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ADVISORY NOTES

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The Benefits of a Contracted CFO for Smaller Nonprofit Organizations

INTRODUCTION

All nonprofit organizations, no matter what size, must have effective financial management. In most organizations, this role is filled by the CFO. A CFO's value should extend well beyond simply providing needed managerial expertise. A high-quality CFO will not only enhance the organization's value, but he/she can also enhance the effectiveness of the CEO and board. These outcomes can be realized when a CFO:

- Becomes a financial consultant for the CEO, thus expanding his/her understanding of the financial aspects of the organization which translates to enhanced leadership in the presence of staff and the board.
- Works closely with the CEO and board to ensure that sound governance and management practices exist and are being followed
- Transforms basic financial data into meaningful management information that effectively supports operational and strategic decisions
- Develops cost allocation tools that optimize reimbursement from external funding sources and provide management with information on the allocation of the organization's human resources
- Optimizes the value of the organization's accounting and finance function. A CFO's breadth of skills and expertise can make accounting and reporting key value-added functions

When an effective CFO provides these types of services, he/she can enable the nonprofit CEO¹ to move from managing the organization to leading the organization.

With smaller-sized organizations, it can be challenging to employ a person with these competencies, usually because the requirements of the position are not extensive enough to warrant the cost of hiring

¹The title of a nonprofit's chief executive varies across organizations and includes: Executive Director, President, and CEO. For purposes of this paper, I will consistently use the title of CEO.

a full-time CFO. Fortunately, for many smaller organizations a cost-effective alternative exists: engaging a part-time contracted CFO. The key advantages of a contracted CFO include:

- Diversity of Perspective. A contracted CFO provides an external perspective that an employed CFO cannot—bringing a fresh set of eyes to every challenge and a continually expanding perspective that he/she gains from serving other clients.
- Cost-Effective Solution. A contracted CFO can provide a cost-effective transitional phase for an organization in need of more sophisticated financial leadership but not yet financially able to invest in it full time.
- Valuable Resource for the CEO. A contracted CFO can be an effective partner for a mission-focused CEO, providing both financial leadership for the organization and financial mentoring for the CEO.
- Valuable Resource for the Board. A contracted CFO can provide information, *both financial and nonfinancial*, that will facilitate a more engaged board. Ultimately a contracted CFO can enable a board to better fulfill its fiduciary responsibilities.

This *Advisory Notes* series is based upon my experiences as both a contracted CFO and consultant for nonprofit organizations. I also drew upon the experiences of nonprofit executives and professionals that service nonprofit organizations, such as CPAs and bank loan officers².

THE BROAD IMPACT OF A CONTRACTED CFO

A contracted CFO's value should extend well beyond simply providing needed managerial expertise. A high-quality contracted CFO will not only enhance the organization's value, but he/she can also enhance the effectiveness of the CEO and board. These outcomes can be realized when a contracted CFO:

- Becomes a financial consultant for the CEO, thus expanding his/her understanding of the financial aspects of the organization which translates to enhanced leadership in the presence of staff and the board.
- Works closely with the CEO and board to ensure that sound governance and management practices exist and are being followed.
- Transforms basic financial data into meaningful management information that effectively supports operational and strategic decisions

² See *Appendix A* for a listing of persons consulted for this paper.

