

Nonprofit Finance Fund



Linking Money to Mission: A Balancing Act

Presented by

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For grantees of



GREATER NEW ORLEANS FOUNDATION

For a vibrant region.

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Agenda



Welcome & Introductions

Challenges of Nonprofit Finance

- “Best practices” that inhibit nonprofit health

Assessing Financial Health

- Understand Operating Performance & Full Cost
- Determine Strength of Balance Sheet

Wrap Up

Nonprofit Finance Fund: Where Money Meets Mission



Served thousands of nonprofits and funders since 1980

- \$300 million in loans; \$100 million in New Market Tax Credit deals; over \$1 billion in capital leveraged
- Over 1,000 consultancies/workshops over past 5 years
- Multiple strategic partnerships to place capital
- Low/moderate income emphasis and orientation
- Nationwide network of experts in nonprofit finance
- Capital Access: Debt, PRI management, New Market Tax Credits, "Philanthropic Equity," Catalyst Funds
- Financial advisors and educators
- Collaboration/Merger specialists
- All sub-sectors served: \$2-\$50MM

"[NFF is]... arguably the most influential voice in the ongoing effort to reshape thinking and practice about nonprofit capitalization."
-The Nonprofit Times

Introductions



Your name

Your role in the organization

**How comfortable are you with nonprofit finance?
(1 to 5 scale)**

Overview: Rules of the Room



Speak freely

No judgments

Ask questions

Please turn off all cell phones and other devices

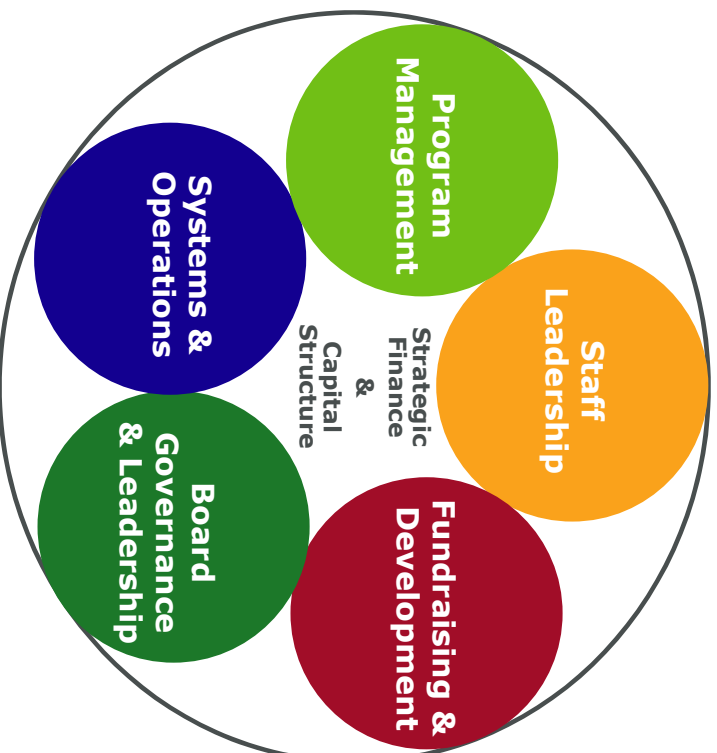
Feel free to get coffee or get up and stretch

Goals for This Session



- Discuss some existing limitations – both structural and behavioral – to nonprofit financial health
- Learn the basics of assessing the financial condition of nonprofit organizations
- Equip you to incorporate your organization's business dynamics and financial condition in planning and decision making for programmatic success

Why Focus on Finance First? Adaptive Capacity



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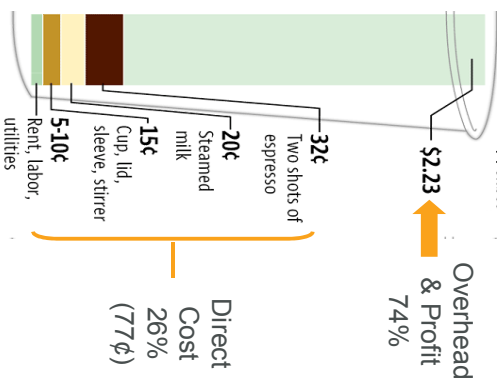
Wrap Up

"Rules" of FOR-PROFIT Finance

In the **for-profit** world,

- ▶ Customer buys the product.
- ▶ Price includes the full cost of doing business.
- ▶ Overhead and profits are seen as **necessary and regular** part of the business

12-ounce latte = \$3.00



A. RAYMOND/THE SEATTLE TIMES

Source: Matt Milletto, Vice President of the American Barista & Coffee School

"Rules" of NONPROFIT Finance

- Nonprofits exist for a reason:
 - Rarely an obvious commercial return
 - Quality considerations make economies of scale elusive
- Client often does not pay or pays partially for the product (e.g., homeless do not pay per night for shelter)
- Nonprofits rely on third parties (donors and funders) to subsidize the cost → **required "dependency"**
- Donors and funders want most of their contribution to go directly to the people served
- Overhead and profits are often seen as unnecessary and unrelated to achieving the mission

