target?
- ❑ Have we filed all reporting and compliance documents on time?

__Sources__: Bellwether interviews; Adapted from Financial Management for Nonprofit Organizations (Zietlow, John; Hankin, Jo Ann; Seidner, Alan; O'Brien, Tim), and Education Board Partners.

Board Governance: Finance Committee Responsibilities

The finance committee of the board is responsible for leading the board's oversight and monitoring of the organization's financial performance; the committee should include at least three board members.

Key Financial Responsibilities

- Conduct a detailed review of all draft financial statements, budgets, multiyear financial forecasts, audit reports, financial policies, and federal form 990s.
- Monitor current and future financial health of the organization by tracking and analyzing key financial indicators and asking strategic questions about cash flow, liquidity, and other indicators of financial health.
- Ensure the full board has enough and the right information to review quarterly financials, approve annual budgets, approve target for cash reserves, and approve other financial policies.
- Provide recommendations as requested by organization leader(s) to strengthen financial management practices, financial planning, investment strategy, etc.
- Review proposals and recommend selection of independent auditor(s).

Finance Committee Structure

- ❏ Committee chair is typically the board treasurer.
- ❏ Senior finance staff and/or outsourced financial services providers should participate in all committee meetings.
- ❏ The finance committee should meet regularly, at least once between board meetings.
- ❏ Meeting frequency and length should be based on when financial data is updated and available.
- ❏ Meeting schedule should be set at the beginning of each fiscal year.

Suggested Finance Committee Agenda Items

- ❏ Review financial reports, including budget to actuals for expenses and revenues.
- ❏ Review bank statements and account reconciliations.
- ❏ Raise questions about off-track expenses or revenues, and unexpected surpluses or changes.
- ❏ Engage in strategic discussions to monitor both current and future financial performance and sustainability, and to ensure resources are best allocated to support the organization's mission and impact.

__Sources__: Bellwether interviews; Adapted from Financial Management for Nonprofit Organizations (Zietlow, John; Hankin, Jo Ann; Seidner, Alan; O'Brien, Tim), and Education Board Partners.

Board Governance: Boards and leaders should proactively avoid the most common challenges to effective board financial oversight.

Challenges to Clear Board Roles and Expectations

1. Board members do not understand they have a fiduciary role or what that means in practice.
2. Board members do not devote sufficient attention to financial oversight and monitoring, cash flows, and/or cash reserves. The board does not devote the time and/or attention to financial oversight and monitoring, assuming staff/back office providers/auditors have responsibility.
3. The board is too deferential to the organization's leadership.
4. There is a lack of transparency and/or trust between the organization's leadership and board members.
5. Organization leadership and/or board does not act on recommendations from auditors.

Challenges to Board Capacity and Structures to Provide Financial Oversight

1. Finance experience of board members does not align with the size or complexity of the organization.
2. The board receives financial reports and dashboards too late; receives insufficient, incomplete, or inaccurate financial information; and/or does not receive financial reports at all.
3. Meeting cadence and agendas to discuss financials are irregular and/or not focused on the big-picture implications.
4. Board treasurer may need training/support to lead the committee effectively (e.g., facilitation skills) and to know when to consult and engage other committee members.

 Sources: *Bellwether interviews; Adapted from Education Board Partners.*

Board Governance: Spotlights

Board members must have relevant *nonprofit* financial management expertise.

National Education Nonprofit

"We have two people on our board with hefty experience in nonprofit financial management. They've been excellent, always encouraging us to adopt stronger practices and holding a high bar of accountability on financial management. When the pandemic hit and we had to manage our cash flows really closely, they were there with us on a weekly basis asking the right questions. Their ability to help us focus on the right fiscal measure at different times has been really critical to our overall health as an organization." —CEO

National Education Nonprofit

"Our board had big names on it, people with star power, but no one with experience running nonprofits. And we didn't have a seasoned senior team. At one point, one of our funders asked us for cash flow documents, and we couldn't produce them. Their confidence was further eroded when our founder announced their departure. At that point, there was no one our funders could pick up the phone and call who had their confidence. That funder pulled out, and we downsized to make up the loss in revenue." —Chief Operating Officer

 Sources: *Bellwether interviews.*

Board Governance: Spotlights

Trust and transparency are key to effective governance oversight.

