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AMS ACCOUNTING MANAGEMENT SOLUTIONS, INC.

Nonprofit Operations

Aligning resources to take your nonprofit to the next level

About *Nonprofit Operations*

Nonprofit organizations exist to serve a wide variety of missions, whether cultural, community based, human services, environmental and more.

These are challenging times for nonprofit organizations. Sustained largely by state or federal funds, external grants and private donations, many nonprofits operate on limited budgets, yet still need to make a substantial impact in their targeted field.

While the mission and goals of nonprofits vary greatly, all nonprofit organizations need to align their operations with their mission in order to make the most progress toward achieving their goals. A limited budget means that nonprofits need to be even smarter about how they structure their internal operations to make efficient use of the available resources: from information technology to budgeting, finance and accounting systems to benefits.

The AMS Nonprofit Operations e-book assembles a collection of articles from an esteemed group of nonprofits authorities and provides nonprofit teams with expert insight and information.

Content

Keeping Your Nonprofit Organization Financially Fit

"It is a good idea for nonprofits to assess their own internal operations at least ***every three years****."*

To stay lean and run effectively, many nonprofit organizations develop their own unique approach to accounting and financial management over time. Unfortunately, as this occurs, they tend to stray from industry best practices that would ordinarily help them stay focused and on track. There are a number of common issues that arise and specific warning signs that can signal trouble ahead.

Typically, a change in senior personnel or adopting a new software system prompts nonprofits to take a closer look at their accounting and finance operation. However, even without a major organizational change, it is a good idea for nonprofits to assess their own internal operations at least every three years. Technology, accounting best practices and government regulations are constantly evolving, and performing an internal assessment can help nonprofits stay financially fit.

Warning Signs a Nonprofit is Overdue for an Assessment

- Senior leadership, including the Executive Director and board members, have a difficult time getting an accurate picture of an organization's financial status
- Senior leadership is not receiving an organization's financial reports in a timely fashion
- Analysis and reporting happens only on request and is not part of the organization's typical operations
- An increasing amount of work is done outside the designated financial systems
- Unexplained fluctuations in an organization's monthly and quarterly numbers

Common Issues Many Nonprofits Encounter

While every nonprofit organization has a unique financial structure of its own, there are common issues that many nonprofits face. First, many nonprofit organization lack documented policies and procedures, which include monthly, quarterly and annual check lists. Most nonprofits do have processes that they follow, but documenting and standardizing these across the organization should be a key area of focus.

Many nonprofits also have insufficient infrastructure to support regular production of budgets, financial statements, cash flow reports and financial projections. Nonprofits have a limited amount of resources in terms of time as well as capital. Many nonprofits do not invest in their internal operating infrastructure, which means they don't have easily accessible information to create accurate budgets, financial statements and financial projections.

In addition, nonprofit organizations also struggle to train their staff, specifically when it comes to complex accounting rules such as revenue recognition. The accounting and finance team is usually rather lean at small nonprofits, so while some organizations may have an employee with a technical accounting background, many organization do not have this subject matter expert on staff.

Lastly, the fourth most common issue that nonprofits run into is a lack of internal controls, including incomplete or inadequate account reconciliations. Strong internal controls are built off a solid financial infrastructure. Not having robust internal operations makes it difficult for many nonprofits to set a tone at the top with regard to having strong internal controls.

Now what?

Many nonprofits will recognize these issues as ones they are dealing with themselves. Often, they do have the internal resources necessary to bring their accounting and finance operations in line with current best practices, but lack either direction, tools or specific training. With coaching or training, these gaps can be resolved.

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Health Care, It's More Than Just Benefits

It's that time of year again. You are scrambling to figure out how you can endure or reduce the cost of this year's health care renewal. If you're working with an insured plan, you're probably thinking that you need to negotiate with the vendor or take the business out to bid. If you're dealing with a self-insured plan, you're probably analyzing vendor discounts or trying to negotiate lower administrative fees. In either case, you may be looking at reducing the plan's value or decreasing the amount that employees are responsible for at the point of service. Five to ten years ago, you would have most likely increased the employee contribution share, but times are changing and the approach that employers take with respect to their health care benefits needs to change as well.