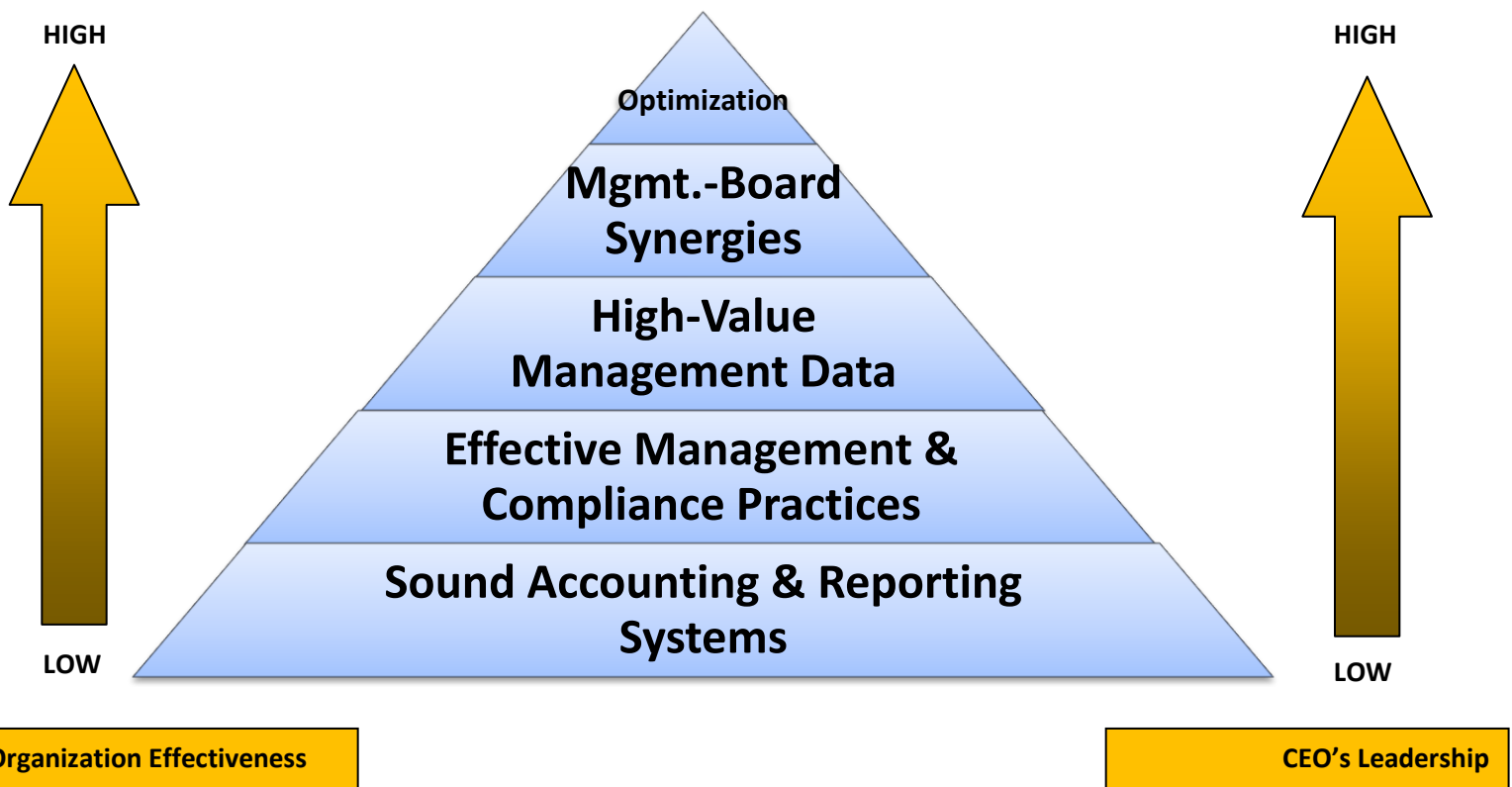
- Develops cost allocation tools that optimize reimbursement from external funding sources and provides management with information on the allocation of the organization’s human resources
- Optimizes the value of the organization’s accounting and finance function. A contracted CFO’s breadth of skills and expertise can deliver both cost savings *and* higher quality reports and information.

These services can enable the nonprofit CEO to move from managing the organization to leading the organization.

THE NONPROFIT ORGANIZATIONAL EFFECTIVENESS HIERARCHY

A contracted CFO can enable an organization to be more successful by enabling it to progress within my *Nonprofit Organizational Effectiveness Hierarchy*. The Hierarchy is comprised of five levels, as illustrated below and explained in the following pages.

An effective CFO plays a crucial role in enabling the organization to advance within the Organizational Effectiveness Hierarchy, and in the process enabling the CEO to move from managing to leading the organization.



Level 1 – Sound Accounting and Reporting Systems

The foundation for an effective CFO is a well functioning accounting and reporting system that assures all underlying financial data are accurate. Without reliable accounting and reporting systems—which includes effective work processes and skill sets within the accounting function—management will lack information necessary to make informed decisions.

Level 2 – Effective Management and Compliance Practices

The next building block for organizational success is effective management and compliance practices. These elements are anchored by an array of policies and procedures, including several that should be reviewed and approved by the organization’s board of directors. Proper engagement of a board in the development and maintenance of organizational policies and procedures represents good governance. More important, it demonstrates that not only management, *but also the board* plays a key support role in ensuring organizational effectiveness.

Most persons involved with nonprofit organizations understand that the IRS, via disclosure requirements in its Form 990, compels nonprofit organizations to publically state if they have adopted and are following policies such as: a) Conflict of Interest Policy; b) Executive Compensation Policy; c) Whistleblower Policy; d) Joint Venture Policy; and e) Record Retention and Destruction Policy. *All nonprofit organizations should actively maintain and follow these policies for reasons that have little to do with IRS compliance.* Rather, these are all sound business and governance practices that effective organizations should naturally follow, regardless of any “IRS mandate”.

Organizations that have mastered Level 1 and Level 2 on the Hierarchy possess the foundational components that position it *and its CEO* to move towards developing a highly effective and successful organization. *Navigating through Levels 3 and 4 is where the contracted CFO’s unique value can result in the entity’s transformation.*

Level 3 – High-Value Management Data

Highly effective CFOs do not simply deliver and report on accounting outcomes; instead they interpret, translate, and ultimately supply management with data that enables an organization’s leaders to make highly informed decisions. At Level 3, the organization leverages high-value management data as a means to make well informed operating and strategic decisions. This is a crucial phase in an organization’s development and can be a crossroads for many entities. I have worked with organizations to develop robust management reports that have played a key role in their improvement, and I have also been involved with organizations that have failed to conquer this level—some showing little or no interest in achieving this paradigm. Those entities that plateau within Level 3 may remain economically viable, but they inevitably fall short of performing to their full potential.

