TOOL KIT #2
# BOARD FINANCIAL GOVERNANCE

## FAQ – FINANCIAL STATEMENTS

**1. What are the balance sheet "red flags?" board members should be aware of?**

The balance sheet is the key for seeing problems. Healthy nonprofits build up assets, cash reserves, and unrestricted net assets, and maintain reasonable amounts of debt.

Nonprofits with serious financial problems report diminishing cash, insufficient working capital, restricted funds diverted to current operations, negative unrestricted net assets, and increasing debt. These red flags should make board members jump up and down and shout – look over here.

**2. We want to allocate our money to program, not "overhead" (management and general) or fundraising, right?**

Yes and no. You want to show that you are spending your money on delivering program services. But, if you are underinvesting in infrastructure and fundraising, you may not be investing what is necessary to sustain your programs.

The "overhead myth" is the false idea that financial ratios are a proxy for overall nonprofit performance. It's essential not to judge solely on percent of expenses that go to administrative and fundraising costs. While very high overhead can signal mismanagement, and serve as a part of an organization's dashboard of financial management metrics, it says nothing about the results of your work (i.e., how you meet your mission).

**3. What is a "direct cost" for the program?**

Direct costs generally include:

- Salaries are wages (including vacations, holidays, sick leave, and other excused absences of employees working specifically on objectives of a grant or contract – i.e, direct labor costs).
- Other employee fringe benefits allocable on direct labor employees.
- Consultant services contracted to accomplish specific grant/contract objectives.
- Staff travel for specific grant/program objectives.
- Materials, supplies, and equipment purchased directly for use on a specific grant or contract.
- Communication costs such as telephone calls, websites, or email marketing identifiable with a specific award or activity.
- Other things like parent or youth support, professional development, etc.

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**4. What are indirect costs?**

Indirect costs represent the expenses of doing business that are not readily identified with a particular grant, contract, project function or activity, but are necessary for the general operation of the organization and the conduct of activities it performs. Cost allocation plans or indirect cost rates are used to distribute those costs to benefiting revenue sources.

The *Uniform Administrative Requirements*, *Cost Principles*, and *Audit Requirements* for Federal Awards (Appendix IV to CFR §200) provides information about indirect cost rates. When a Parent Center has more than one grant, it may be useful to consider negotiating an indirect cost rate with the federal government. The Uniform Guidance Principles allows, in certain situations, to use a default rate of 10%. The cognizant agency to contact when most federal funding of a Parent Center comes from the U.S. Department of Education is the Office of the Chief Financial Officer/Indirect Cost Group (https://www2.ed.gov/about/offices/list/ocfo/fipao/icgreps.html) which has delegated authority to negotiate and issue indirect cost rates. Please note that fundraising costs may not be included in the indirect costs allocated to your federal grants.

**5. So, for example, is rent a direct cost or an indirect cost?**

It depends. . . if you rent a community center auditorium to do trainings, it's a Program expense. If you rent a separate office for your admin offices, that's a Management & General expense. If your grant writer works out of shared Hub space, that's a Fundraising expense. If they all share offices, the rent is a shared cost, and can be apportioned by a variety of acceptable methods.

*Takeaway for board members: Talk with the organization's auditor or accounting advisor – or ask the Board Treasurer to do so -- to be sure your nonprofit is using one of the acceptable allocation methods that minimize your Management & General and Fundraising expenses.*

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