"In order to take full advantage of your health care budget, employers should determine if ***the direction aligns with the goals and culture*** *of the organization."*

It is important that employers, especially nonprofits, treat their benefit package as more than *"just something we had to offer"* or as something that you "*deal with"* once a year. In order to effectively manage and take full advantage of your health care budget, employers should take a long-term view of health care and determine if the direction aligns with the goals and culture of the organization.

Nonprofits often have to deal with underfunded programs, reduced staffs and labor shortages, which unresolved, eventually lead to wage freezes and high turnover. Conversely, some employees who work for nonprofits feel that although their salary may not be exceptional, they at least have great benefits. Nonprofits, just like for-profits, are under pressure to reduce benefits in order to keep other programs running.

According to the Mercer 2011 National Survey of Employer-Sponsored Health Plans, the average total health benefit cost per employee increased by 6.1% in 2011, with a 5.7% increase anticipated for 2012. This anticipated increase would be the lowest since 2009 and is in stark contrast to the 20 year high of 14.7% in 2002[1]. Why are we seeing lower trend rates?

There are many different factors that affect lower health care increases. The addition of Consumer Driver Heath Plans (CDHP), increased cost pressure on providers to reduce or limit rate increases, the increased importance placed on disease management and a strengthened economy all help to lessen the increase, but the biggest reason for a less severe increase is employers' willingness to develop a long term strategy around health care.

The health care marketplace is changing rapidly as employers try to understand what their potential liabilities will be, including health care reform, cost increases, and provider contracting, as well as what their potential funding gap will be three to five years from now. Employers cannot afford to sit idly by and hope that trends will decrease on their own. The best employers are being proactive by looking for ways to impact trends while also discovering ways to use benefits to attract, retain and engage employees.

Although this line of thinking is prevalent in the for-profit marketplace, it is now becoming more common among nonprofits. Nonprofits must take the same approach to making health care decisions as for-profits in managing costs and retaining key talent. These areas are critical to any organization.

Plan Design: Which design is right?
When developing and planning your health care strategy, you need to identify the organization's financial and operational goals. Next, you will need to determine the key source of your costs, including inappropriate utilization of care, provider utilization, high cost claims, and unhealthy populations. Once you have defined goals and identified cost drivers, there are many levers beyond the traditional -- copayments, coinsurance, and disease management -- that you can pull to influence plan members' decision making.

In addition to the traditional levers, many employers are moving toward Consumer-Directed Health Plans (CDHP) with Health Reimbursement Accounts (HRA) or Health Savings Accounts (HSA), as well as tying wellness incentives to these plans. According to a recent Mercer Study[1], 20% of employers surveyed offer a CDHP in 2011, up from 15% of employers in 2009. CDHPs have also been shown to trend at lower rates, especially in the first year (16% lower compared to traditional PPO plans[2)]. As these plans become more prevalent, employers are beginning to realize that in addition to trending at lower rates, they also align well with their wellness initiative or retiree strategy.

Providing incentives through an HSA to support wellness initiatives is an effective way to tie your health benefits to your organization's health care program. In addition, as more and more employers distance themselves from employer provided retiree coverage, they find that CDHPs, especially when paired with an HSA, provide a funding vehicle to access only plans through individual exchanges.

Another purpose of CDHPs is to incent members to spend their dollars wisely and avoid unnecessary utilization of certain services, such as emergency rooms, specialists, hi-tech imaging or brand drugs. Reducing or eliminating unnecessary services is a key component to lower medical trend, but without cost and quality transparency, members are finding it difficult to know where to spend their dollars.
In response for this need for greater transparency, tiered-network plans were introduced to the marketplace. Tiered-network plans typically place providers and hospitals in three tiers, based on how they compare in cost and quality metrics. Tiered-network plans incent members to use lower cost, high quality providers through minimal to low co-pays. Members are discouraged from utilizing higher cost or lower quality providers with high deductibles or copayments. The goal of these plans is to provide members choice as well as place pressure on providers to lower the cost of services or improve quality.

