Wolf, Keens & Co

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How does your organization help your trustees exercise their fiduciary responsibilities? How do you handle the presentation of financial data to the Board, to funders, and to the public? We're interested in hearing from you on this topic. Send an e-mail to info@wolfkeens.com or fax a response to 617.679.9700. We'll post your comments on the web for you in the Publications section of our web site, located at www.wolfkeens.com.

Working Paper

Making Sense of the Numbers

Communicating Financial Information Effectively

Jane Culbert

Senior Consultant, Wolf, Keens & Company

Ask a trustee of a nonprofit corporation to explain the organization's financial statements and you may be surprised. Many would have great difficulty. And you can hardly blame them. Since new standards affecting financial reporting for nonprofits were introduced by the Financial Accounting Standards Board (FASB) in 1993 (implemented beginning in 1995), trustees have struggled with confusing and counterintuitive balance sheets and income statements.

This was not always the case. Before these new standards were imposed, most reasonably intelligent people could exercise their fiduciary responsibilities, assessing the financial health and activity of their organizations. But today, at a time when national attention has been focused on the need for greater Board oversight, many nonprofit trustees must take on faith what financial specialists tell them. And while there has been much hand wringing about "cooking the books," the real problem in most cases is making sense out of what are accurate financial statements.

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Consider the current requirement that a contribution must be recognized as current income — even if it is in support of operations or programs that are to take place at some time in the future. If an organization receives a grant this year for a program happening next year, all of the revenue must be booked immediately. The books overstate this year's revenue since this is really deferred revenue (under old standards) and some trustees may become overly optimistic. In the next year, exactly the opposite takes place and there is no revenue reflected to offset expenses. How many staff people have had to explain to a confused trustee that their organizations are not losing money and that several categories of revenue were actually booked in previous years?

Or consider the fact that a capital campaign pledge must be recognized as cash in the year it is made even if that cash will not materialize for several years if at all. Imagine an organization that receives a million dollar pledge from a donor and then cannot collect on it. The hapless trustee who thought the million dollars that he saw on the financial statements was real money rather than a broken promise can make many bad decisions on behalf of his organization with such information.

These examples are but the tip of a very large iceberg that is undermining trustees' abilities to fulfill their legal oversight function. So what to do? At Wolf, Keens & Company, we focus on how things are really working in organizations. We've seen all of the following options in action:

- Present the official statements with a full explanation from the Treasurer of what they mean. However, in the press of a Board meeting, there may be little patience with a comprehensive journey through complicated numbers.
- Present the full statements with extensive explanatory notes. However, the statements may become so complex the layman may find them indecipherable.
- Ignore the accounting rules until the year-end audit and offer statements during the year that present the simplest, most comprehensible version of what is going on. But be prepared for the trustee who is reasonably upset when the audit presents a very different version of the facts.
- Or offer two sets of financial reports — one meeting accounting standards and the other that translates these statements for the Board. But beware of the anxiety of trustees when the differences are significant.

There are in fact many things an organization can do and each has its pitfalls. In the end, the effort should be to present accurate and understandable information and help trustees do their jobs. We have assembled comments from three different perspectives — a funder, a Board member, and a staff member. Let us know how you are dealing with these same issues.

[1]FASB Statements 116 and 117.

Nancy Lewis
Assistant Dean and Executive Officer
School of Music, Boston University

Training Board members to be informed readers of financial statements must be a priority in nonprofit organizations today. New accounting standards developed by FASB make this a necessity. If the staff is not equipped to do the training, an organization's auditing firm can often help. But it is management's responsibility to focus trustees' attention on this important need. Trustees have a fiduciary oversight responsibility.

As a Chief Financial Officer in the nonprofit field for sixteen years, I have seen the before and after of the new accounting standards. As Jane Culbert suggests, prior to FASB 116/117, statements were much more reflective of actual operations and were more readily understood by the uninformed reader. After FASB, my financial team would struggle to present internal monthly statements in such a way that they were comprehensible to trustees. Our strategy was to focus the Board on understanding the activity in the "unrestricted fund" (or current unrestricted operations). The reasoning was that if we managed our current operations profitably, the rest of the organization's finances would take care of themselves, assuming solid management of the endowment.

But there were problems. In one year, more was taken out of the so-called "temporarily restricted fund" than was brought in. This was entirely appropriate given the nature and timing of the restrictions. But at year-end, the Board was surprised to find that the company had "lost money" (their words) for the year. The deficit had deepened because overall there was less money than before. The Board cried "Why is our deficit worse than we expected?" The answer was that they hadn't been replenishing the organization's funding for future years.

