Strong Financial Oversight

21 A charitable organization must keep complete, current, and accurate financial records. Its board should receive and review timely reports of the organization’s financial activities and should have a qualified, independent financial expert audit or review these statements annually in a manner appropriate to the organization’s size and scale of operations.

Complete and accurate financial statements are essential for a charitable organization to fulfill its legal responsibilities and for its board of directors to exercise appropriate oversight of the organization’s financial resources. A board that does not have members with financial expertise should retain a qualified paid or volunteer accounting professional to establish whether financial systems and reports are organized and implemented appropriately.

Having financial statements prepared and audited in accordance with generally accepted accounting principles and auditing standards improves the quality of the information. Each organization must ensure that it has its annual financial statements audited or reviewed as required by law in the states in which it operates or raises funds or as required by government or private funders. When an audit is not legally required, a financial review offers a less expensive option that still provides the board, regulators and the public with some assurance of the accuracy of the organization’s financial records. Many smaller organizations that have opted to work with an independent accountant have noted that the accountant provided invaluable guidance.

Every charitable organization that has its financial statements independently audited, whether or not it is legally required to do so, should consider establishing an audit committee composed of independent board members with appropriate financial expertise. By reducing possible conflicts of interest between outside auditors and the organization’s paid staff, an audit committee can provide the board greater assurance that the audit has been conducted appropriately. If state law permits, the board may appoint non-voting, non-staff advisors rather than board members to the audit committee.

Organizations with small boards of directors or limited organizational structures may not choose to delegate the audit responsibility to a separate committee. Audit committees may also be inappropriate for charitable organizations that are organized as trusts rather than as corporations.

22 The board of a charitable organization must institute policies and procedures to ensure that the organization (and, if applicable, its subsidiaries) manages and invests its funds responsibly, in accordance with all legal requirements. The full board should review and approve the organization’s annual budget and should monitor actual performance against the budget.

Sound financial management is among the most important responsibilities of the board of directors. The board should establish clear policies to protect the organization’s financial assets and ensure that no one person bears the sole responsibility for receiving, depositing, and spending its funds. Day-to-day accounting and financial management should be the task of staff or, in the case of organizations with no or one staff member, designated volunteers who have the necessary time and skills. The board is responsible for reviewing practices and reports to ensure that those staff or volunteers are adhering to the board-approved policies.
The organization’s annual budget should reflect the programs and activities the organization will undertake in the coming year and the resources it will need to raise or generate to support those activities. Careful review of regular financial reports showing both budgeted and actual expenditures and revenues will permit the board to determine whether adjustments must be made in spending to accommodate changes in revenues. Financial reports should also reflect how the organization has adhered to any restrictions placed on funds by donors or grant programs.

Prudent financial oversight requires that the board look beyond monthly or annual financial reports to consider how the organization’s current financial performance compares with that of previous years and how its financial future appears. If the organization’s net assets have been declining over a period of years, or if future funding seems likely to change significantly, the board may need to take steps to achieve or maintain stability.

Whenever possible, an organization should generate enough income to create cash reserves for its future. When an organization has built sufficient reserves to allow for investments, the board is responsible for establishing policies that govern how the funds will be invested and what portion of the returns, if any, can be used for immediate operations or programs. The boards of organizations with sizeable reserves or endowments generally select one or more independent investment managers to handle the organization’s investments. In those cases, the board or a committee of the board should monitor the outside investment manager(s) regularly.

A charitable organization should not provide loans (or the equivalent, such as loan guarantees, purchasing or transferring ownership of a residence or office, or relieving a debt or lease obligation) to directors, officers, or trustees.

The practice of providing loans to board members and executives, while infrequent, has created both real and perceived problems for public charities. While there may be circumstances in which a charitable organization finds it necessary to offer loans to staff members, there is no justification for making loans to board members. Federal laws prohibit private foundations, supporting organizations and donor-advised funds from making loans to substantial contributors, board members, organization managers and related parties. Many states also forbid such loans or allow them only in very limited circumstances.

When a charitable organization deems it necessary to provide loans to an employee—for example, to enable a new employee of a charity to purchase a residence near the organization’s offices—the terms of such loans should be clearly understood and approved by the board. Such loans then must be reported on the organization’s annual information returns (Forms 990 and 990-PF).
A charitable organization should spend a significant percentage of its annual budget on programs that pursue its mission. The budget should also provide sufficient resources for effective administration of the organization, and, if it solicits contributions, for appropriate fundraising activities.

Charitable organizations have an obligation to devote their resources to the charitable purposes for which they were granted tax exemption, and to spend donated funds on the programs and activities for which the funds were contributed. At the same time, the successful operation of any business or organization—including the responsible pursuit of nearly any kind of charitable purpose—requires effective management and administration. Administrative activities include financial and investment management, personnel services, recordkeeping, soliciting and managing contracts, legal services, and supporting the governing body of the organization. Not only do these elements ensure that the organization complies with all legal requirements, but they also help provide complete, accurate, and timely information to donors, the public, and government regulators.

Charitable organizations rely on other supporting services to carry out their missions. Most public charities have fundraising operations to encourage potential donors to contribute money, materials and other assets and to ensure that donors receive necessary reports about how their contributions were used. Some public charities also rely on membership development activities to solicit prospective members, collect membership dues, and ensure that members receive promised benefits. Private foundations and some public charities also have expenses associated with making grants and contributions to other organizations and individuals.

Qualified personnel are crucial for providing programs, recruiting and managing volunteers, raising funds, and ensuring proper administration. The costs of compensating personnel, including salaries and benefits, must be allocated to the particular functions they perform for the organization based on appropriate records.

Some self-regulation systems and “watchdog” organizations recommend that public charities spend at least 65 percent of their total expenses on program activities. This standard is reasonable for most organizations, but there can be extenuating circumstances that require an organization to devote more resources to administrative and fundraising activities. The board should review the budget and financial reports to determine whether the organization is allocating its funds appropriately.
A charitable organization should establish clear, written policies for paying or reimbursing expenses incurred by anyone conducting business or traveling on behalf of the organization, including the types of expenses that can be paid for or reimbursed and the documentation required. Such policies should require that travel on behalf of the organization is to be undertaken in a cost-effective manner.

A charitable organization’s travel policies should be unambiguous and easy to follow, and should reflect the organization’s principled judgment about what it considers “reasonable” expenditures for individuals who must travel to conduct business on its behalf. These policies should include procedures for properly documenting expenses incurred and their organizational purpose.

As a general practice, travel policies should ensure that the business of the organization is carried out in a cost-effective manner. Decisions on travel expenditures should be based on how best to further the organization’s charitable purposes, rather than on the title or position of the person traveling. Charitable funds generally should not be used for premium or first-class travel, but boards should retain the flexibility to permit exceptions when they are in the organization’s best interest. Such exceptions, if any, should be explicit, consistently applied and transparent to board members and others associated with the organization.

An organization’s policies should reflect the requirements and restrictions on travel expenditures imposed under current law. The detailed guidance provided in IRS Publication 463: Travel, Entertainment, Gift and Car Expenses should serve as a guide for managers of charitable organizations in avoiding lavish, extravagant or excessive expenditures.

A charitable organization should neither pay for nor reimburse travel expenditures for spouses, dependents or others who are accompanying someone conducting business for the organization unless they, too, are conducting such business.

If, in certain circumstances, an organization deems it proper to cover expenses for a spouse, dependent, or other person accompanying someone on business travel, the payment generally must, by law, be treated as compensation to the individual traveling on behalf of the organization. This principle need not apply to de minimis expenses such as the cost of a meal at organization functions where participants are invited to bring a guest.