SURPLUS SIZE MATTERS: BREAKING EVEN IS NEVER ENOUGH



Like any organization, nonprofits need to cover the 'full cost' of delivering programs

- Tax Status vs. Business Model
- Full Costs > Operating Expenses

Full costs include:



MISSION SUPPORT (SUBSIDY) BUSINESS



Since nonprofits can rarely charge prices sufficient to cover the full cost of their core mission programs, they require support businesses (a.k.a the "subsidy" business)

Common subsidy businesses include:

When program growth or change occur, one of two things happens:

- more subsidy; OR
- financial chaos

RESTRICTED FUNDING



In the for-profit world, we place no restrictions on the money we give to corporations either as buyers or investors

However, in the nonprofit sector, restrictions are the norm:

- Restricted contributions implicitly...and often times explicitly... forbid organizations from using funds to pay for "indirect" costs
- Nonprofit leaders have become desensitized and trained to 'accept what they can get' rather than ask for what they need

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Wrap Up

Financial Health: Uncovering the Financial Story



Understand Operating **Performance**



Determine **Strength** of Balance Sheet



Assess Ability to Handle **Risk** and Pursue **Opportunity**



Comprehensive Financial Analysis

SOURCES OF NONPROFIT FINANCIAL DATA

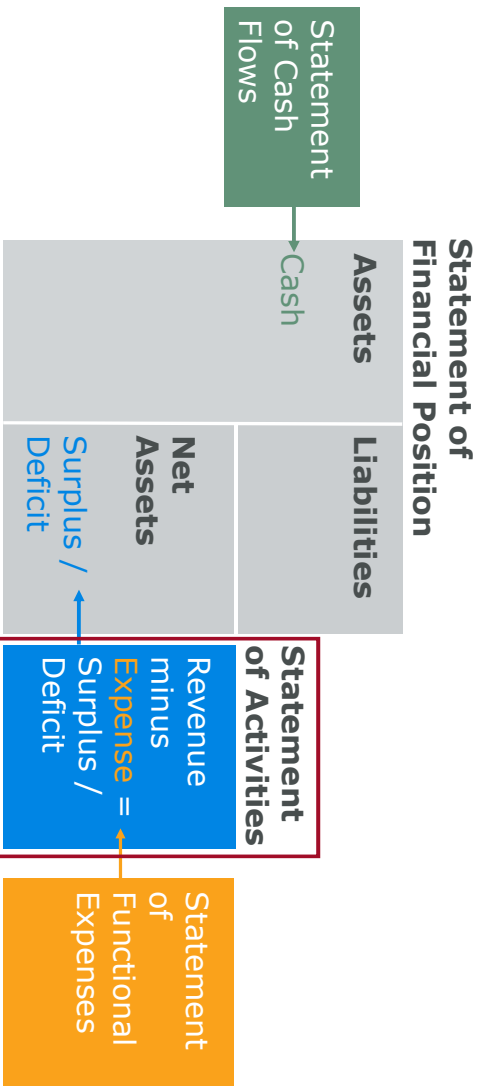


What documents do you currently use to assess financial health?

- Audited financial statements (compilation or review)
 - Balance Sheet
 - Statement of Activities
- Organizational budget (projections, if any)
- Current year actuals/forecast vs. budget
- Program-specific budgets (ideally full cost basis)

