

Financial focus prescribed for nonprofits

Todd Cohen | March 16, 2010

The economic storm stressing nonprofits makes it critical they know their finances, financial risk and strategic options, and be bold in making financial plans and changes, experts say.

"Nonprofits should be on top of their numbers now more than ever before," says Clara Miller, president and CEO of the Nonprofit Finance Fund, a community-development financial institution that makes loans to nonprofits, provides financial consulting to them, and advocates for improvement in their finances.

Judith Alnes, executive director of MAP for Nonprofits, a nonprofit in St. Paul, Minn., that provides management consulting to nonprofits, says nonprofits need to think big about their financial strategy.

"What we're urging organizations to do is to be bold," she says. "That will make the biggest difference in communities we serve if we are bold in our planning and bold in our execution. Simply reducing expenditures isn't going to be enough."

The bottom line

Nonprofits need to "tell the truth about their financial situation in order to even think through what the right strategies are for their future," Alnes says.

In particular, she says, nonprofits need to pay attention to their cash position.

So nonprofits should create a cash-flow forecast for at least a year into the future, looking at "each and every source of revenue" and conservatively estimating what is likely to happen with each of them, she says.

Miller says nonprofits typically have responded to the economic downturn by generating profit-and-loss statements and cash-flow projections, reports she says nonprofits should be preparing each month.

And those numbers should reflect "the actual, the real revenue," she says.

"You should be making sure your numbers are good and you are looking them straight in the eye," she says. "If you don't have the windshield cleared, you're going to drive into a tree."

Board and staff roles

In addition to its fiduciary responsibility, the board's role in the organization's financing is to "pay attention to the strategic direction of the organization," while the staff's role is to "pay attention to the extent to which each program aligns with the strategic direction," Alnes says.

Miller says the board's role is "paramount and distinct" from that of the organization's managers.

"The role of the board is to represent the public, to say, 'We are serving the public and our fiduciary responsibility is to make sure these resources are deployed with the best interest of the public in mind,'" she says.

So managers need to communicate with the organization's board and other stakeholders, and to "over-communicate, if necessary," she says.

And in tough economic times, she says, deploying resources for the best public use can be challenging.

"It's particularly tough because, in some cases, simple survival of jobs and organizations may not serve the public interest as well as other possibilities, and that's in the most dire set of circumstances," she says. "That is sometimes heartbreaking, but in these times sometimes important."

Financial tools

A key financial tool for nonprofits is a program-profitability analysis that tracks the profitability of each line of business, Miller says.

A homeless shelter that runs an overnight program, a training program and a substance-abuse program, for example, should track the distinct funding sources and direct expenses for each of those programs, she says.

"It doesn't mean if you're not making money, you shouldn't do it," she says. "But if you're not making money and it's not core to your mission," she says, "you should consider doing away with it, or at least get the staff and board rallied to make sure you're funding it."

Tracking fundraising directly tied to a particular program or line of business "clarifies the relationship of the program to the basic finances of the organization," she says. "It's having good information to make decisions, rather than making decisions because of desperation or sentimentality."

And the staff needs projections on revenue and expenses, possibly every day or at least every week, Miller says.

The idea, she says, is for the staff always to be able to see the actual financial picture across the entire organization, not just for individual projects and not just what is budgeted.

The board, in turn, needs a "very clear dashboard to understand what's getting done," she says.

Drilling down

Nonprofit accounting, using generally accepted accounting principles, "tends to obscure and distort financial results," Miller says, because all revenue, regardless of its source, is entered into the organization's income statement.

So proceeds from a capital campaign or a bequest, for example, both would be treated as regular income, she says.

"So it's a little difficult to figure out what the reliable and repeatable income is," she says.

"That is important because a primary measure of operating risk is the relationship of your reliable revenue to your fixed costs," she says. "If your reliable revenue is a lot less than your fixed costs, you have structural deficit you have to fix."

The challenge for nonprofit managers, she says, is to "work around" by identifying "extraordinary revenue to understand your financial risk and vulnerability."

One-time project grants, for example, "may mask the reality that the organization is unprofitable in its core business," she says.

With annual expenses for the overwhelming majority of nonprofits less than \$250,000, Miller says, lines of business are limited, and keeping track of finances is relatively uncomplicated.

But as organizations grow and their annual revenue totals \$500,000 to \$2 million, they need to set up a regular system for tracking and analyzing cash flow.

"Cash is king in tough financial times," she says.

Weighing the options

Many nonprofits have responded to the impact of the recession by eliminating optional expenses such as travel and training, freezing salaries and asking staff to pick up more of their health-insurance costs, Alnes says.

"Organizations need to go beyond just freezing expenses and think about how they can organize themselves to have a bigger impact with the resources they do have available," she says.

That kind of thinking should be constant, she says.

"Instead of using an old-fashioned agenda for a board meeting, with program reports and financial reports, every conversation at board and staff meetings needs to be about the strategic choices that face the organization," she says.

Miller says nonprofits should use "scenario planning" that projects the financial impact, over a number of years, of a specific financial or programmatic decision.

And the thinking needs to be bold, Alnes says.

"It includes answering questions about what our organization's size and scope and structure should be in order to do the work that advances our mission," she says. "And putting daring choices on the table, like getting out of certain lines of business, changing the geography you serve, identifying potential merger partners."

Alnes' organization encourages nonprofits "to be very inquisitive about what some of their choices are so they are prepared to make tough decisions if they need to make those decisions," she says. "If their cash-flow picture shows them they're likely to be in a negative cash position for half of the year, for instance, they're going to have to make a decision whether they're too big for their financial britches."

The nonprofits that worry her "are the ones that aren't doing that," she says, "because they're going to get caught off guard."