National Education Nonprofit

"The first time we are talking about financial data is not at the board meeting, it is well before the meeting. We look at the data together and try to make meaning of it and drive a shared understanding of the implications." —CEO

Charter School

"We tried to strengthen the board and make it a more active board over time, to only middling success. Then, the Silicon Valley Bank failure happened. I got an email from the executive director along with the whole board, and it was not clear to me immediately how serious the situation was. It was not evident how bad the situation was from that email — literally all our money was in Silicon Valley Bank, and we couldn't get it out. The executive director should have called or texted me and asked for help, because this was truly a crisis." —Charter School Board Chair

National Education Nonprofit

"It is so tricky. You don't want your board to be overactive or micromanaging. If they aren't engaged, it's easy for the board to miss things, but it's dangerous if they become managers themselves. It's boggling to get that appropriate level of oversight just right." —Chief Operating Officer

 Sources: *Bellwether interviews.*

Recommendations

Recommendations

Bellwether research and interviews surfaced a set of recommendations for key stakeholders.

Organization Leaders

- Understand how the organization's finances work.
- Collaborate and be transparent with board members about financial management challenges and opportunities.
- Recognize when the imperative to invest in internal systems and talent warrants spending less on direct program expenses.

Board Members

- Ensure dollars are well spent to address the organization's most pressing needs.
- Create an environment of collaboration with the organization's leader.
- Participate in financial management training to build or hone skills.
- Recruit nonprofit financial management expertise to the board.

Funders

- Support general operations; do not cap administrative rates.
- Consider making explicit contributions to a grantee's cash reserves.
- Do not penalize prospective grantees for having healthy cash reserves; take the long view to help current grantees be sustainable.

Field Builders

- Support training and development of nonprofit leaders in effective financial management practices.
- Foster a sense of community among nonprofit leaders, so they have trusted peers to turn to when facing an otherwise potentially isolating challenge or crisis.

Conclusion

Effective financial management is mission-critical to secure and sustain the work of education nonprofits.

This guide outlines the essentials of effective financial management in five interrelated areas: 1) tax and accounting, 2) financial planning, 3) risk management, 4) metrics and monitoring, and 5) board governance. The resources are a starting point for nonprofit leaders and board members to strengthen their organizations' financial health and resilience in the short and long term.

Leaders do not have to shoulder the work of strengthening financial management practices alone. Many nonprofit leaders interviewed noted how isolating it can be to navigate a financial crisis or unexpected event. They shared how moments of uncertainty highlight the importance of board transparency, investment in a skilled finance team, and candid communication with funders.

The recommendations provided amplify how organization leaders, board members, funders, and the field can work together to shape a more financially secure and resilient education nonprofit sector. ✦

Appendix

Tax: What is the difference between a public charity and a private foundation?

Most organizations are qualified for tax-exempt status under Section 501(c)(3) and are usually termed "charitable" but two terms are often confused with one another.

Public charities must continually solicit donations from the public and can receive funds from a variety of sources, including individuals, government, and private foundations.

- **Board Composition**: A public charity's board must be composed of diverse members and it must get part of its support from the public, as required by the IRS.
- **Use of Funds**: Public charities use their funds to carry out activities, including grantmaking, that are directly related to the exempt purpose for which the organization was granted public charity status.
- **Establishment**: Private foundation is the default classification for a 501(c)(3) organization. An organization is presumed to be a private foundation unless it qualifies as a public charity.

Private foundations are generally funded by an endowment from a single source, such as an individual, family, or corporation. A private foundation often relies on investment earnings as its source of ongoing support.

- **Board Composition**: The board is typically controlled (i.e., majority) by individual family members or representatives of the corporation that provides the funding.
- **Use of Funds**: Private foundations use their funds primarily to make grants to other charitable organizations.

__Note__: Learn more about IRS qualifications to be a public charity. __Sources:__ Investopedia; IRS.

Accounting: Leaders must understand three key financial statements and interpret the financial story they convey (1 of 2).