The answer to this conundrum is a fund-raising challenge, not an accounting one. Nonprofit organizations must seek to establish an annual giving campaign that is largely self-renewing. Once the goal of a strong annual fund is accomplished, the energies of the Board should focus on raising money for future years and should replenish those restricted funds that have been utilized for current operations.

Richard Flynn

CPA, Treasurer
Wellspring House, Inc.

Financial statement presentation has always been an issue in both the nonprofit and for-profit accounting worlds. As the accounting profession has tried to standardize financial statement reporting, they have lumped large and small organizations into one set of standards. This has brought commonality to published statements, but it has often not provided trustees with the information they need to make informed decisions. Trustees bring varied backgrounds and skills to their jobs and fiduciary responsibility is just one part of a trustee's work. Making the presentation of financial information simpler for most of them is essential.

Internally generated financial statements should always help trustees make informed decisions and set effective policy. One strategy is to provide internally generated reports based on the actual cash activity for the year. This statement can then be compared to the budget, allowing trustees and staff to see how fund-raising activities, earned income, and expenses are proceeding against the budget plan. This is especially important for trustees since one of their primary responsibilities is fund-raising. Knowing what was projected for the year and what has been raised is critical if they are to perform this duty effectively. Reports of actual cash activity also give trustees a picture of current operations so they can decide if short-term adjustments need to be made.

When the required external financial statements are prepared and presented to the trustees, they should be linked as much as possible to the internally prepared statements described above. A minimum breakout should give the reader a good accounting of present operations (the Unrestricted Fund). But it will also offer trustees a more complete picture of both the near future (Temporarily Restricted Fund) and long-term (Permanently Restricted Fund) fiscal strength or weakness of the organization.

Michael Marsicano

President and CEO
Foundation For The Carolinas

How does the staff of a nonprofit organization communicate complex financial statements, practices, and accounting regulations to a Board? As Jane Culbert's piece correctly attests, many Board members do not have the background required to review such reports and yet are responsible for policies and decisions influenced by them.

The answer lies in the partnership that is established between a nonprofit CEO and Board Chair — a partnership of reciprocity, a covenant between volunteer and professional leader. With less specificity, the same covenant must be established between the CEO and each Board member. Central to that covenant is the CEO role as gatekeeper of information.

In the case of financial statements, it is the responsibility of the CEO (or his or her representative) to translate the reporting into a language that leaves no Board member behind. Effective presentations of financial information may well be very different than the reports required by FASB. The intent is to maximize understanding and minimize the counter-intuitive language of the accounting profession.

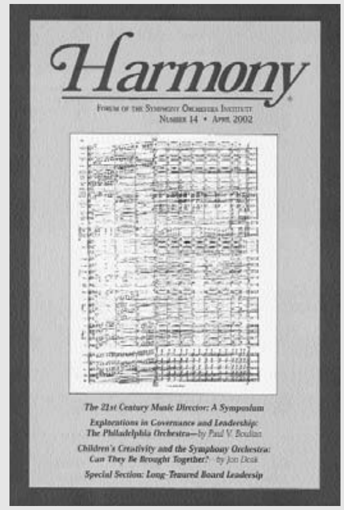
Can the Board trust that the translated financial presentations are accurate? Having an experienced finance person on the Board (such as a certified public accountant) can support the CEO's gatekeeper role when he or she presents seemingly unconventional translations of financial information to the Board.

Trust in the gatekeeper is also important to foundations. Quality information and good communication not only serve the Board well, it raises money for the cause. Of course, we require those cumbersome financial reports; but "layman" translations, when appropriate, frequently win the award.

Wolf, Keens & Company in *Harmony*

Curious about those charismatic "maestros" who conduct our symphony orchestras? Are they hold-overs from the 19th century or are they models for 21st century leadership?

Wolf, Keens & Company facilitated and documented a symposium held at Tanglewood to consider these questions. Sponsored by the Boston Symphony Orchestra, along with the Hewlett, Knight, Mellon, and Packard Foundations, the focus was on the role of music directors in the 21st century. Nearly thirty individuals – including music directors, musicians, orchestra administrators, managers, trustees, and funders – attended the two-day meeting. The proceedings of the symposium appear in the most recent issue of *Harmony*, Forum of the Symphony Orchestra Institute. Included in the report are comments on the four areas of change the symposium participants highlighted as critical to the success of 21st century music directorships.



The "21st Century Music Director" report is available for download from the Publications section of www.wolfkeens.com.