Tiered-network plans are still fairly new and results on how well they are performing are still not definitive, but early results from Blue Cross Blue Shield of Massachusetts indicate lower trend rates for 2012. Outside of Massachusetts, tiered-network plans are not as prevalent, yet increased success could spur similar networks to spring up in various states.

*“**Communication and education** are critical to the success of any health care strategy, especially when asking employees to take **a greater responsibility** in making health care decisions.”*

Communication and Education

Prior to implementing a new design or strategy, the organization will need to determine how each aspect of a new healthcare strategy will impact their own organization from a budgetary and employee perspective. From a budgetary point of view, organizations should review each strategy, determine potential costs for the next five years, and analyze how that particular strategy would reduce or eliminate the organization’s funding gap. This is especially important for nonprofits, as every current dollar counts toward the ability to maintain programs and every future dollar saved allows programs to expand.

Just as important as developing a long-term budget strategy, employers need to incorporate a communication and education campaign for the employees. Communication and education are critical to the success of any health care strategy, especially when asking employees to take a greater responsibility in making health care decisions. Determining how to support employees through change will allow you to have greater success in employee understanding and overall buy-in.

In summary, developing a long-term strategy that aligns with the organization’s goals and culture is critical for nonprofits. A fully developed strategy will allow your organization to better anticipate costs, navigate future liabilities and grow in the future.

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1: Mercer’s National Survey of Employer-Sponsored Health Plans 2011
2: CIGNA Choice Fund® Experience Study: February 2012

When to Upgrade to a New Accounting System

When first starting out, most organizations begin with relatively basic accounting software, with many nonprofits specifically choosing QuickBooks. As your nonprofit grows and expands, it may face a number of challenges as you hit the limits of accounting functionality inherent in particular accounting packages.

Some software is simply not designed to provide specific financial management capabilities. For example, some growing organizations may require increased visibility into financial and operational performance, such as automating key processes. Others may not provide universal access, support multiple locations and integrate with other critical applications.

So, as a nonprofit organization, how do you know when it is the right time to upgrade to more robust accounting software? Which software options should you consider, and furthermore, how do you know if a new system is worth the investment? Overall, you need to understand the hidden costs of your current system and be able to identify the need for additional productivity before you can make the decision about whether or not to upgrade.

The Hidden Cost of Your Current System

Growing organizations that continue to use basic accounting software may find that they are spending an increasing amount of time doing work outside of their accounting system. This scenario impacts organizations whose operational requirements outpace what their system can manage. For example, organizations with sophisticated accounting requirements, such as grant tracking and purchase order tracking, often find the need to develop "work-arounds" because their system, including Microsoft Excel, a legacy software product, or both, doesn't provide built-in capabilities for these complex processes. Work-arounds can lead to duplicate entry errors or reports based on incorrect or stale data, and fixing these errors consumes additional time and resources.

*"With a limited amount of employee bandwidth, organizations need to employ efficient processes to **maximize employee output.**"*

These inefficiencies and work-arounds impair day-to-day business operations, yet over time often become part of the overall process. Using an antiquated system does not immediate impact an organization's cash outlay, so it often seems as if doing nothing is the most cost-effective option. However, organizations can incur a broad range of hidden costs, the largest of which is employee time. Nonprofit organizations are typically very lean, functioning with limited staff members, many of whom wear many different hats. With a limited amount of employee bandwidth, organizations need to employ efficient processes to maximize employee output.