Statement	Key Components of the Statement	Key Line Items in Each Statement and Questions That They Answer
Statement of Activities To what extent does revenue exceed expenses?	**Revenue**: What the organization has earned for a service and/or what others have donated to fund the work.	• **Earned Income**: What was earned through fees for products and services? • **Grants from Individual Contributions and Foundations**: What was donated? • **Government Revenue**: What public revenue was earned from government contracts? • **Other Investment Income**: What dividends did the organization earn?
	Expenses: What was spent to support the mission (e.g., personnel or rent)?	• **Personnel**: How much money was spent on program and non-program personnel? • **Professional Fees**: How much was spent on consultants and/or contractors? • **Occupancy and Admin**: How much was paid for rent and other internal needs? • **Other Program Expenses**: Excluding program personnel, what was spent on program?
Statement of Financial Position What is owned by the organization and what is owed to other organizations?	**Assets**: What resources can the organization access to support the mission? What does it own?	• **Cash**: How much? How liquid? • **Receivables**: Are they slow to collect? Are they at risk? • **Investments**: How much? Are they restricted? • **Property, Plant, and Equipment (commonly referred to as PPE)**: How were maintenance issues dealt with?
	Liabilities: What the organization owes.	• **Payables**: How is cash flow managed (i.e., grants payable)? • **Deferred Revenue**: What products or services are outstanding to deliver? • **Line of Credit, Debt**: Is there a plan to pay back debt?
	Assets - Liabilities = Net Assets: What is owned after paying what is owed?	• **Net Assets Without Restrictions**: Is more owned than is owed? • **Reserves**: Are there any? If so, are they sustainable? Are there other designations? • **Net Assets With Restrictions**: Do they support the core program? What is the purpose and timing?

__Note__: Deferred revenue refers to advance payments a company receives for products or services that are to be delivered or performed in the future.
__Sources__: Adapted from Financial Management for Nonprofit Organizations (Zietlow, John; Hankin, Jo Ann; Seidner, Alan; O'Brien, Tim); Investopedia.

Accounting: Leaders must understand three key financial statements and interpret the financial story they convey (2 of 2).

Statement	Key Components of the Statement	Key Line Items in Each Statement and Questions That They Answer

Statement of Cash Flows
 	
How have cash and cash-like assets changed entering and leaving an organization from one year (or quarter) to the next?
	Cash Flows From Operating Activities: How much comes in from products and services?	• **Net Income** (noncash items, assets, and liabilities) + or - (revenue, expenses, and credit transactions).
		  • **Revenue**: receipts from sales of goods and services, interest payments.
		  • **Expenses**: salary and wage payments to employees, rent payments, program expenses, and other operating expenses.
		
		• ***Note****: Depreciation is not a cash expense.*

	Cash Flows From Investing Activities: How much comes out when the organization invests in assets?	• How was cash used to buy equipment and other assets? This could be reflected as purchases or sales of assets and loans made to vendors or received from customers.
	Cash Flows From Financing Activities: How much comes in or out with loans, debt, and dividends?	• Changes are "cash in" when capital is raised, such as sources of cash from banks and dividends earned on investments. • Changes are "cash out" when debt is repaid.

Note*: Deferred revenue refers to advance payments a company receives for products or services that are to be delivered or performed in the future.*
Sources*: Adapted from Financial Management for Nonprofit Organizations (Zietlow, John; Hankin, Jo Ann; Seidner, Alan; O'Brien, Tim); Investopedia.*

Risk Management: Use a risk action plan to prepare for potential risks.

Risk Action Plan: Illustrative Example

Risk Event	Outcome	Level of Risk	Likelihood of Event	Management Controls
School contracts and partnerships may be terminated due to the funding cliff.	Of total contracts, X% may be terminated.	Low Medium High	Best Case Moderate Case Worst Case	Set a clear criteria for consistent decision-making for risks.

