



Results from Blackbaud's 2006 Accountability Assessment

Oversight | Transparency | Internal Controls | Best Practices

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Accountability in the nonprofit world means always being open and ready to answer to those who have invested their trust, faith, and money in your organization. In general, organizations that demonstrate accountability are likely to raise more money and make processes more effective, ensuring their long-term health and well being. During 2006, Blackbaud conducted the Accountability Assessment to help organizations find out where they stand in relation to their peers and identify areas for improvement. The questions in the Accountability Assessment were grouped into four relevant areas:

Blackbaud has compiled the results of the 2006 Accountability Assessment and created this summary to share with clients and organizations in the nonprofit community, hoping that the results help them benchmark their progress and ensure continued success for the future.

- ◆ Oversight and monitoring
- ◆ Transparency and communications
- ◆ Internal controls
- ◆ Best practices

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executive summary

Many nonprofits have made significant progress towards making accountability, stewardship, and transparency the hallmarks of their organizations. Other organizations are in the early stages of their improvement process and may not know where they stand in relation to other organizations. This Accountability Assessment points out areas for improvement for those organizations, and benchmarking your organization against similar organizations is the first step in the process. In reviewing the results, we have made some major conclusions, including:

- ◆ For many organizations, tracking income and expenses by core activity is still a challenge.
- ◆ Many organizations do not have a consistent method for tracking donor-imposed restrictions.
- ◆ Half of all organizations have yet to establish an audit committee.
- ◆ Half of all organizations cannot readily explain the quantitative impact a donation will make.
- ◆ Approximately 20% of organizations do not have documented internal controls.
- ◆ One-third of organizations do not have integrated technology to automate many of the internal controls.
- ◆ 16% of organizations continue to operate on the cash basis of accounting.
- ◆ Nearly 20% of organizations do not have a formal process for reviewing grant or donation restrictions prior to accepting them, and more than half do not have a plan for dealing with post-donation requests by donors.

In the following sections, we examine the results for each of the four categories — we then share the total responses to individual questions by percentage and provide an analysis of the results in light of the current nonprofit environment.

oversight and monitoring

Oversight and monitoring is a process used by an external or internal supervisor that involves evaluating the performance of a specific person or organization. It is a system that addresses potential problems by implementing guidelines, regulations, or other structural policies. This concept typically refers to the oversight by the IRS of exempt organizations at the federal level. One way the IRS accomplishes this is by requiring nonprofits to file Form 990.

	Yes	No
Does your organization go through an annual audit?	87.4%	12.6%
Does your organization accurately complete its annual IRS Form 990 for tax-exempt organizations and submit it within the required time frame?	95.4%	4.6%
Does your board regularly monitor your organization's financial health and performance?	91.9%	8.1%
Does your organization track its income and expenses by core activity (grants, endowments, projects, events, etc.)?	88.6%	11.4%
Does your organization have a consistent method for tracking restricted donations?	76.8%	23.3%
Has your organization's board established an audit committee?	49.6%	50.4%

Interestingly, 12.6% of respondents indicated that they do not participate in audits conducted by outside accounting professionals. While annual audits consume time and resources, they are also a way for organizations to learn and improve their current processes. In many instances, an annual audit is a necessity rather than a luxury, since many funding organizations, including most government entities, typically require audited financial statements as a condition of funding. Many funding organizations require three or more years of audited financial statements before considering an organization for funding. For this reason alone, the vast majority of responding organizations already perform annual audits.

If your organization does not, you should consider beginning this process during 2007. To help you prepare for your audit, most auditors will provide a standard checklist of items that will be required. Having these documents ready and organized in the proper format can save many hours and lead to a more satisfactory result for everyone in your organization, as well as your auditors.

While the vast majority of organizations indicated that they track income and expenses by core activity, just over 11% of respondents indicated that they do not. When tracking income and expenses for areas like grants, endowments, programs, projects, and events, Generally Accepted Accounting Procedures (GAAP) require conformity. Expense information must also be tracked this way for audits and for the IRS Form 990. Aside from the compliance requirements, this accounting approach best reflects the way nonprofits communicate their programs and accomplishments, which indicates that functional tracking is a useful management tool for board reporting.



