Financially Robust, and Good Governance

Contents (version 1.04)

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For: **Environment Hubs Aotearoa**

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*A reference paper developed on behalf of **Environment Hubs Aotearoa** (EHA).*

Introduction.

This paper is based around section 6 of the EHA questionnaire that you, as one of their funded organisations, were asked to answer. Your final assessment is based on how you assessed your own organisation, combined with a comparative and informed external assessment by EHA.

AIM: The aim of the paper is to make quite clear what EHA requires for each of the criteria they set, and to provide some initial guidance as to what your organisation needs to know (or do) in order to satisfy each of those criteria.

GOAL: The goal is for your organisation to be more professional - not only to satisfy EHA, but also to appeal to other supporters and funders, and to help ensure that you survive and thrive. As the title says – EHA wants your organisation to be financially robust, and to enjoy good governance.

Methodology.

In the EHA funding assessment questionnaire, section 6 is all about FINANCE. It has 5 subsections, and eligibility points are based on how well you rate against each of them:

a) Diversity of sources of income
b) Diversity of grant funding
c) Self-generated income
d) Robustness of financial policies
e) External oversight of annual accounts

What follows is a **broad** look at each subsection to help you determine **if** and **how** your organisation might improve its assessment. Note: d) and e) are considered most critical, and are covered first.

(d) Robustness of financial policies:

Appropriate finance policies and **realistic** controls are key. It is important for any organisation that comprehensive finance policy is developed, approved by the Board, and adhered to by all. This does not imply "wordy" – it suggests simple, clear, policy and guidelines that ensure your organisation has a suitable level of oversight, and yet does not cripple the financial process with over zealous controls.

[EHA affiliated organisations may request an easy to edit "Finance Policy template" that covers many finance policies worth considering, by emailing tam.alexander@outlook.com]

From the point of view of a funder, they would generally love to have full control over how funding they provide is spent. Of course this is not a realistic scenario, nor generally attractive to the funded organisation. So funders tend to be relatively hands off, but they do often attach strict accountability to the funds they provide.

Not surprisingly, funders prefer to provide funds to organisations that can demonstrate transparency and robust financial policies and practice. In essence, they want reassurance that funds they provide are for a purpose they approve of, and that there is a strong possibility that the funds will be utilized effectively in pursuit of that purpose. At the same time the funded organisation wants the freedom to operate without constant external scrutiny. Essentially a balance has to be struck.

How is this balance best achieved?

Key is to understand how not for profit finances are different from those of commercial entities.

[EHA affiliated organisations may access the paper "How Not for Profit Finance is Different" by emailing tam.alexander@outlook.com for a copy.]

Also important is the critical relationship between the board (governance) and the employees (operations) of an organisation. This relationship may be somewhat blurred by necessity in smaller organisations, or through poor boundaries (or over-zealous board members) in larger ones.

Funders essentially want funded organisations to operate as professionally as possible, and it is hard to argue with their logic. There are however some caveats to this:

- Particularly for organisations with smaller budgets being professional or following "best practice" is not always affordable. This is not an easy excuse to rely on because the majority of "best practice" operating is quite feasible for any size of organisation.
- Smaller organisations simply may not have enough staff to always follow best practice. For example, best practice for receiving cash is that two staff members should be present when receiving and counting cash. This is not possible if there **is** only one staff member.
- Some best practice guidelines feel as if they were written for organisations that have nothing else to do than seemingly endless accountability, controls and compliance routines. You may have to tone down the enthusiasm of some guidelines, and aim for policy and practice that is set at an appropriate level for your particular organisational needs.

It is useful to consider some of the things auditors look for when carrying out an audit, and to ensure that your organisation has policy and practice that is "audit standard" regardless of whether you are actually audited or not. Some audit checks (along with a few other potential "red flags") follow:

- Are **tagged** funds (i.e. funds granted with conditions) treated as grants in advance?
- Is holiday pay owed to employees reconciled in the balance sheet? Monthly?
- Do all payments made require **two** to authorise?
- Does the organisation prepare a budget every year?
- Does the board have a treasurer role?
- Does the board receive accurate and up to date finance reports when it meets?
- Does the board have access to all financial information if they ask for it?
- Is a conflict of interest policy in place and adhered to? (board and staff)
- Does GST paid to and received from the IRD reconcile with the balance sheet?
- Are there any controls on authorisation **levels** for spending?
- Does the organisation have a suitable level of financial oversight?
- How is cash received handled?
- Does the Board produce signed minutes that accurately record board decisions?
- Does the organisation use accrual accounting as far as possible?
- Are the organisations accounts fully up to date?
- Is there a plan in place in case something happens to the primary finance person?