NFF looks at three to five years of financial data

Using Financial Statements to Assess Financial Health



Understanding Your Income Statement

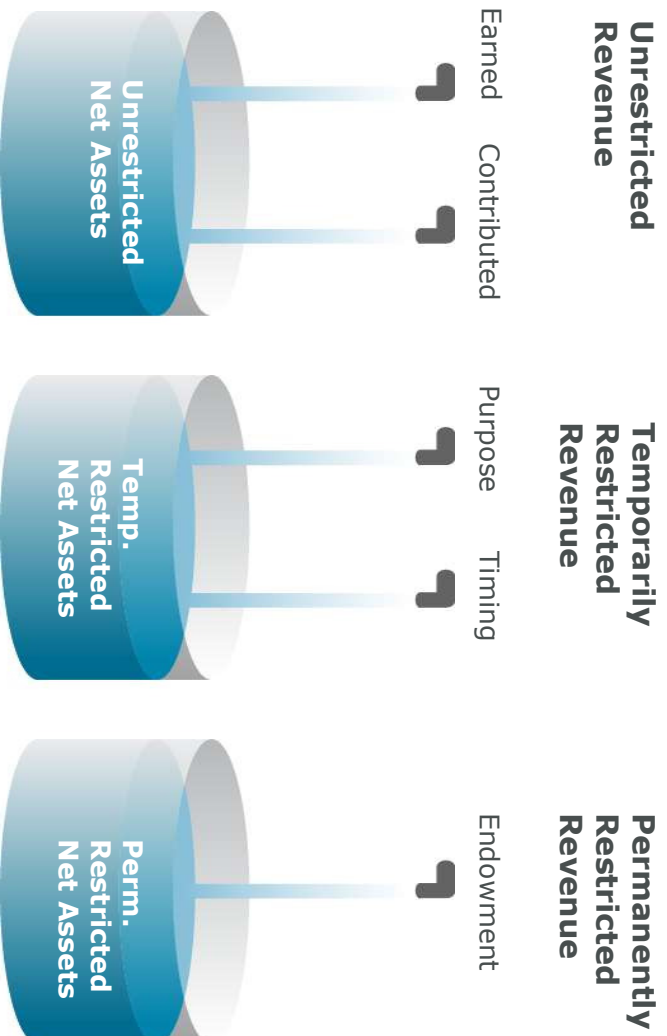


INCOME STATEMENT

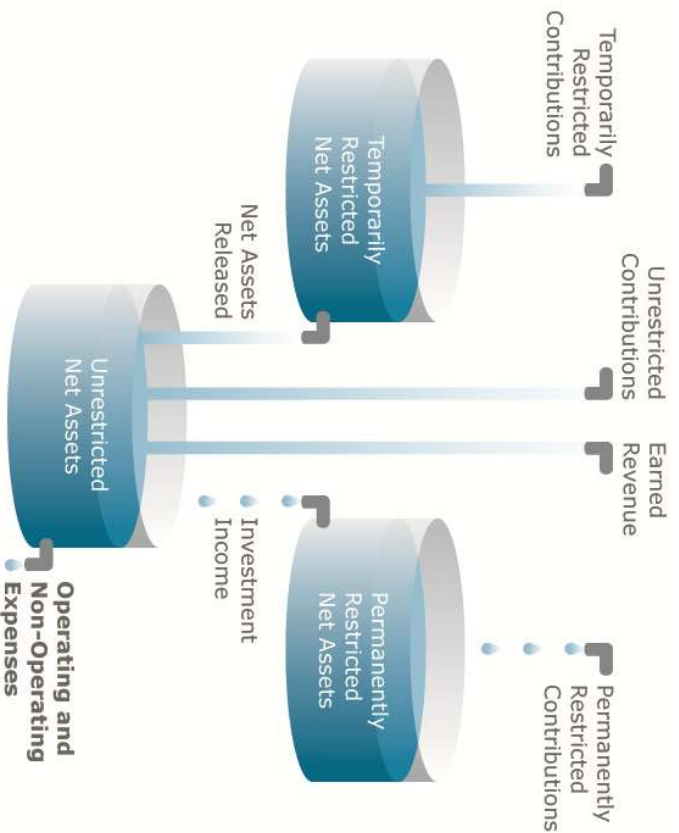
REVENUE
Earned Contributed <i>Private Sources</i> <i>Government</i>
EXPENSES
Personnel Professional fees Occupancy Program Costs Admin Costs Other
Surplus/Deficit

- **Revenue Dynamics:** Where did your money come from? Were revenue streams reliable or at risk? Was seasonality a factor?
- **Expense Dynamics:** How did you spend your money? Were expenses predictable? Which expenses were your responsibility? Was management responsive to operating changes and prepared to make difficult decisions?
- **Profitability & Savings:** Were costs covered? Were you able to generate savings?

Revenue Goes into Three "Buckets"



Relationship of Revenue Restrictions to Operations



Where Do I Find the Bottom Line?



ABC Center Statement of Activities

Years ended June 30, 2008 (\$ in thousands)

	Operating Activity			Total
	Unrestricted	Temp. Restricted	Perm. Restricted	
Revenues, Gains and Other Support				
Support				
Foundations	113	58	-	171
Government Corporations	57	-	-	57
Individuals	49	-	-	49
Individuals	248	-	-	248
Total Support	467	58	-	525
Investment Income	7	-	-	7
Tickets, Dues, Other	484	-	-	484
Net Assets Released from Restriction	749	-749	-	-
Total Revenue, Gains and Other Support	1,707	-691	-	1,016
Operating Expenses				
Program Services	1,004	-	-	1,004
Supporting Services				
Administrative	209	-	-	209
Development	49	-	-	49
Total Supporting Services	258	-	-	258
Total Expenses	1,262	-	-	1,262
Change in Net Assets	445	-691	-	-246

Nonprofit Accounting Masks True Operating Results



ABC Center Statement of Activities

Years ended June 30, 2008 (\$ in thousands)