Portfolio of Actions	Accountable Team Members	Key Thresholds for Risk Event
Reduce executive-level salaries. Draw 25% of organization reserves. Reduce staff salaries by 10%.	**Executive Director and the Board**: Decide which action to take. **Finance Team**: Monitor contract revenue. **Program Staff**: Communicate contracts that will not be renewed (trigger point).	Total projected organization revenue will reduce by X%. X number of contract terminations.

 Sources: *HBR; The Bridgespan Group.*

Risk Management: Sample Internal Controls

There are a range of internal controls to put in place.

1. Assessing potential risks aligned to the organization's objectives.
2. Setting strong control policies and procedures.
3. Training for staff and the board about controls.
4. Implementing systems (i.e., software) to monitor internal controls in practice.
5. Establishing processes (i.e., meetings) to monitor internal controls in practice.
6. Creating a risk management-minded culture in the organization.

Sample cash management procedures:

- ❏ Cash is always counted by two people.
- ❏ The person who cuts the checks does not sign the checks.
- ❏ The person who requisitions the purchase of goods or services does not approve the purchase.
- ❏ The person who receives goods does not purchase or process payments for them.
- ❏ The person who opens the mail does not make bank deposits.
- ❏ The person who processes payroll does not distribute checks.
- ❏ If there is not a back-office provider:
    - ❏ The person who cuts the checks does not reconcile the bank account(s).
    - ❏ The person who makes the bank deposits does not reconcile the bank account(s).

***Sources**: Adapted from BES; Financial Management for Nonprofit Organizations (Zietlow, John; Hankin, Jo Ann; Seidner, Alan; O'Brien, Tim).*

Metrics and Monitoring: Craft a financial story and ask for what the organization needs.

An illustrative, fictional financial story: Reflecting on past trends and asking for operating support.

Steps to Create a Financial Story	Metrics Used
Lead with a story about the organization's mission: *Since 2000, XYZ Organization has demonstrated improvements in classroom behavior and attendance. We have also successfully grown our mission in advocacy.*	Program outcome data
Explain what happened recently: *In March 2020, mandated COVID-19 closures interrupted programs, which resulted in a 50% loss in revenue.*	Revenue, current and historical
Explain the organization's response to recent events: *XYZ Organization quickly pivoted to remote operations and online program delivery. We asked funders for advance commitments and have changed the gala into a giving drive, which closed the revenue gap by 25%. We meet as a team weekly to review cash flow statements and projections.*	Revenue and expense analysis Cash flow projections
Describe the impact of this event on the organization's mission: *We deepened our connections to schools on the island and are having good conversations about future work. However, based on cash flow projections we anticipate a cash flow gap of $100,000 in November. Year-end giving should put us back on track in terms of managing cash flow by January.*	Cash flow projections
Ask the board, funders, or other stakeholders for key organizational needs: *Do you have any connections to local banks to help us apply for a temporary line of credit for $100,000? Would you consider increasing and/or expediting your year-end giving to October?*	N/A

Sources*: Adapted from Telling Your Financial Story, NFF.*

Metrics and Monitoring: Which metrics should be monitored for strong financial management?

Nonprofits should regularly assess their effectiveness in achieving their mission through financial reporting, which presents the current state of financial health and ideally also provides recommendations for future action. While the following ratios are standard and relatively easy to monitor, organization leaders should adapt this initial list of metrics to meet specific contexts and needs.

Indicators	Sources of Data	How It Is Calculated
Program Efficiency Ratio: How much of expenses are being spent on program.	Statement of Activities, Bank Statements	$\frac{\text{Total Program Expenses}}{\text{Total Expenses}}$
Fundraising Efficiency Ratio: How much one net dollar costs the entire organization.	Statement of Activities, Bank Statements	$\frac{\text{Total Fundraising Expenses}}{\text{(Total Dollars Raised - Total Fundraising Expenses)}}$
Savings Indicator Ratio: How effective an organization is at saving money.	Statement of Activities, Bank Statements	$\frac{\text{(Total Revenue - Total Expenses)}}{\text{Total Expenses}}$
Dependency Quotient: To what extent an organization is dependent on top donors to operate.	Statement of Activities, Internal Fundraising Reports	$\frac{\text{Sum of Contributions from the Five-Largest Donors or Funders}}{\text{Total Expenses}}$

***Sources**: Adapted from Financial Management for Nonprofit Organizations (Zietlow, John; Hankin, Jo Ann; Seidner, Alan; O'Brien, Tim); BoardSource; Jitasa Group.*

Metrics and Monitoring: Which metrics can an organization monitor to signal potential red flags?

