

# Financial management in nonprofit organizations essay sample

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Financial management plays a very significant role to make an organisation successful whether it is a non-profit organisation or a profit motive organisation. Financial management is considered as a critical path, which all organisations have to follow to attain success. This paper provides us an insight of the application of financial management techniques of a Not for profit organisation and also a comparing with For-profit organisation.

Although, the strategic management process for both the organisation is very similar. However, a non profit organisation often function in a monopolistic environment which render services or produce product which offers low measurability (profit) and depends on finances from outside sources. The nonprofit sector is growing and the need to understand its efficiency, governance is very important for its stake holders, investors, donors, tax authorities and regulators.

## Introduction

A Not for-profit organisation or Nonprofit organisation or NPO is a tax exempted organisation which is formed with the primary objective or goal in mind. It renders service to the public without making a profit. To be considered as a non profit organisation an organisation needs to be classified as an educational, religious, charitable or scientific organisation. A Non profit organisation does not distribute its excess funds to its owners or stake holders rather the surplus funds are reinvested to pursue and meets the organisation mission and goals. Legally, we can say that a Not For-profit organisation are those organisation that does not declare profit rather utilises all their revenues available with them after meeting their operating

expenses for the benefits of the society or public. As per Internal Revenue Service an unincorporated nonprofit organisation is not given a tax exemption status or the designation of 501(c) (3) organization.

For profit and non-profit organizations there are various things common, but they cannot be ruled out from some significant differences.

One of the main points of distinction between a nonprofit organization and profit organization are the reason of existence. A Profit organization generates income for its owners, employees, investors etc whereas a NPO are formed to serve the environmental or humanitarian needs. Under non profit organizations its income are channelized into services and programs that aims to meet people need and their benefits such as food, shelter, education, water and various other issues like deforestation, water, shelter & education and also other issues like deforestation, endangered species etc. A profit organization offers product and services that has a demand in the market and the profit earned is shared among its owners, stake holders, investors, employees etc.

### Features

For any organization revenues (cash & receivables) are considered as a life blood of the companies. In For-profit organization they rely on income earned from the suppliers, lenders to finance their operation whereas a non profit organization completely rely on the donation, grants received from the individuals, government agencies and other organization. For profit and nonprofit organization income source describes the use of its money. In an

NPO the money received from the donors is used to render services for the public or to accomplish the objectives and mission of the nonprofit organization and in case of for-profit organization income earned are retained by the owners or to pay the debts. These organizations have a more ethical leeway of spending their money.

### Tax and Liability Considerations

A for Profit organization is taxed in a number of ways depending on their size of organization. In case of Small businesses houses like sole proprietorships & partnerships firms IRS treats the income as a personal income and in case of debts the individual is liable for all its debt where as a nonprofit organization can register itself under section 501(c)3 of the tax code. People who contribute to nonprofit organization as donation are offered tax exemption on the money donated. As per Service Corps of Retired Executives (SCORE) a nonprofit companies are considered as a legal entities for tax purposes leaving founders of the company not liable for its debts.

### Human Resources Considerations

The work force of a nonprofit organization is very different compared with the For-profit organization. For- Profit Companies are staffed with salaried and contractual employees. Whereas a nonprofit organization usually employees a small workforce with a large number of people working for the company as volunteer. The procedure of hiring of employees, firing them communication, employee motivation vary considerably in both the organization.

## Financial Management in Nonprofit Organizations

Financial planning & management are the major sections of a nonprofit organization which have to be taken seriously in order to keep the organization running. However, a not for profit organisations has to face some difficulties that they must overcome in order to succeed. Proper measures have to be in place like specifying goals and having clear objectives along with the benefits required by the organisation.

Finding out the actual cash flow is difficult because the NPO depends solely on the revenues from donors who are not even beneficiaries of the service rendered. Consequently, the means of NPO's primary purpose of financial planning ; management as mentioned earlier is to capitalize on the benefits of any resource contribution. The difficulties in this area are that it is not common to predict when money will come from donors and as a result it could cause serious crisis in management when there is a high demand for their services. This, is why budgeting is very important for a not for-profit organization.