	Operating Activity			Perm. Restricted	Total
	Unrestricted	Temp. Restricted	Perm. Restricted		
Revenues, Gains and Other Support					
Support					
Foundations	113	58	-	171	
Government Corporations	57	-	-	57	
Individuals	49	-	-	49	
Individuals	248	-	-	248	
Total Support	467	58	-	525	
Investment Income	7	-	-	7	
Tickets, Dues, Other	484	-	-	484	
Net Assets Released from Restriction	152	-152	-	-	
Total Revenue, Gains and Other Support	1,110	-94	-	1,016	
Operating Expenses					
Program Services	1,004	-	-	1,004	
Supporting Services					
Administrative	209	-	-	209	
Development	49	-	-	49	
Total Supporting Services	258	-	-	258	
Total Expenses	1,262	-	-	1,262	
Operating Surplus/(Deficit)	-152	-94	-	-246	
	Non-Operating Activities				
Unrestricted Non-Op. Revenue/Expenses (e.g. capital campaign receipts/releases)	597	-597	-	-	
Net gain (loss) on sale of assets	-	-	-	-	
Change in Net Assets	445	-691	-	-246	

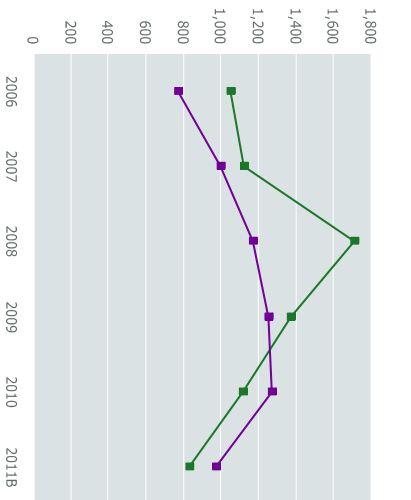
Determine true **Operating Surplus / Deficit**

Non-operating revenue segregated and placed "below the operating line"

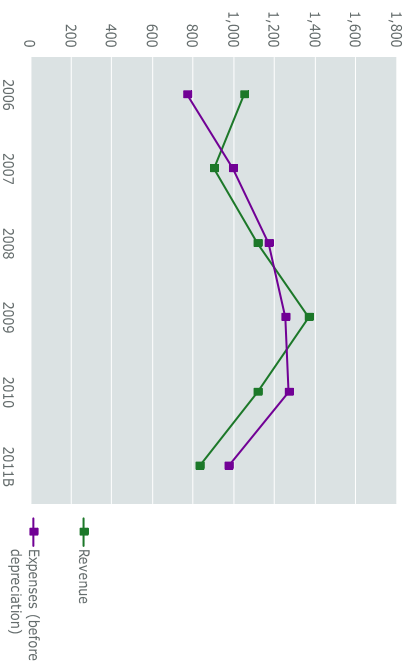
Non-Operating Dollars Hide True Operating Performance



Unrestricted Revenue & Expenses
(including non-operating)
(\$ in thousands)



Operating Revenue & Expenses
(\$ in thousands)

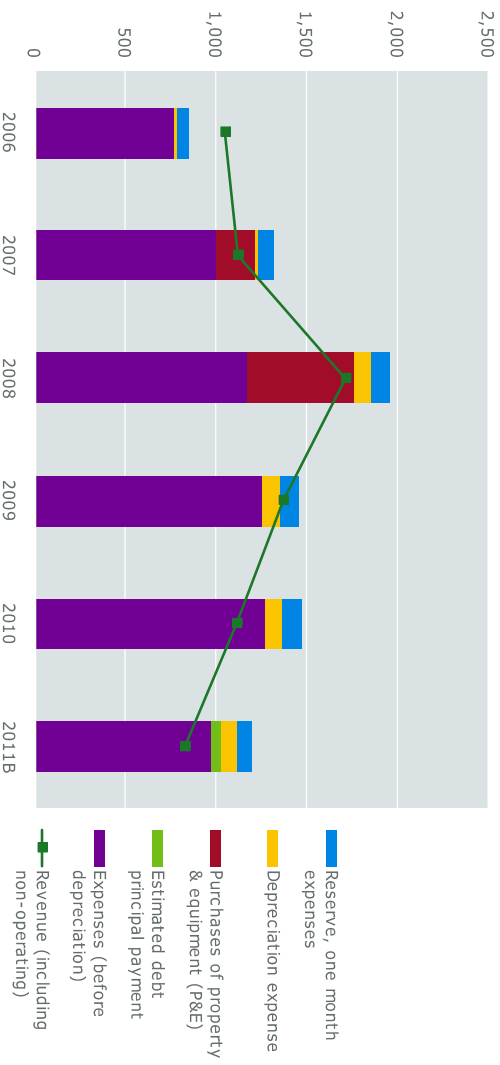


With revenue for capital projects "below the line," this organization is not breaking even!