Identifying a Need for Increased Productivity

*"To properly plan and forecast, **organizations need to budget** for technology changes."*

While it is clear that work-arounds can slow down an organization's operations, some basic accounting software is perfectly adequate for certain organizations. There are nonprofits that have and will only ever need to use QuickBooks, for example. However, basic accounting software and legacy software systems are not designed for growing organizations that need additional functionality to manage sophisticated processes. To properly plan and forecast, organizations need to budget for technology changes. For example, growing organizations should not be limited to manual reporting, using Microsoft Excel. Microsoft Excel and legacy software limitations drive the need for most organizations to eventually graduate to a more robust system. Organizations want flexible reporting with built-in multidimensional architecture that delivers accurate and timely reports with relevant insights into data.

Is it time to upgrade?

Leading applications enable organizations to easily assemble systems that provide them with the flexibility and information they need. When considering an upgrade, many organizations conclude that it is smarter to keep their current system. However, some systems can be extremely cost effective as the time they save an organization is well worth the monetary cost.

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Top Tips for Nonprofit Budgeting

Creating an annual budget is a necessary step for any organization but is especially important for nonprofits that often require even tighter fiscal controls than their for-profit counterparts. Having a thoroughly developed budgeting process not only leads to the creation of a comprehensive budget, but also makes the budget creation process itself less onerous. While our consultants suggest you kick off your budgeting process at least four months before the start of a new fiscal year, we know many organizations are either still struggling or may have just started the process *after* the beginning of the fiscal year. With them in mind, we have pulled together a few practical tips applicable to any nonprofit organization.

Know your Goals and Objectives

Planning and goal setting must be completed before the budgeting process can begin in earnest. A lack of proper planning and goal setting leads to a poorly scoped and defined budget. If people do not know their goals for the upcoming fiscal year, they may not know how to start budgeting or may repeat current modes of operation. In addition, they may miss substantial changes, either budgeting too little or too much, which causes frustration, missed budgets and could require a lot of rework.

"Getting upper management support is a crucial step in the budgeting process. If upper management does not give their support, no one else will."

Get Upper Management Support

Getting upper management support is a crucial step in the budgeting process. If upper management does not give their support, no one else will. Upper management is responsible for several tasks. They need to lead approval of organizational goals and operations plan. They also need to be involved as leaders in the budgeting process. They need to support the process by managing their staff to set timelines to ensure product completeness and accuracy. Lastly, they need to approve all budgets prepared by those that they supervise.

De-centralize the Budgeting Process

While getting upper management support is important, every manager who is responsible for a budget should be involved in the budgeting process. Understanding the rationale for their budget enables them to “own” it and act as stewards of their department’s expenses. The finance department can help coordinate the budgeting process but should not be putting together program budgets. Ultimately, they are not the individuals responsible for the budget.

Involve Staff at Other Levels

Dispersing responsibility throughout the organization helps the process overall. Individuals that aren’t upper management and don’t have direct control over a department’s budget should still be involved in the budgeting process. Getting their buy-in and delegating projects for them to plan for and budget is important, as the more they are involved, the more they can work to help the organization succeed.

Example: The Event Planner reports to the Director of Fundraising, and while the Director of Fundraising is the manager involved in the budget process, the Event Planner also needs to be part of the budget process.
Example: A Day Care Center has 4 breakfasts a year for the mothers of the toddler group; the Assistant Toddler teachers are in charge of this; getting them involved in the budgeting discussion is important.

