

Lack of Financial Control

by

Norman E. Wallis, Ph.D.

President, PAI Management Corporation

Bethesda, Maryland, USA

(from *A&A: Assembly and Association, 1989*)

Many board members of small associations are totally ignorant of the financial status of their organizations. Conscientious and capable leaders who know their own net worth, or their own salary to the penny, are often oblivious of the need to have the same detailed understanding of their association's finances. Board members have a responsibility to the member of the association to assure its financial health. The following tell-tale signs are those of a board that has no control over the association's finances.

No annual budget

The most critical element in assuring financial control is to adopt an annual operating budget. Far too many small- and medium-sized associations operate in the financial dark. The consequence of this is that decisions to undertake projects are made without concern for any financial structure. Even the most rudimentary budget, based on estimates of income and expenses, is essential before any decisions for the future of the organization should be contemplated. The budgeting process need not be complex, and can be based on historical information and intelligent estimates. A budget is a guide and a financial plan. When adopted *before* the beginning of the next fiscal year, it becomes the benchmark against which quarterly financial reports to the board should be compared.

The question that must be asked about any proposed new project is: "Can this be carried out within the limits of the adopted budget?" If the answer is No, then the board is forced to find the resources elsewhere (from reserves or by a loan) or to delay implementation. This self-imposed discipline is critical for the future development of small associations that have little, if any, reserve funds.

No regular financial report

Quarterly financial statements are essential for any organization, whatever its size. Financial statements must include a balance sheet (a statement of assets, liabilities and fund balances) and an income statement (or operating statement). When presented quarterly, a balance sheet provides the governing board a snapshot of the financial condition of the organization every three months. It shows how much money is in the bank and any other assets the organization may have in the way of equipment or prepaid expenses.

On the other side of the equation, the size of the organization's liabilities, such as bills due and payable, provides an understanding of what the association owes. The difference between the assets and the liabilities is equivalent to the personal worth of an individual, and is referred to in not-for-profit organizations as a fund balance. In a for-profit organization this represents the value of the organization, however this is true also of not-for-profit organizations. Without

accurate quarterly statements there is no way that leaders can determine the financial health of their organizations.

The income statement, or operating statement, is essential for *tracking* the actual income and expenses against the estimates that were used in developing the annual budget. On a quarterly basis, this information provides early warning signals if certain income items are not meeting their expectations (such as fees or subscriptions) or if certain expense categories are exceeding the original projections (such as printing). This scheduled reporting to the board by management (even if management is by an elected ‘managing director’), provides one element of control to assure future financial stability.

No annual audit

Another important element of control, which many times is waived by the small organization as an ‘unnecessary expense’, is an outside annual audit. This need not be expensive, and a CPA (or chartered accountant) might donate this service to a small charitable organization. However if is conducted, an external financial review by an *impartial* and *uninvolved* (i.e., *not* a member of the board) competent third party, will ensure that the governing board receives accurate financial information about the association on an annual basis. This also provides another mechanism to annually evaluate the competence of staff. Incompetent staff can create financial mayhem, and an inattentive board is equally guilty if it does not recognize the problem before long-term financial damage occurs.

Insisting on signing the checks

Inexperienced board members often believe that they have control over the financial affairs of their association by requiring that one or two officers sign every check. Nothing could be further from the truth. Financial control comes from reviewing regular financial reports, which when understood by board members will provide far more information on the financial health of the organization than requiring that every check be signed by a member of the board. Financial control of an organization comes from demanding accurate financial reports from management so that the governing board can make appropriate decisions.

Deliberately avoiding a surplus

Some leaders of not-for-profit (non-commercial) organizations believe that their organizations should not end the year with a surplus of income over expenses. After all, they reason, the organization is ‘non-profit’. In spite of its corporate tax status, a non-profit, or non-commercial, organization must be run even more prudently in terms of its financial reserves than any for-profit company. A good rule of thumb is to aim at developing a reserve fund equal to at least one year’s annual operating budget. To achieve this, it is useful to add a ‘reserve’ expense line to the budget, so that this goal is not overlooked. While not a true expense in pure accounting terms, such a board action will force the small to medium size association to build a reserve fund for future expansion or for unanticipated financial contingencies.

Even for non-commercial organizations, surplus is not a dirty word! In fact, a healthy reserve fund will assure the future of the organization, and the members will applaud the prudent financial leadership of the board.

Summary

1. Whatever the size of the organization, and whatever the amount of money involved, an annual operating budget is a critical element if a board is to control its association's finances.
2. Quarterly financial statements (balance sheet and an income or operating statement) allow a board to assess the financial health of its association and staff competence.
3. An annual audit by an independent third party is essential, whatever the size of the association, if board members are to exercise their responsibilities to the association's members.
4. It is perfectly appropriate, and even desirable, for a non-profit (not-for-profit or non-commercial) organization, such as an association, to end the year with a surplus of income over expenses. In fact good financial stewardship calls for the planned development of a reserve fund equal to one year's budgeted expenses.

An organization that does not have control of its finances can be as close to bankruptcy as any for-profit company which ignores the 'bottom line'. Financial control is based on information. Without it, a governing board operates in the dark!