

## Why Do So Many Nonprofits Have Problems With Their Accounting?

Here is a troubling observation: many nonprofits, certainly more than half, have problems with their accounting and financial reporting. I would further maintain that the real number of underperforming accounting departments in the nonprofit world is closer to 70% or 80%. These problems manifest themselves in financial reporting that is often inaccurate, late, or not available at all. The for-profit world has its problems too, but not on this scale. This is an important issue for the nonprofit sector to address. Most of the data on which boards and Executive Directors rely to run their organizations comes from their accounting departments. Data that is late, erroneous, or nonexistent will have a deleterious effect on decision-making. It hinders an organization's ability to operate efficiently and effectively and thwarts the organization's ability to properly execute and deliver on its nonprofit mission. All of this worries the funders of these organizations too.

Why is this problem so pervasive? In our work with hundreds of nonprofit organizations over the years, we see the following patterns repeat themselves over and over.

**Nonprofits have a remarkable propensity for hiring people who do not know accounting to do their accounting.**

These nonprofits typically do not have sufficient funds to be able to pay a more qualified employee to get the job done. Or they may skimp when it comes to paying up for a qualified person in order to use scarce resources elsewhere. But you know the saying: you get what you pay for.

There is also, however, a mistaken belief that all you have to do is sit a non-accountant in front of a computer with some accounting software and he or she can learn what they need to know in a few hours or days. The reality is that no matter what accounting software is used, if the user does not know debits and credits, he or she will not be able to properly support your organization as you try to fulfill your mission. Your accounting software, no matter how good, will not correct for bad data input. There is another saying for this: "garbage in, garbage out."

**Accounting rules for nonprofits are more complicated to understand and to apply than for-profit accounting rules.**

Nonprofit accounting rules regarding the recording of donor-restricted funds and for handling multi-year grants are just two examples of rules with an added degree of complexity for a nonprofit organization. Your accountant or bookkeeper either knows these rules or they don't. If they don't know them, their ability to produce accurate financial reports is compromised.

**There is in general, greater demand for financial data in a nonprofit environment, so expectations of your accounting department are greater.**

All nonprofit organizations have a board of directors. Most also have some combination of finance committees, executive committees, development committees, audit committees, and investment committees. When these committees meet, they need reports to look at, and many of these reports are financial reports that come from your accounting department. In addition, data needs to be provided with some regularity to funders, donors, contributors, lenders, and various government agencies. The organization's internal department and program managers also need financial reports with comparisons to budget and other metrics with which to run their areas.

Many states around the country require nonprofits above certain sizes to have an annual audit. Even in states without such requirements, many nonprofits have audits done anyway if their boards or outside funders require it, or because they consider it to be good practice. If your organization receives federal funding above a certain threshold, it is required to submit to still stricter audit oversight.

In addition to everything else, public charities are required to make financial information – such as the Form 990 – available for public inspection.

Consider the implications of the informational demand on a \$2 million nonprofit compared with a \$2 million for-profit. The nonprofit has to crank out a high volume of accurate, timely information, usually in various formats and levels of detail, while following more complex accounting rules. The \$2M for-profit is probably a single owner without all these committees, needs, and demands. He or she simply gets the information they need to run their business. As a result, the nonprofit has a much greater need for a skilled accountant, or group of accountants, to keep its books.

Moral of the story: Jim Collins, author of the book *Good to Great*, says you need to get the right people on the bus. More specifically, if you want your accounting and financial reporting to be done right, you must get the right people with the right skills and the right experience.