(e) External oversight of annual accounts:

Independent oversight is important. Transparency is also important.

The starting point has to be **governance** oversight. A treasurer role is a good idea, and this person must have full access to all of your organisation finances. Remember, primary roles of a not for profit board are oversight and 'big picture' planning.

[This is covered in the paper "Nor for Profit BOARD Essentials" – also available to you as an EHA affiliated organisation, on request.]

If size and budget allows it, the ideal option is an independent audit. Next best is a review by registered auditors, however this is often so close to an audit in cost that it is seldom worthwhile.

An independent review by an appropriate person or organisation can be significantly less expensive and may be the best bet for a smaller organisation. [A key word here is "independent"].

NOTES:

- Any review should be by someone who is not only suitably qualified and experienced, but also familiar with how not for profit finances differ from those of a commercial entity.
- Some funders **require** that your accounts be audited. In this case your organisation will have no option but to stump up for an audit.
- For either an audit or any level of review, full access to all financial records is vital.

A key part of financial oversight is ensuring **separation of duties**. So for example, if a treasurer is responsible for the organisation finance operations (directly or indirectly), then they **cannot also** provide the necessary independent oversight. Situations like this can lead to a point where the board might be accused of crossing the line and "meddling" in operations.

On the other hand, board members of smaller organisations do often get involved in operations – especially where skills exist on the board that the employees do not have. The 2019 Trusts Act is clear on when this is acceptable for trust board members. Trustees must not profit unduly from their relationship with their organisation.

What is generally considered acceptable is that a trustee may be paid for goods or services provided to their organisation as long as certain control measures are both in place, and adhered to.
[There is a similar expectation where board, or committee, members are not **trustees**.]

Sometimes having board members involved in operations may be desirable or even necessary. With the proper controls in place this need not be of concern. What is of concern is where appropriate controls are not in place.

The following may be considered the minimum that is acceptable in practice:

- Full **transparency** in writing of the arrangement, the work to be carried out, the cost, and the oversight that will be in place.
- **Evidence** that the goods or services will be supplied at the same cost, or less, than what the organisation would be able to obtain otherwise. The comparison should be a fair one – in other words aim to compare with realistic alternatives – not with higher priced options that would never be used. In most cases board members will offer a discount to the organisation as compared to what they would normally charge, however care must still be taken – a high initial price with a discount may still be more than other options.
- Regular re-assessment of the arrangement. Annually is recommended.

(a) Diversity of sources of income:

While obviously desirable, this may not be something you can do much about. Some organisations simply have limited funding options – for example relying on a central government grant provided purely for a specific purpose. In many ways EHA itself falls into this category.

For most of us though, making an effort to diversify our sources of income is an excellent idea.

How to do this?

There is generally no "quick fix" solution to this very common question. Developing a fundraising strategy is a good starting point. In most cases diversifying funding will mean **changing from trying to squeeze more out of an existing funding pool, to concentrating more on enlarging that pool**.

A well planned approach is the way to go. Some organisations are plain lucky, but most of us have to work hard at securing the funding we need. Avoiding shortcuts helps ensure your organisation will thrive rather than just eke out an existence. It also helps set in place what is needed for long-term stability and success.

Do you have a **funding strategy**? If not, you probably need one. Developing a good funding strategy lays the foundation for if and how your organisation is able to diversify its sources of income.

[As an EHA affiliated organisation you may access the reference paper "Not for Profit Fundraising Strategy" by emailing tam.alexander@outlook.com]

It is easy to forget that **saving** money is as good as, or better than, receiving money. A crucial part of an organisation being prudent with expenditure is to share the accountability for budgets wherever possible. In practice this works best if team and project leaders are given a level of budget holder responsibility. In many instances they instantly become much better at conserving funds.

(b) Diversity of grant funding:

For organisations that rely heavily on grants, it is a huge risk where their very survival is reliant on one or two major grants. Sometimes this is unavoidable, but wherever possible you should make a concerted effort to diversify your funding sources. *How*?