### Budget of Non-profit Organisation

All the companies of Not For-profit, commercial or government organisation uses budgeting to establish a proper use of resources as planned by their management and to maintain good record keeping. The capability to budget effectively is part of being a successful not for-profit organization. Budget is important because it can be use to set performance and motivation standards of its staff ; board members. It can also be use as an

implementation tool for measuring results if the organization's mission is met or not. It is imperative to include accounting staff, fundraising staff, board members & other department leaders in the process. Thus, established a clear concentration on the direction for which resource will be distributed and make good use of what is available for the delivery of services. Budgeting is an excellent planning strategy that can help sketch potential financial goals and enhance management.

### Planning of Nonprofit Organisation

Planning a budget in a nonprofit organization includes an extensive glance of general operating expense, base on sizes and assets. Considering future inflows is very important in any organisation. Budgeting appears to be very complicated because of the legal structure to maintain a nonprofits organization. Nonprofits have the tendency to centre most of their issue on board development, fundraising and volunteer management, and while for profit centre on information presented in the situation of nonprofit planning. In the budgeting procedure there is a possibility of discovering future shortfalls that may lead to stringiest fundraising etc.

For example, if an organization has goals to organize for building capital than a serious campaign maybe needed or an expert may be brought in to assist with planning arrangements for the company to meet it needs. It is also important to consider the fact that, unlike commercial business; nonprofit excess might be looked upon by donors and other citizens as the organization's failure to deliver on its defined mission. With nonprofit

organization, it is imperative to approximate projects cash flows and program priorities have to be balanced in an excellent budget. Nonprofit managements have to assign its capability and capital to correspond to their intended spectators and recipients. Some nonprofits do request for some form of compensation in services and that makes things difficult for the organization to increase service prices.

The planning process must include lead-time for donations and should be included in the budget. Nonprofit financial managers preparing budgets should make sure that enough funds are available to manage programs even over the expected period of the budget cycle to avoid shortages etc. Once the budget is approved by the Board of Directors, it should then be used as a managing instrument to build towards measuring efficacy. An excellent budget should show resources allocated to all programs connected to strategic goals. It should be able to show that operation objectives and performance of an organization are effectively using resources and can show that an action is needed for modification.

A modified budget within an operational period shows proper supervision arrangement. A modified budget should be able to address unexpected circumstances. An important part of budgeting is staff management's responsibilities because responsibility should be placed in the hands of staff that are able to lead the organization to accomplish its objectives. Thus, staff and management's complete consciousness and involvement is highly needed if the organization wants to meet its mission and make good use of their budget.

## Nonprofit funding Sources

Srinivasan in her article makes it that the one fundamental element which defines the capacity of the nonprofit zone is funding. The purpose of charitable companies is to enhance the public good. However, an organization needs working capital to be successful, along with a good team of accountant, operations, and financial management. Accounting takes care of the company's payable and receivable, while operations focus on inventory and financial management deals. It also determines how funds are used on fixed assets and prepare dividend strategies corresponding to the companies' goals.

Funding is solicited through two major sources public and private funding in case of an NPO so that the organisation can meet its goal.

## Conclusion

For a Not For-profit organisation budgeting and cash management is very crucial. This aspect speaks loud by overextending stewardship compulsion of a nonprofit company that accepts financial donations to meet its supposed goals from the public. Management faces some challenges dealing with nonprofit company's revenue sources because of its unpredictable switch as a result of political atmosphere or economic factors. Financial accounting takes care of the organizations payable and receivable.

A fund accounting structure in the present day may combine both traditional accounting principles and applying the classified operations of FAS 117



standards. This method is challenging for a money-making organization to trail finance at a specific time and period to make sure that limited goals are accomplished. Nevertheless, using a fund accounting structure by a nonprofit organization management must consider the two most important elements which are the financial management day to day reporting requirements and the capability to show stewardship of donated capital.