Operating Surpluses May Not Cover the Full Cost of Business



Total Cost of All Business Activity
(\$ in thousands)



Understanding Performance: A Guideline



Financial Indicator	Healthy	Moderately Healthy	Requires Immediate Attention
Unrestricted Surplus/Deficit	Surpluses <i>consistently</i> cover annual debt repayment, depreciation expense, fixed asset investments and reserve goals	Surpluses that are periodic or insufficient to cover full costs	Consistent and/or growing deficits

GROUP EXERCISE: The Center for Care



The Center for Care is a human services organization whose mission is to empower clients to take charge of their health and well-being. Their programs and services often win awards for innovation and excellence.

It is the only social service organization in its county whose mission is dedicated to serving women, children and families.

The Center bought a building in 2003, utilizing \$450K in debt financing. In June 2013, the organization will need to make a balloon payment of \$300K.

The organization has received a challenge grant of \$350K for its family violence prevention program, with annual renewal for up to 5 years. It must raise an additional \$175K to meet the challenge. (Total new revenue=\$525K/yr)

You have recently joined the organization as Executive Director. You are currently in the beginning of FY2010, and the board has said it expects to see a 'breakeven' budget.

GROUP EXERCISE: Understanding Operating Performance



How would you interpret their 2008 and 2009 Statement of Activities?

- How large is the grant relative to current operations? What would be the new size of the organization?
- What changed between 2008 and 2009?
- What are the unrestricted operating results?
- What is the composition of revenue* and expenses?

*For this audit, "support" is contributed dollars and "revenue" is earned dollars.

GROUP EXERCISE: Understanding Operating Performance



- How large is the grant relative to 2009 operations?
 - -
 - -
- What changed between 2008 and 2009?
 - -
 - -
 - -
- What are the unrestricted operating results?
 - -
 - -
- What is the composition of revenue and expenses?
 - -
 - -
 - -