There are really only two options:

- Secure additional grants in order to spread the grant funding risk, and/or
- Find non grant funding

Before anything else, it makes sense to do a simple overall evaluation of your organisation. This will help quantify the level of this particular risk versus other risks, and may also broadly suggest some possible avenues for your organisation to explore. The easiest way to do this is to carry out a tried and tested "SWOT analysis" of your organisation.
(In case you don't know - SWOT stands for Strengths, Weaknesses, Opportunities and Threats.)

[For a template and suggestions on how best to do a SWOT analysis, email tam.alexander@outlook.com and request this information.]

If the SWOT analysis confirms lack of grant diversity as a weakness and/or a threat, then remedial action may be needed. Often your strengths and opportunities will provide clues or stimulate ideas on what can be done to reduce this risk.

Now would be a good time to develop a fund raising strategy as discussed in section (a) above. This will help determine whether your organisation should concentrate of getting more grant funding, on other sources of revenue, or both.

*[If you plan on securing additional **grants** as part of your funding strategy, then you may email tam.alexander@outlook.com for some simple yet effective ideas on how to improve your grant funding "hit rate".]*

(c) Self-generated income:

Most funders like it a lot when an organisation self-generates income. Although in itself compelling, this is far from the only reason why it makes sense to self-generate as much income as possible.

Other reasons include improved funding diversity, more independence from grants and similar traditional funding sources, improved income security, more employment options, and simply the feeling of achievement you will get if working towards your vision and mission is actually **rewarded** by income that helps your organisation thrive.

Increasing self-generated income is often not easy. Once again an important factor is the type of organisation that you have. Some of the more common ways of self-generating income include:

- Offering classes, training, or other education.
- Hiring out space or equipment
- Fundraising events
- Providing services for a fee

- Commission on sales
- Membership fees

Monetary value is sometimes attributed to volunteer time, however great care should be taken if/when doing this. An obviously inflated value ascribed to volunteer time will not easily fool a professional funder, and may even make them suspicious or sceptical of your organisation.
(And, of course, it does not actually put any money in the bank…)

The main trap to avoid is where the cost of self-generating income exceeds the benefit. While this may sound obvious, it is surprising how easily it can sneak in.
There are perhaps three main areas to watch out for:

- The **financial** cost exceeds the income.
- The **overall** cost exceeds the overall benefit (where cost includes time and other resources spent that could have been used for furthering your vision and mission instead).
- The endeavour causes your organisation to **lose focus**.

NOTES:
Sometimes however there are benefits other than income that make a loss worth it. For example if a Council grant includes the requirement that you must be open for business on a day or time where income does not cover costs. Or a loss leader event where you pick up enough new supporters to outweigh a financial loss on the event. (Of course almost all advertising and marketing is premised on exactly this – the hope that gain will outweigh pain.)

Realistically, in many cases attempts at self-generating income will put your organisation in direct competition with commercial entities. Sometimes those entities will be part of a large group with massive funding reserves, or they might simply not have the ethics that you do and drive their staff harder, or pay only minimum wage. This can make it hard to compete directly, however there may be advantages that you can harness. Your advantages will usually hinge on leveraging community support – something only possible because yours is a not for profit, community based organisation.

Contrary to what many board members often seem to think, it makes sense for an organisation to build up reserves over time. More than anything else, this provides security for staff, for growth, and for the future of the organisation. Also contrary to what many people think, funders generally **like** to see some money in the bank – it reassures them that the organisation is well run, and generally does not have the feared effect that funders may think your organisation does not need more funding!

In Conclusion

It is clear that some people find anything to do with finance boring. If that sounds like you, fair enough. However, it is important to remember that while funding is not the reason why a not for profit exists, it is similar to oxygen for humans – not the reason for existence, but vital for survival.

If finance is not your thing, if you simply feel like a primer, or if you would like some reference material that you can call on, then you might be interested in having a paper that covers the basics.

> *[EHA affiliated organisations may access the paper "Not for Profit FINANCE essentials" by emailing tam.alexander@outlook.com for a copy.]*

Possibly the best advice anyone can give if you struggle with finance, is to read or do a little bit and then do something else. Keep doing this until, suddenly, the job is done.

It may make sense to go through this paper and tick off things as you complete them, as well as those your organisation has already done. It also makes sense to keep your organisation looking attractive to funders and supporters by checking annually that nothing has slipped.

Good news is that once your organisation is up to standard, it is relatively easy to keep it there.