> *"Gathering a team to teach them how the budgeting process works can **empower them** to take on a larger role."*

Create Strong Tools & Training
Budget training and tools are essential parts of creating a budget. Gathering a team to teach them how the budgeting process works can empower them to take on a larger role. A budget toolkit is created by the finance team, starting with key assumptions and likely trends that affect the business environment during the budget's timeframe. A comprehensive toolkit should include the following:

- Written instructions and timelines with dates/deliverables
- Budget template (fill in the blanks) – managers fill in blanks and the template automatically calculates and assigns overhead
- Historical info (ops and projects) and year-to-date Info
- Some research (for new programs or events, get estimates and provide narratives)
- Include any projects/costs that received restricted funds or grants

Create a Budget Template
An example budget template in Excel should:

- Include an instruction page
- Have a color coded "fill in the blank" format
- Have some information already pre-filled
- Link to worksheets, which import into the accounting system
- Format Budget and General Ledger accounts so they can easy be reported for Uniform Financial Statements (UFR) and audit

Work Closely With Revenue-Generating Staff
Regardless of whether an organization is grants-based or a membership organization, working closely with revenue generating staff is important. The budget team within a grants-based organization works with the development office, and in a membership organization, with their finance department. Potential revenue sources should be

weighted based on the likelihood of actually receiving funds. The goal is to have all the staff review the source of all funds.

Budget Capital Expenditures

Capital expenditures should be budgeted for even if they do not show up on the income statement. Capital expenditures will increase budgeted depreciation expense and increase overall expenses, which thereby increases the need for operating revenue. This will also increase cash flow/cash outlays. Budgeting for a surplus ensures that an organization can sustain itself during an unexpected downturn or difficult period.

Budget Temporary and Permanently Restricted Revenue

Temporary and permanently restricted revenue should be budgeted for, even if they do not show up on the income statement. Temporary and permanently restricted revenue will affect the final organization surplus/deficit results, and provide revenue goals and results for fundraising for future years.

Manage Your Operating Budget and Your Audited Financial Statements

Don't forget to budget for non-cash expenses, such as depreciation expenses, vacation expenses, deferred salary or benefits. Vacation accruals can turn a $10,000 surplus in an operating budget into a deficit – don't be surprised at year end. Understand the difference between the cash basis and accrual basis of accounting and communicate this to management.

"The budget process is not a once-a-year activity. Management should be meeting with the managers ***once-a-month.***"

Make Budgeting an Ongoing Activity

The budget process is not a once-a-year activity. Management should be meeting with the managers once-a-month to review the actual vs. budgeted performance and plan for the rest of the year. Some organizations even re-budget mid-year if there are substantial operational changes.

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Leveraging Technology to Manage Human Capital

Many nonprofits nowadays are faced with the challenge of less funding, lack of available grants and decreased local government support due to the economic downturn. At the same time that these organizations are feeling the economic squeeze, their services are in even higher demand because of the downturn. The pressure from both sides leaves many nonprofits struggling to control and reduce internal costs. In response, some nonprofit organizations have reduced employee headcount, which not only increases the workload for remaining employees but makes it more difficult for the organization to maintain consistent internal processes and have access to critical information.

Nonprofits have also responded to these pressures by investing in new or innovative technology services that automate internal processes. One area that has seen rapid transformation is human resources (HR), as implementing cloud-based HR technology is quickly becoming an industry best practice. In the past, dynamic HR technologies were only affordable to the largest organizations with the deepest of pockets. Prior to the adoption of cloud-based technology, organizations would purchase software and house it internally on their own servers. Not only was the organization responsible for software updates, upgrades and support, research has shown that in many cases, as little as 35% of the capability of software applications was typically utilized.

*"**Cloud-based HR technology** allows an organization to enable fewer people to do more mission critical work and automate internal processes, which typically results in **more efficient operations**."*

Cloud-based technology now enables an organization to use the same software, but since the technology operates on a subscription basis, the associated costs are significantly lower, making it a viable resource for many mid-market nonprofit organizations. The software is constantly upgraded as new releases become available and the systems are maintained by the service provider, which takes the burden off of the organization. Information is also available to users anywhere in the world.