Managing restricted contributions is one of the trickiest parts of nonprofit financial management, and just over 23% of respondents indicated that they do not have a consistent method for tracking restricted donations. Having a consistent approach for tracking these funds is an essential element of accountability. Today it seems donations come with more and more strings attached. If your organization is not able to demonstrate that it has complied with the wishes of the donor, it not only jeopardizes its relationship with the donor but could also be putting its 501(c)3 status at risk. Many states are also considering additional legislation in this area, therefore it is wise to have these processes in place.

The Sarbanes-Oxley Act requires corporations to establish an audit committee, a process for electing audit committee members, and a method for maintaining adequate reporting procedures. In addition, the Act calls for regulations relating to document destruction and whistle-blower protection, and these provisions do apply to nonprofits.

Just over half of respondents indicated that they do not currently have an audit committee. Since the Sarbanes-Oxley Act (SOX) was signed on July 30, 2002, significant changes to corporate financial practices and governance regulations have taken place. Although most portions of the Act are not currently applicable to the nonprofit sector, there are some nonprofits that are beginning to take proactive measures towards becoming SOX-compliant.

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While many larger nonprofits already have audit committees, some smaller nonprofits will be establishing this committee for the first time. Your organization may also already have a finance committee in place; therefore, it is important to understand that an audit committee serves a different role. While the finance committee monitors the funding of the organization and reviews investments, the audit committee provides independent oversight of the organization's accounting and financial reporting and oversees the organization's annual audits (both external and internal). The audit committee may oversee a broad range of areas under the blanket of this primary purpose. These areas may include:

- ◆ Governance and ethics
- ◆ Internal controls and policies
- ◆ Staff compensation
- ◆ Accuracy of records and reports presented to the board
- ◆ Proper authorization of expenditures
- ◆ Review of the tax-exempt status and risk factors that could jeopardize this status
- ◆ Protection of employees raising concerns about accounting or auditing irregularities

A board of directors appoints an audit committee and has the authority to remove members at will. The committee should consist of at least three members of the board of directors and one financial expert. At least one member of the committee should be able to understand and analyze the organization's financial statements and be able to assess the capabilities of the audit firm. Consideration should be given to individuals with expertise in finance, and all members should be financially literate.

Additionally, the committee should meet at least four times a year and schedule additional meetings as necessary. The committee is required to have at least one meeting annually with

an outside audit firm. The audit committee should ensure that the audit firm has the skills and experience to carry out the auditing function for the organization and that its performance is carefully reviewed. The audit committee should meet with the auditor, review the annual audit, and recommend its approval or modification to the full board.

The director of finance and administration or the office manager plays a critical role in the process. Here are a few suggestions for working effectively with your audit committee:

- ◆ Staff members should act as liaisons between the audit committee and the auditors; they should be willing to provide as much background information as needed so the audit committee members are well-educated about the day-to-day issues the organization faces.
- ◆ Be sure to provide your audit committee with as much background information about the organization's policies and procedures as possible.
- ◆ Invite them to review the current accounting/financial manuals, any outgoing requests for proposals when looking at new auditors, and any other policies that affect the finances of the organization.

Since Congress passed the Sarbanes-Oxley Act, many state legislators and attorneys general have been considering various proposals to increase nonprofit accountability at the state level. Your state may have already adopted similar measures or may be considering future measures. As officials explore ways to apply elements of the law to the nonprofit sector, industry experts recommend that nonprofits voluntarily incorporate certain provisions of the Act that make good governance sense. If oversight and monitoring aren't a priority and don't occur at an organization, the organization could be at risk of overspending the budget, undergoing government scrutiny, tarnishing its reputation, and even fraud.

transparency and communications

In the nonprofit world, transparency is defined as the widespread availability of relevant, reliable information about the performance, financial position, and governance of an organization. In other words, it is the amount of information that an organization tells the public about itself and how honestly and quickly it reveals this information.