The types of management information of greatest value to an organization will vary depending on its needs, priorities, and even the information processing style of its CEO. However, following are some of the more common reports I have developed with organizations within Level 3.

1. Key Performance Indicators measure an organization's performance against factors crucial to its success. I like to segment these indicators into the following categories:
 - a. Operational Indicators track outcomes that are important to short-term success
 - b. Sustainability Indicators report the organization's effectiveness in ensuring its long-term viability
 - c. Transformational Indicators provide management and a board with an assessment on those activities, or planned activities, that have the potential to drive the organization to achieve greater value
2. Resource Allocation Reports show where employees devote their time, not only for grants allocation purposes, but also for understanding how effectively the organization is deploying its human resources to support the mission.
3. Customized Cash Flow Reports provide valuable information on cash flows. If the organization is grant-funded, the reports should segment cash activity between proprietary cash (cash "owned" by the organization) and fiduciary cash (cash provided by grantors that must be spent in restricted or designated fashions)
4. Reports that present Cash and Short-Term Liquidity Needs typically forecast cash needs and balances for a period of 6-24 months and illustrate the laddering of excess liquidity in short-term investment instruments.
5. Financial Forecasts look 3-5 years out, focusing of programmatic opportunities as well as environmental threats.

At least some of these reports (perhaps in a varied format) should be shared at the board level as a means to enhance oversight and governance. The sharing of this data also increases a board's trust and confidence in management and sets the stage for moving to Level 4.

Level 4 – Management-Board Synergies

Nonprofit boards, with their diverse range of talents and perspectives, can be an invaluable resource to the organization. Obviously, the CEO is the person best positioned to engage the board (and its committees), but the CFO can also play a key role in this process by providing information that facilitates board/committee synergies. Information the CFO can share at the board level that will trigger valuable feedback include: a) financial forecasts that illustrate outcomes under various combinations of favorable

and unfavorable scenarios; b) treasury management practices and performance; c) updates on major capital projects or initiatives; and d) dashboard-style key performance indicators reports.

Organizations that master Level 4 will have succeeded in engaging their most valuable resource: the wisdom and support of those entrusted with not just their governance, but also their financial success. Management-board synergies mean that the CEO not only welcomes, *but encourages*, candid feedback from the board on any and all matters that can be important to the organization's success. Likewise, in Level 4 the board has great trust and confidence in management and is excited about helping the organization become even better. When these conditions exist, the organization and its CEO are well-equipped to achieve the Hierarchy's summit: Optimization

Stage 5 – Optimization

By this point, I suspect the reader recognizes that the Organizational Effectiveness Hierarchy bears a fair resemblance to *Maslow's Hierarchy of Needs*. In the Organizational Effectiveness Hierarchy, optimization is akin to Maslow's self-actualization level, where, to reach this point, a person must not only achieve the underlying four levels, *he/she must master them*. When an organization reaches optimization it is a dynamic entity that, by virtue of mastering the underlying four levels, is a recognized leader in delivering its mission.

In Maslow's Hierarchy, persons that achieve self-actualization are living creatively and to their full potential. I believe this is a fitting assessment of a CEO running an organization that has achieved optimization. These executives exude confidence in themselves—and their organizations—that is anchored by a solid understanding of the entity's strengths and financial health. They are deeply engaged in their community and are constantly seeking additional opportunities to expand and enhance mission delivery.

Conclusion

I believe the most crucial ingredient that enables an organization to reach its full potential is the superior leadership skills of the CEO. In the case of many smaller nonprofit organizations, a contracted CFO is uniquely qualified to support the CEO— and the board— in a manner that enables the organization to improve, grow, and ultimately succeed. The most unique and influential competencies the contracted CFO possesses that can drive such achievements are his/her ability to enable organizations to successfully master Levels 3 and 4 of the Organizational Effectiveness Hierarchy and, in the process, position the organization, and its CEO, to achieve optimization.

ABOUT THE AUTHOR

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APPENDIX A
Persons Consulted

The following lists the people who gave of their valuable time to either be interviewed for this white paper, or critiqued various draft versions. *I want to thank all of you for your input.* I am wiser for it.

Name	Title/Organization
Douglas L. Berman, CPA	Partner, Reinsel Kuntz Leshar LLP, York, PA
John Bonawitz, CPA	Principal, Brown Schultz Sheridan & Fritz, Camp Hill, PA
Nora Habig	Administrative Vice Pres., M&T Bank, Harrisburg, PA
Rhonda Hakundy-Jones	President, Ten Mile Mile Run Website Design & Marketing, Harrisburg, PA
Kathleen Pavelko	President & CEO, WITF Inc., Harrisburg, PA
Greg Poland	CFO, WITF, Inc., Harrisburg
David T. Warren	Vice Pres. for Core Markets and Philanthropy, Everence Financial Services, Mount Joy, PA
Matthew A. Zieger	President & CEO, Team Pennsylvania Foundation, Harrisburg, PA