Financial Health: Uncovering the Financial Story



Understand Operating **Performance**



Determine **Strength** of Balance Sheet

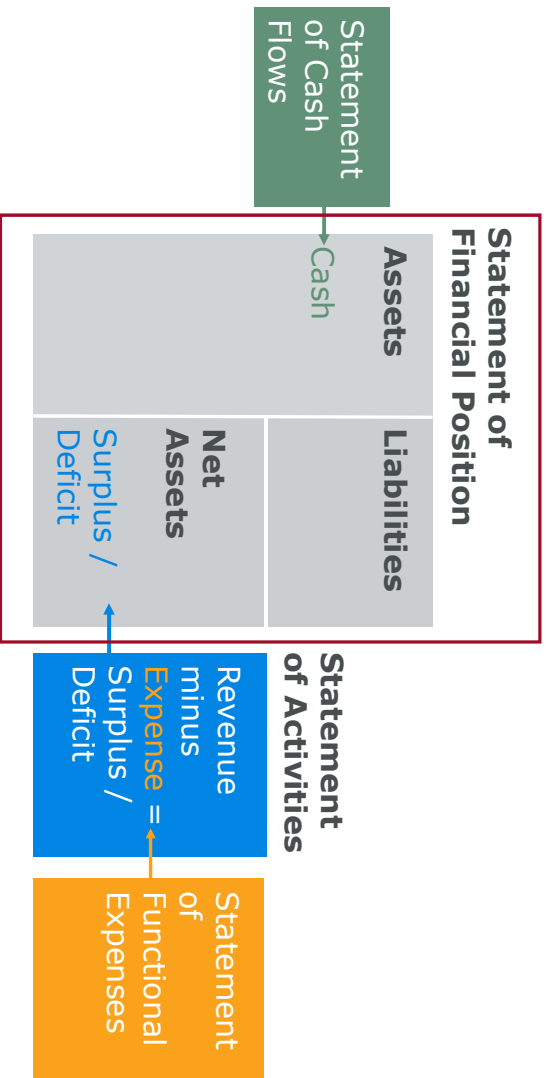


Assess Ability to Handle **Risk** and Pursue **Opportunity**



Comprehensive Financial Analysis

Using Financial Statements to Assess Financial Health



Determine **Strength** of the Balance Sheet

The Two Bottom Lines

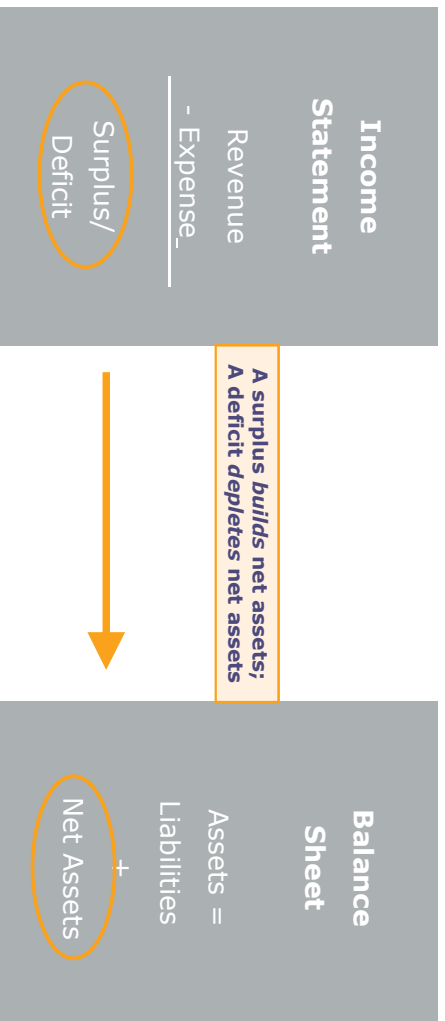


Income Statement: Surplus/Deficit

- Income Statement reflects the annual results of a nonprofit's business

Balance Sheet: Net Assets

- Balance Sheet provides a picture of overall financial health



How to Read the Balance Sheet: Know Where You Stand



BALANCE SHEET	
<p>ASSETS Does the organization have access to appropriate resources?</p> <ul style="list-style-type: none"> Cash - How much? How "liquid?" Receivables - Are they slow to collect? Are they at risk? Investments - How much? Are they restricted? Property & Equipment – How do you deal with maintenance issues? 	<p>LIABILITIES Does the organization owe more than it owns?</p> <ul style="list-style-type: none"> Payables, Debt - How is cash flow managed? Are you using debt appropriately?
<p>NET ASSETS</p> <ul style="list-style-type: none"> Unrestricted Net Assets – Do you own more than you owe? How much is liquid? Temporarily Restricted Net Assets – Do they support core programs? Reserves – Do you have them? Are they suitable to your needs? 	

Balance Sheet: Why Does it Matter?

An organization's **adaptive capacity** –its ability to change – is directly tied to the strength of its capital structure (balance sheet)

If the organization has...

- No unrestricted cash or receivables
- A fully drawn line of credit
- Little or no reserves available to management
- Significant wear-and-tear of fixed assets

...It has very little ability to adapt or grow

- Borrowing to replace lost income is rarely appropriate

Risk – Cash = Crisis

Reading the Balance Sheet: Looking for the Story

From 7/1/07 to 6/30/08, ABC Nonprofit engaged in operations reflected on the Statement of Activities.

Statement of Financial Position

FYE 06/30/07 (\$ in thousands)

Assets	Liabilities	Total
Cash	296 Payables	131
Receivables	612 Debt	0
Prepaid Exp.	22	
Other	29	
P&E (Net)	256	
Long-term receivables	39	
	Total Liabilities	131
	Net Assets	325
	Total Unres.	797
	Temp. Rest	0
	Perm. Rest	0
Total Assets	Total Net Assets	1,122
	Total Liab./Net Assets	\$1,253

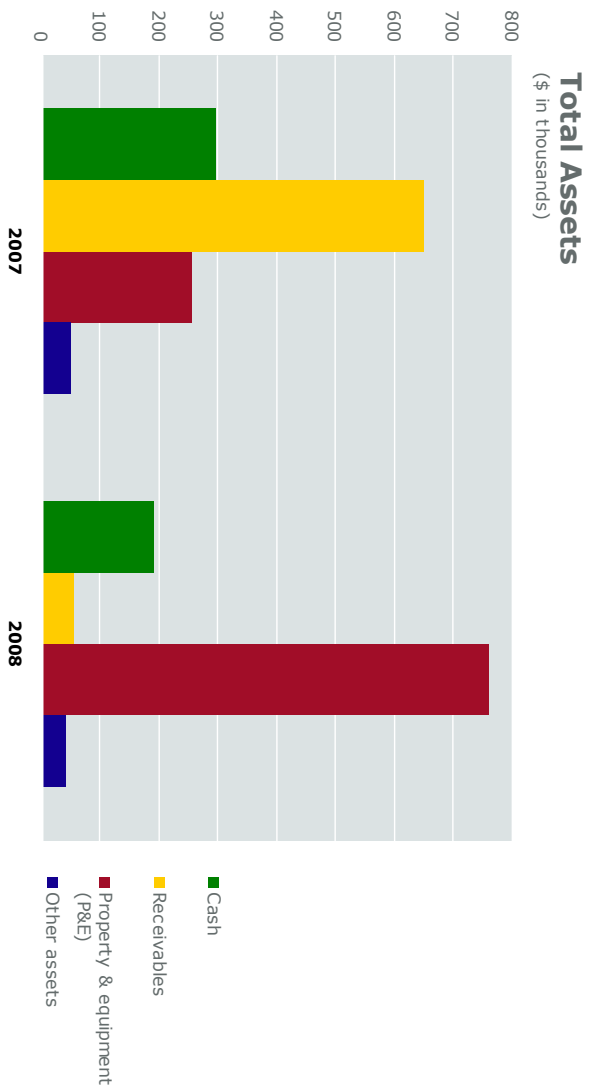
Statement of Financial Position

FYE 06/30/08 (\$ in thousands)

Assets	Liabilities	Total
Cash	191 Payables	57
Receivables	55 Debt	114
Prepaid Exp.	41	
Other	-	
P&E (Net)	760	
Long-Term receivables	-	
	Total Liabilities	171
	Net Assets	771
	Total Unres.	105
	Temp. Rest	0
	Perm. Rest	0
Total Assets	Total Net Assets	876
	Total Liab./Net Assets	\$1,047

What changed? What might this mean?