	Yes	No
Are copies of your organization's most recent IRS Form 990 accessible on your Web site, available to be mailed out, or on-hand for immediate delivery in case a donor walks in the door and asks for this information?	73.8%	26.2%
Can your organization quickly explain how donor dollars will be spent?	85.8%	14.2%
Can your organization quickly explain the quantitative impact donations will have?	49.9%	50.1%
Are copies of your organization's most recent financial statements provided to donors upon request?	91.7%	8.3%

Recent studies indicate that well over 97% of nonprofits have some type of Web presence, and this survey indicates that just over 26% of respondents do not have a copy of their IRS Form 990 available on their Web sites or readily available for donors. More and more donors are requesting this type of information early in their decision process to support an organization, and publishing



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this information demonstrates transparency and saves valuable staff time in responding to such requests. Making this type of required documentation readily available frees you to focus on more important strategic matters.

Presentation of the financial and operational status of an organization has always been a complicated subject. Just over 14% of respondents indicated that their organizations cannot quickly explain how donor dollars were spent. Many donors are interested in the percentage of their donation that supports actual service delivery versus overhead costs. Overhead is necessary in every organization; from an accountability and efficiency standpoint, it is far better to clearly identify overhead costs in your financial statements. While overhead costs can lead to scrutiny, failing to clearly identify these costs can lead to erroneous assumptions by outside parties and ultimately results in negative financial implications for the organization.

While delivering on their missions is paramount to nonprofits, it's just as critical to communicate the outcomes of their actions to the outside world. Just over half of respondents indicated that they cannot quickly explain the quantitative impact of donations. But this is an organization's chance to shine! Donors want to ensure that their contributions generate results. Demonstrating how critical a need is, as well as how your organization meets that need indicates transparency and contributes to your organization's overall mission.

Increased transparency on behalf of nonprofits and better information available on the Internet could help donors achieve greater confidence in the sector. Transparency works as a trust-building tool; the more accountable and transparent your organization becomes, the more trustworthy it will be viewed by the public, donors, constituents, and regulators.

internal controls

While nonprofit organizations are still exempt from Sarbanes-Oxley regulations, they are not exempt from fraud. As evidenced by several high-profile scandals in the industry, nonprofits should be practicing tight internal controls, such as self-governance, to avoid the expenses associated with full Sarbanes-Oxley compliance.

Internal controls are the measures that an organization takes to encourage adherence to policies and procedures, promote operational efficiency and effectiveness, safeguard assets, and ensure the reliability of accounting data. Internal controls encompass both internal administrative procedures and internal accounting procedures

	Yes	No
Does your organization complete an organization-wide budgeting process at the beginning of each fiscal year?	89.3%	10.7%
Does your organization have documented internal controls in place to ensure that transactions are properly authorized, recorded, and reported?	83.2%	16.8%
Does your organization maintain documented internal controls?	77.3%	22.7%
Has your organization ever received a complaint from a donor about the manner in which fundraising proceeds were spent by your organization?	19.1%	80.9%

Do you always honor commitments made in fundraising appeals about the way in which donations will be spent?	91.1%	8.9%
Does your organization use spreadsheets created and maintained outside of its financial applications?	77.8%	22.2%
Does your organization utilize an integrated software application (can you post directly from your fundraising software to your accounting system)?	32.2%	67.8%

Just over 10% of respondents indicated that they do not utilize an organization-wide budgeting process. An inclusive annual budgeting process is essential to good organizational planning and results in a valuable tool to be used by the board and staff throughout the year. Involving all affected departments in the budgeting process aids buy-in and decreases the likelihood of misunderstandings during the course of the budget year. Many progressive organizations include all departments and utilize tools like “zero based budgeting;” this allows the organization to focus on the actual needs for the upcoming year rather than just repeating the prior year’s budget with minor modifications.

Once the budget is in place, organizations need to have documented internal controls in place to ensure that all transactions are authorized, recorded, and can be reported on. Between 17% and 23% of respondents indicated that they do not have documented internal controls. Such controls are the foundation of sound financial management and protection of the organization’s assets. Without good internal controls, an organization increases the chances that it will be the victim of theft or fraud by its employees. It also lessens the credibility of its own financial reporting; a documented comprehensive system is required to produce accurate data.