Certain metrics can help alert leaders to a financial irregularity or potential concern (e.g., if the cash balance falls below a desired target or if operating expenses are tracking higher than budgeted for the fiscal year). The following metrics are a starting point for many nonprofits, and can be adapted to a specific organization's context.

Line Item	Red Flags
Cash	Low or negative balance.
Accounts Receivable	Remains constant throughout the year and does not decrease.
Accounts Payable	Remains constant or steadily increases.
Payroll Liabilities	Payroll taxes and/or retirement balances are constant or steadily increasing.
Current and Long-Term Debt	Borrowed amount is excessively high.
Fund Balance	Declining (unless special project) or negative balance.
Operating Expenses	Higher than budget.

 Sources: *Adapted from Financial Management for Nonprofit Organizations (Zietlow, John; Hankin, Jo Ann; Seidner, Alan; O'Brien, Tim) and BES.*

Methodology

Research
The Bellwether team conducted desk research to build a fact base of recommendations for education nonprofits and the nonprofit sector.

Interview
The Bellwether team conducted 17 interviews with leaders of education nonprofits, including board members and executives who represent diverse experiences in terms of organization type, size, maturity, and geographic focus. The interviews also included finance and operations team leaders.

Review
The funder and subject matter experts gave the team feedback to refine and improve the content. The Bellwether team also tested some of this content with interviewees to gauge potential usability.

Disclaimer

The information provided in this guide should not be used as a substitute for consultation with professional accounting, tax, legal, or financial advisers, as appropriate. Bellwether is not a financial advising firm and has no plans to build this capacity.

This is designed as a guide to financial management; Bellwether is not liable or responsible for the outcomes of decisions taken as a result of the information provided in the guide, and for any claims that may arise thereof. Bellwether is not a legal services organization, and we do not provide legal advice under any circumstances. The receipt of this guide and our recommendations should NOT be construed as creating an attorney-client relationship or as advice from an attorney or legal representative, and there should be no presumption of any special legal privilege.

About the Authors

REBECCA GIFFORD GOLDBERG

Rebecca Gifford Goldberg is a senior partner at Bellwether and leads the Strategic Advising practice area. She can be reached at **rebecca@bellwether.org**.

CARRIE C. IRVIN

Carrie C. Irvin is a senior adviser at Bellwether in the Strategic Advising practice area. She can be reached at **carrie.irvin@bellwether.org**.

LIZ McNAMEE

Liz McNamee is an associate partner at Bellwether in the Strategic Advising practice area. She can be reached at **liz.mcnamee@bellwether.org**.

SHRUTI NAGARAJAN

Shruti Nagarajan is a consultant at Bellwether in the Strategic Advising practice area. She can be reached at **shruti.nagarajan@bellwether.org**.

ANDREW J. ROTHERHAM

Andrew J. Rotherham is a co-founder and partner at Bellwether in the Policy and Evaluation practice area and External Relations team. He can be reached at **andy@bellwether.org**.

About Bellwether

Bellwether is a national nonprofit that exists to transform education to ensure systemically marginalized young people achieve outcomes that lead to fulfilling lives and flourishing communities. Founded in 2010, we work hand in hand with education leaders and organizations to accelerate their impact, inform and influence policy and program design, and share what we learn along the way. For more, visit **bellwether.org**.

About City Fund

City Fund partners with cities to build innovative public school systems because we believe that quality education can help move children out of poverty and into thriving adult lives. This is possible when all families have fair access to quality schools, when educators have the flexibility to meet the diverse needs of their students, when education leaders reflect the communities they serve, and when those most impacted by the system have the power to change it. We're inspired by the growing number of cities that have empowered educators to dramatically expand opportunities for students in public schools. For more, visit **city-fund.org**.

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