Cloud-based HR technology makes it easier to track and manage employee related expenses that would be difficult to manage with typical software. Nonprofit leaders still need empirical data to run an organization and control costs. Cloud-based HR technology allows an organization to enable fewer people to do more mission critical work and automate internal processes, which typically results in more efficient operations. For example, reporting software can be set to automatically run and distribute reports, such as employee headcount, workers compensation expense and tax liability. By being automated, a system can replace the work normally done by several individuals, which allows an organization's staff to direct their attention elsewhere and focus on larger projects. By being able to track, manage, control and report on human capital, the cost savings of the new system over time usually pays for the cost of the implementation.

Case Study:
Below are the top areas for poorly tracked employee related expenses for nonprofit organizations. All of these costs can be managed using cloud-based HR technology.

Specific Expense	Average Annual Cost (Based on a 50-person company)
Paid Time Off	$18,269
Lost/Unaccounted Property	$6,500
Leave of Absence	$5,000
Time and Labor	$7,000
Government Audits	$14,000
Not Removing an Employee from COBRA	$700-$3500
Pension Integration and Carrier Feeds	$25,000

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A 5-Step Operations Assessment

"Routinely focusing some attention ***assessing an organization's fiscal health*** *can go a long way in helping the organization* ***achieve their goals*** *for the year."*

While almost all nonprofit organizations can benefit from a routine review of their internal operations, very few take the time to perform even a simple operations assessment. For the organizations that do conduct a quick operations review, they typically set time at the end of the calendar year, as this is generally the midpoint of a nonprofit's fiscal year. Routinely focusing some attention assessing an organization's fiscal health can go a long way in helping the organization achieve their goals for the year. Overall, there are five questions that managers and board members need to answer to assess key areas of fiscal health.

Is revenue tracking close to expectations?
Halfway through an organization's fiscal year, revenue is probably fairly stable and predictable. For example, higher education institutions can reasonably predict tuition and fee revenue for the year once second semester registration is complete. The variables then become how investment performance and fundraising will affect operating results. Annual events may generate revenue on a different cycle than the fiscal year, so organizations need to ensure that these timing differences have been incorporated into the plan and progress for the event revenue is being tracked to the budget. Carefully reviewing grant revenue to contract balance is another good step to take.

Are expenses in line with budget?
Many organizations find that payroll and benefits expenses represent an overwhelming majority of outlays, and ratios of 60% to 75% are not unheard of for less capital intensive organizations. Staff vacancies, turnover and other events may cause unexpected variances from the set budget. In an operations assessment, it is a good step to examine current staffing levels and redeploy resources to meet current or emerging needs. Additionally, if it becomes clear that revenue is falling short of the organization's expectations, an organization needs to realign priorities and redistribute resources.

Will cash flow be sufficient to sustain the operations?
Too often organizations focus on results of operations and not cash flow. The working capital needs of an organization should be reviewed and updated on a regular basis, which is particularly important if the organization receives restricted contributions or pledges. The timing of the receipt of cash may require an organization to maintain a line of credit, while utilizing a monthly cash flow forecast may help with monitoring and adjusting spending.

What impact could regulatory changes have?
The political and regulatory environment can cause uncertainty for nonprofit organizations. Proposed changes to funding levels for human services programs, cuts to Pell Grant funding and other hotly debated funding sources have left a level of ambiguity that can be unsettling. Organizations should evaluate the impact that these

changes could have on their operations and consider preparing what-if scenarios and contingency planning. Taking the time to prepare and plan will help any organization be ready for any future regulatory changes.

What is the industry's competitive landscape?
An organization needs to assess their competitive environment to make sure the programs they deliver and the manner in which they deliver them will remain relevant in the coming months. In addition, any programs or initiatives that stray from an organization's mission need to be undertaken thoughtfully and deliberately. Launching any new initiative will have a substantial impact on the rest of an organization's internal operations.

While these 5 questions can help any organization begin an operational assessment, they are only a framework that can be helpful when evaluating an organization's internal operations. These are not questions to be asked only once a year, but should serve as key components of any organization's overall governance program. Minimal planning, when done the right way, can help an organization stay focused on long-term goals and sustain a high level of operations.

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