Reading the Balance Sheet: Looking for the Story



Financial Health: Uncovering the Financial Story



Understand Operating **Performance**



Determine **Strength** of Balance Sheet



Assess Ability to Handle **Risk** and Pursue **Opportunity**

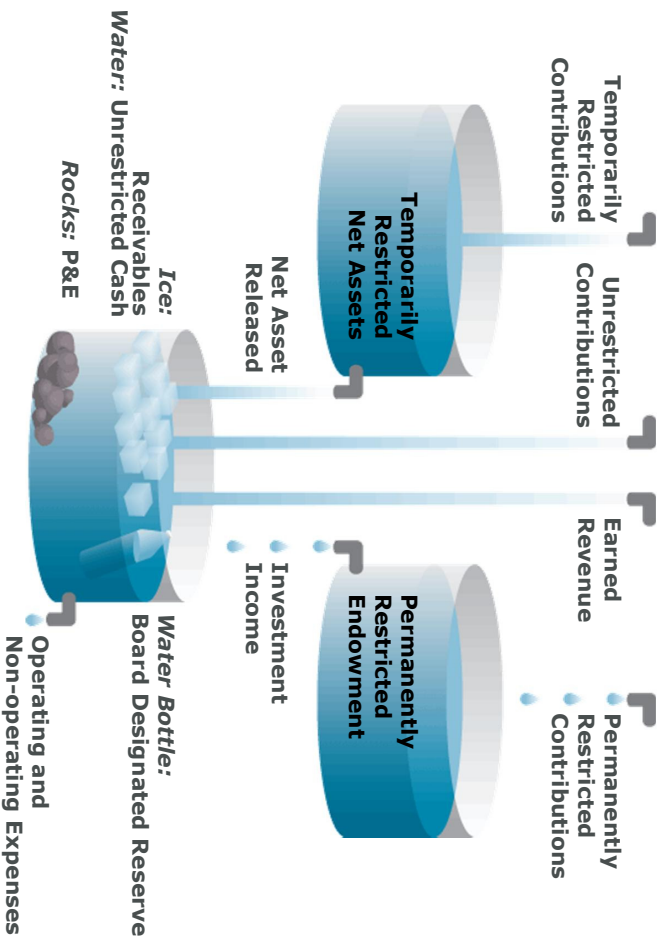


Comprehensive Financial Analysis

Liquidity: Different Measures to Assess Risk

	Cash	Working Capital	Liquid Net Assets
Liquidity Source	Existing cash balance	The difference between current assets and current liabilities	The <i>liquid</i> portion of unrestricted net assets

Examine Net Asset Composition

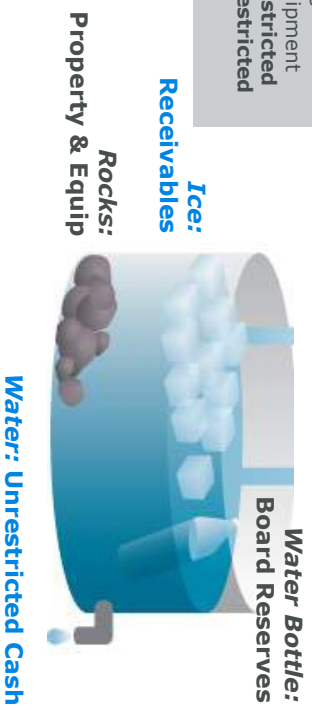


Measures of Liquidity on the Balance Sheet



Balance Sheet

Assets	Liabilities
Cash	Payables
Receivables	Debt
Investments	
Property	
Net Assets	
Unrestricted Liquid Net Assets Board Reserves Property & Equipment Temporarily Restricted Permanently Restricted	



Measuring Liquidity



Months of Cash =

$$\frac{\text{Total Cash}}{(\text{Total Expenses} / 12)}$$

Months of Liquid Net Assets =

$$\frac{\text{Unrestricted Net Assets} - (\text{P\&E} - \text{P\&E Debt})}{(\text{Total Expenses} / 12)}$$

Months of Liquidity: Rule of Thumb

Right amount for an organization?