Once the controls and documentation are in place, then comes the task of making the staff aware of the processes and training them on how to follow them properly. Many organizations also make the internal controls publicly available as a show of transparency and to gain the trust of all interested parties. Having such a comprehensive plan and documentation in place greatly reduces the chances of internal fraud in the future.

Just over 19% of respondents indicated that they have had complaints from donors regarding the manner in which fundraising proceeds were spent. As part of an accountability plan, organizations must have a process in place to identify and take action on complaints. First you must monitor the methods by which you receive feedback from donors. Once an organization receives a complaint, a specific individual within the organization should be assigned the task of handling the complaint. This assignment may be based on the individual’s functional area, relationship with the outside person, or knowledge of the situation.

Spreadsheets are a valuable tool for accounting and finance professionals, and 78% of respondents indicated that they routinely use spreadsheets created outside of their financial systems. One inherent weakness is that spreadsheets are prone to errors and, by design, do not reconcile back to an organization’s financial systems. Study after study has demonstrated that the vast majority of spreadsheets do, in fact, contain errors. A large part of internal controls and accountability rely on the controls built into your internal financial software applications. Maintaining and manipulating critical data outside your systems creates the opportunity for errors

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and sends up a red flag to auditors. Retaining critical data in spreadsheets also creates the risk of accidentally disseminating of confidential information to outside parties.

On a related note, over 32% of respondents indicated that they do not utilize integrated software applications for fundraising and accounting. Reconciliation of development efforts with the general ledger is critical to accountability. Hours can be wasted just getting the contributions and related restrictions entered correctly into financial systems! And, from a development viewpoint, future donations and grants most likely will be dependent on the organization's ability to report on how those funds were utilized in compliance with the restrictions on the original gift. Many organizations today have discovered that non-integrated development and accounting systems can actually limit their capacity to raise funds. Regardless of the system provider, efficient integration of these two areas is key to both accountability and the future prospects for an organization.

Internal controls help organizations achieve their performance targets, prevent loss of resources, and ensure reliable financial reporting. They can help ensure that the organization complies with laws and regulations and, therefore, avoids damaging its reputation. In sum, it can help an organization get to where it wants to go while avoiding pitfalls and surprises along the way.

best practices

One of the main priorities of nonprofits is to be responsible stewards of the funds entrusted to them. One important way to demonstrate this responsibility is through the successful execution of accounting best practices, which can ensure an organization provides accurate and timely information about how donations were used.

	Yes	No
Does your organization use accrual-based accounting?	84.0%	16.0%
Are all of the people who raise money for your nonprofit either salaried employees, volunteers, or independent contractors paid on a project basis?	82.3%	17.7%
Does your nonprofit pay any fundraisers on a commission basis?	8.0%	92.0%
Are grant requirements imposed by grantors formally reviewed prior to the acceptance of grant funds?	81.6%	18.4%
Are grant reporting requirements by grantors always met?	81.6%	18.4%
Does your nonprofit have a plan or strategy for responding to post-donation requests from donors, including those that the organization cannot grant?	46.0%	54.0%
Does your nonprofit take specific steps to safeguard the privacy of donors?	86.4%	13.6%

Sixteen percent of respondents indicated that they still do not use accrual-based accounting. The accrual basis of accounting is consistent with GAAP standards and, in most instances, is more accurate than cash-basis accounting. Income is recorded when earned, and expenses are recorded when incurred (in contrast to cash-basis accounting, in which income and expenses are tracked by deposits and payments). This process can become very complicated when tracking earned income and expenses back to various projects, programs, and grants. For most nonprofits, salary is the largest portion of the operating budget, so recording how staff time is allocated

is a crucial part of understanding full program costs, as well as producing accurate reports for funding sources.

The vast majority of participating organizations reported paying staff, volunteers, or independent contractors on a project basis — not commission basis — for fundraising efforts. Fundraisers who work on an organization's behalf are accountable to both the nonprofit and the donors they contact. Generally speaking, staff and volunteers are people who believe in and support the organization's mission. They have a personal stake in representing the nonprofit and assisting in meeting fundraising goals. From time to time, a nonprofit finds that it may need a fundraiser on a short-term basis. Independent contractors can help meet this need without adding to overhead expenses. However, paying these independent fundraisers a commission on the funds they raise can create the specter of inappropriate behavior in the minds of donors and would be a red flag for auditors.

