Nonprofit Organization Financial RED FLAGS Checklist

THE BASICS – If the answer to any one of these questions is no, a RED FLAG exists.

1. Can the executive director explain succinctly the current financial situation of the organization? Does he/she appear comfortable with the numbers?
2. Does the organization have at least five periodic meetings of the board of directors each year?
3. Is the board treasurer financially savvy and does he/she provide adequate oversight and governance?
4. Can the organization’s executive director provide you with a current balance sheet (also called a Statement of Financial Position) and income statement (also called a Statement of Activities)?
5. Does the organization prepare and monitor an annual budget?
6. Has the IRS issued the organization a 501(c)(3) determination letter so that it is tax exempt and can receive tax-deductible contributions and grants? If not, does the organization have a fiscal sponsor that is a 501(c)(3) organization? (Note that other IRS nonprofit designations exist for organizations operating as business leagues, fraternal societies, social clubs, labor organizations, etc. For further information, visit http://www.irs.gov/charities/nonprofits/content/0,,id=132157,00.html)

BEST PRACTICES – If the answer to any two of these questions is no, a RED FLAG exists.

1. Is the organization periodically audited or reviewed by an independent accounting firm?
2. Does the organization maintain a general ledger? If so, does the organization use an accounting software package such as QuickBooks, Peachtree, or Quicken?
3. Are bank reconciliations performed monthly? If so, are they prepared by somebody other than the person who maintains the accounting records?
4. Can the executive director provide you with the most recently submitted IRS Form 990?
5. Does the organization have up to date annual WA Secretary of State forms such as the Charitable Organization registration/renewal (replaces the Charitable Solicitations report), the Charitable Trust registration/renewal (if required), and the Nonprofit Corporation annual report? (For further information on Washington’s nonprofit registration requirements, visit http://www.sos.wa.gov/charities/)
6. If a balance sheet and income statement are available, quickly determine the following:
   a. Balance Sheet: Is the organization’s cash balance more than 1/6 (two months) of total annual expenses?
   b. Balance Sheet: Does the organization have a low level of debt compared to the level of total assets?
   c. Balance Sheet: Does the organization have a positive net assets balance?
   d. Balance Sheet: Does the organization record accounts receivable and payable? If not, the organization may not have an accurate picture (be it positive or negative) of their current financial situation. Note, however, that small organizations often only accrue amounts receivable and payable at the end of the year, so you may want to look at a balance sheet from a full fiscal year.
   e. Income Statement: Is the bottom line positive? Is enough income coming in the door to cover expenses?
7. Does the organization maintain adequate commercial general liability insurance coverage? A directors and officers liability policy is also encouraged.

EMPLOYEES AND INDEPENDENT CONTRACTORS - These are high risk areas. If an organization is not in compliance in either of these areas, a RED FLAG exists.

1. If the organization has employees, are the appropriate payroll taxes being withheld and submitted on a timely basis?
2. Is the organization possibly paying people as independent contractors who should be employees? If so, visit http://www.irs.gov/businesses/small/article/0, id=99921,00.html to determine if the person is truly operating as an independent contractor. The IRS has recently identified independent contractors as a target area for heightened compliance monitoring.

Prepared by 501 Commons Financial Fitness consultant Eric Sanders