Months of Expenses Covered by Liquidity	Operating Situation
< 1 month	Crisis – Scrambling for cash, delaying payment to vendors, overdrawing checking account.
< 3 months	Cash is tight – Relying on line of credit, delaying payment to vendors.
3-6 months	Room to breathe – Can do some long-term thinking. Little room for “rainy days.”
6+ months	Handles risk – Able to withstand increasingly acute shocks such as large facility repairs, funding cuts and possibly recessions.

Where are Liquid Net Assets?

ABC Center Statement of Financial Position

(\$ in thousands)

	Audit		Audit	
	06/30/07	06/30/08	06/30/07	06/30/08
Assets				
Current				
Cash and Equivalents	296	191	127	57
Grants & Pledges Receivable	612	55	-	-
Accounts Receivable	-	-	5	-
Inventory	-	-	-	-
Prepaid Expenses	22	41	-	-
Other Current Assets	29	-	-	-
Total Current Assets	959	287	131	57
Long-Term				
Long-Term Investments	-	-	-	-
Deposits and Prepaid Rent	-	-	-	-
Grants & Pledges Receivable	39	-	-	114
Net Fixed Assets (P&E)	256	760	-	-
Other Long-Term Assets	-	-	-	-
Total Long-Term Assets	295	760	131	114
Total Assets	1,253	1,047		
Net Assets				
Undesignated			70	11
Board Designated			-	-
P&E			256	760
Total Unrestr. Net Assets			325	771
Temp. Restricted Net Assets			797	150
Perm. Restricted Net Assets			-	-
Total Net Assets	1,122	876		
Total Lab. & Net Assets	1,253	1,047		

Look for “Undesignated” or “Liquid” Unrestricted Net Assets

Different Balance Sheets will have different classifications

GROUP EXERCISE: Determine the Strength of the Balance Sheet



It's your turn again. Refer to The Center for Care's Statement of Financial Position for 2008 and 2009.

- What changed from 2008 to 2009?
 - What is their balance of unrestricted liquid net assets in 2009? (Hint: debt is facility-related)
 - Calculate months of cash for 2009 and months of unrestricted liquid net assets for 2009.
-
- What are The Center's "full costs" (balance sheet needs)? (Examples: reserves, facility reinvestment)
 - Will a "breakeven" budget this year make the organization sustainable ?
 - How might The Center be managing cash flow?*

*The Center does not have a bank line of credit.

GROUP EXERCISE: Determine the Strength of the Balance Sheet



- What changed from 2008 to 2009?
 - -
 - -
- What is balance of unrestricted liquid net assets in each year?
 - -
 - -
- Calculate months of liquidity for 2008 and 2009
 - -
 - -

What Is TCC's Full Cost of Business?



New Revenue Needed for Operations

"Structural" Deficit (every year)	
Match	
Total	\$ ____

Capital Needed for 3-Year Balance Sheet Goals

To fill in the "hole" (Year 1 only)	
To save \$300 Balloon in 3 years	
To get 1 month ULNA by 2013	
Total	
To get 3 months ULNA by 2013	
To create facility reserve	
Total	\$ ____ Year 1 \$ ____ Year 2, 3...

GROUP EXERCISE: Wrap Up



- Growth changes overall capitalization and full costs, altering an organization's surplus needs.
- New sources of revenue, like the large matching grant, can fundamentally change an organization's business model. Ensuring that a new funding source is sustainable may require investments in new skills and tools.
- Ignoring or delaying balance sheet needs over time (like saving for a balloon payment) will ultimately inhibit an organization's ability to scale when the opportunity presents itself.

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Wrap Up

Nonprofits Need Profits



- Many business choices are risky; a cash cushion can help manage this risk.
- Risk minus Cash = Crisis
- Surpluses need to be sufficient to:
 - Pay for the annual “wear-and-tear” of PP&E
 - Finance investments in new fixed assets and/or improvements that may not be fully financed through a capital campaign
 - Cover debt principal payments
 - Contribute to growth and savings
- Surpluses are an indicator of good management and increasingly recognized as such by the funding community

What You Can Do: Identify What Stands in the Way of Open Dialogue



As an Executive Director, why might you resist an open dialogue with your funder about your financial health?

1. Feeling of personal failure/ blame
2. Fear of being rejected for a grant
3. Fear of 'airing their dirty laundry' or 'looking bad' in the community
4. Not capable of interpreting/ communicating their financial health (or fear of exposing this area as a weakness)
5. Don't understand why the funder wants to talk about these issues
6. Belief that it's in appropriate to talk about money
- 7. Other?**

What You Can Do: Encourage Your Funder To Overcome the Barriers to Dialogue



How can funders help an Executive Director feel comfortable about having this dialogue?

1. Find common ground in the "flawed system"
2. Explain why you want to have the conversation- and how it fits into your grantmaking process
3. Explain what level of confidentiality he/she can expect
4. Ground the conversation in the numbers; use specific data points
5. Ask the leadership to tell you the 'story behind the numbers'
6. Invite the right people to the meeting

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