Just slightly more than 18% of respondents indicated that they do not have a formal process for reviewing grantor imposed requirements prior to accepting grant funds, and the same number reported that they have difficulty meeting the reporting requirements in grants. Failing to carefully review grant requirements prior to accepting funds is a potentially dangerous practice, yet one that is rather common in the nonprofit sector. Many nonprofits rush to send grant documents back to a funder and never fully understand or appreciate their requirements under the grant. This situation also creates bad feelings between development and accounting when requirements and restrictions are not properly communicated to the finance department. Development is responsible for acquiring the funds; however, in most instances, accounting has primary responsibility for reporting on how those funds were used in compliance with the terms of the original grant. Errors or omissions in reporting most likely will jeopardize future funding from this source.

On a related subject, 54% of respondents indicated that they do not have a plan or strategy for responding to post-donation requests from donors, including those the organization cannot meet. Consistency is the key to successfully navigating these very difficult situations and requires everyone to be on the same page. Having a documented policy that is applied equally can save relationships, funding, and an organization's reputation. Staff also needs to be very clear with potential contributors on what can and cannot be accommodated after the check clears.

With the Health Insurance Portability and Accountability Act (HIPAA) and other privacy related initiatives today, guarding the privacy of donors is paramount. Amazingly, 13.6% of respondents indicated that they have not taken any specific steps to safeguard the privacy of donors. Privacy is really the first step in accountability when dealing with donors! If donors cannot trust an organization with their personal information, how can they trust that their funds will be used to carry out a specific mission? Having stringent policies and procedures related to personal and private information is a necessity in today's environment. It is important for organizations to ensure that they have systems in place to adequately secure information related to donors, contributions, employees, volunteers, and independent contractors. Certain aspects of an organization should be readily available to the public; however, personal information regarding staff and donors should be treated very differently.



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about Blackbaud

Blackbaud is the leading global provider of software and related services designed specifically for nonprofit organizations. More than 15,000 organizations use one or more of Blackbaud's products and services for fundraising, financial management, Web site management, school administration, and ticketing. Blackbaud's solutions include **The Raiser's Edge®**, **The Financial Edge™**, **The Education Edge™**, **The Patron Edge®**, **Blackbaud® NetCommunity™**, **The Information Edge™**, **WealthPoint™**, and **ProspectPoint™**, as well as a wide range of consulting and educational services. Founded in 1981, Blackbaud is headquartered in Charleston, South Carolina, and has operations in Toronto, Ontario; Glasgow, Scotland; London, England; and Sydney, Australia.

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As more importance is placed on financial accountability, those that make decisions about programs and generate donor-requested reports rely heavily on data. Data is a crucial factor in making decisions about best practices, as well as proving later that the right decisions are made. Are your fundraisers compensated properly? Is the success that results from a specific donation communicated to donors appropriately? Are you able to identify trends so that you can make decisions about staffing, program design, and funding needs? Organizations that fail to demonstrate accountability have complicated audits and, ultimately, run the risk of losing both their donors' trust and charitable support. The proactive establishment of best practices and the implementation of a financial management system that supports them can make all the difference to the long-term well being of your organization.

conclusion

Nonprofits must be accountable to multiple stakeholders, including private and institutional donors; local, state, and federal agencies; volunteers; program recipients; and the public at large. Everyone who works for a nonprofit, whether as a paid staff member or a volunteer, has a role to play in ensuring that the organization is answerable to its constituents.

The charitable sector is based on public trust. Every nonprofit should have in place a governance structure and strict financial controls to assure stakeholders that every dollar invested in its organization is well spent. Nonprofits should also put in place technology to help them be accountable and communicate with donors about how their gifts are being used to carry out the nonprofit's mission.

Managers of nonprofits must invest wisely in assets for both today and for the long-term so that those charged with carrying out the mission in the future have access to the same level of financial resources. Nonprofits that demonstrates such accountability are responding to those who have invested their trust, faith, and money in them.