Case Study

A Nonprofit's Financial Crisis and an Accountability Turnaround

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A nonprofit with a $4,000,000 budget was facing an organizational crisis with the retirement of the CEO and a serious projected shortfall in the budget. The new CEO found that the board relied completely on the previous CEO to handle all fundraising and finance matters, as well as to set the direction of the organization as a whole. The board was largely uninvolved in reviewing financials and in making important strategic decisions. There was a real possibility that the organization could fail without immediate intervention.

The nonprofit survived and is now thriving. How did they do it?

First, the new CEO and the board chair met with all of their major funders. They were honest about the challenges they faced and the need to move quickly. Two funders stepped up to offer immediate assistance because the nonprofit provided crucial services to the community. One funder offered an immediate infusion of operating cash to keep the doors open. The second provided a comprehensive review of the financials and programming to get an accurate picture of the cash status of the nonprofit and to look for efficiencies in programs and areas where cuts could be made without compromising services.

Second, the reports on current financial status and programming analysis were presented to the CEO and the board with recommendations for budget revisions and staff cuts. The board accepted the recommendations and approved a new budget and staff cuts. The board learned through this experience that they needed to become a governing board and not just a rubber stamp.

Third, because of this realization, changes were made in the governance of the nonprofit. Retired executives stepped up to volunteer to facilitate planning, board governance training and facilitation of a board retreat. Through these donated services the board established finance, governance and fund development committees. The board received training on understanding and reviewing financial statements.

Board members were surprised to find that they were excited and energized about their new and crucial roles in this nonprofit. Board members are actively participating in the business of the nonprofit. They review financials, raise money and ask questions. The CEO continues to review programs for viability and efficiency. It has taken a couple of years for the nonprofit to stabilize.

The lessons learned?

- Transparency is important with funders.
- Board members cannot delegate their responsibilities to the CEO.
- Governance is more than attending meetings. It is actively participating in meetings by being prepared, asking questions and being willing to make hard decisions.
- Governance is also working to financially sustain the nonprofit through participation in fundraising.

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Assessment of Recession Risk and Preparedness for Nonprofit Organizations

Use this tool for a quick assessment of risk in four essential areas for nonpofit organizations. The rating and guidance provided will help to start discussions, set priorities, and focus attention as nonprofits develop plans to weather the recession. This assessment is a starting point developed to indicate the level of urgency and priority. It cannot take the place of a comprehensive organizational review or in-depth analysis of financial trends and forecasts.

	FINANCIAL HEALTH	**1 point**	**2 points**	**3 points**	**Score**
1	The number of the most recent three fiscal years that ended with a surplus in unrestricted funds (positive change in unrestricted net assets)	3 years	2 years	0 or 1 yrs	
2	Percentage of contributed income included in the budget that is committed or highly reliable	75% or more	50 - 75%	less than 50%	
3	Percentage of contracts and earned income included in the budget that is committed or highly reliable	75% or more	50 - 75%	less than 50%	
4	The percent of variance between budget and actual results for total income for the most recent year	Less than 10%	10 - 18%	Over 18%	
5	Number of months in the past year in which cash flow challenges required out of the ordinary steps such as delayed payments or use of reserves	None	1 or 2 months	3 or more months	
6	Number of months of operating expenses available in unrestricted cash (whether designated as reserve or not)	More than 3 months	1 to 3 months	1 month or less	
7	Percentage of annual budget supported by income paid from an endowment	Less than 5%	5 - 15%	More than 15%	
	Financial health risk total **9 or less: lower risk, 10 - 12: moderate risk, 13 or more: high risk**				

	FINANCIAL INFORMATION	**1 point**	**2 points**	**3 points**	**Score**
8	Budgets and actual financial performance, including full program costs, are understood and monitored for each significant program	Yes	Somewhat	No	
9	Financial reports prepared by staff or outside contractors are accurate and available every month within 30 days of month end	Always	Usually	Sometimes	
10	Accurate cash flow projections are prepared and used for management decisions	Monthly	Quarterly	Irregular or never	
11	Financial information identifies and tracks use of grant funds received for restricted purposes	Always	Sometimes	No	
12	Annual audit is completed in a reasonable time after the fiscal year	Within 4 months	4 - 7 months	More than 7 months	
13	Required reports and data submissions for funders are prepared and submitted on schedule	Always	Almost always	Inconsistent	
	Financial information risk total **8 or less: lower risk, 9 - 10: moderate risk, 11 or more: high risk**				

Assessment of Recession Risk and Preparedness for Nonprofit Organizations

	ORGANIZATIONAL CHANGE	1 point	2 points	3 points	Score
14	Length of time the Executive Director or CEO has been in their position	More than 3 years	1 to 3 years	Less than 1 year	
15	Significant changes in program or strategic direction have been implemented in the past two years	No	Some change	Major change	
16	Level of increase (or decrease) in quantity or level of program services provided in past 12 months that were driven by external changes	Typical	Above Average	Significant	
17	A capital campaign or building project is currently underway	No	Small project	Large project	
	Organizational change risk total **5 or less: lower risk, 6 - 7: moderate risk, 8 or more: high risk**				

	LEADERSHIP ENAGEMENT	1 point	2 points	3 points	Score
18	All staff leaders understand the organization's financial condition and risks and their role in addressing the current siuation	Yes	Somewhat	No	
19	The majority of board members understand the organization's financial condition and risks and their role in addressing the current situation	Yes	Somewhat	No	
20	Tangible action has already been taken to prepare for and respond to the downturn and prepare for a tougher economic environment	Yes	Minimal	No	
	Leadership engagement risk total **4 or less: lower risk, 5: moderate risk, 6 or more: high risk**				

USING THE RISK ASSESSMENT SCORES
Financial Health Risk Level
High: The financial weaknesses allow little breathing room and require urgent and decisive action and short-term planning. **Moderate**: Scenario planning is important using conservative assumptions for highest risk items. Test all assumptions. **Lower**: Strong financial health allows for longer-term planning and affords opportunities for innovation and strategic partnerships.
Financial Information Risk Level
High: Smart, timely decisions can't be made without reliable information. The first priorities are tracking cash flow & budgets. **Moderate**: Focus on improving areas of weakness, especially understanding true program costs, restricted grants & cash flow. **Lower**: If budgets are reduced, try to maintain the infrastructure for reliable financial information to support management.
Organizational Change Risk Level
High: Multiple, simultaneous changes require diligent oversight, focus on strategic goals, and willingness to say no. **Moderate**: Big changes put pressure on everything and require balanced decisions based on level of risk in other areas. **Lower**: Because major change is not a factor (yet), stay focused on managing uncertainty in other areas.
Leadership Engagement Risk Level
High: The organization urgently needs a leader to step forward to call attention to the challenges, even if it causes discomfort. **Moderate**: Champions within the organization need to work together to bring others up to speed and focused on taking action. **Lower**: Leaders who have taken steps to plan and manage challenges can help develop others in the organization.

Nonprofit Management:
Checklist for Evaluating Internal Controls

Review the following internal control activities for your organization.
Determine what areas your organization meets or does not meet.

Meets	Does not meet	Control Activity
		Accounts Payable and Purchasing
		The organization has written procedures for purchases.
		Pre-numbered purchase orders are used.
		Prior approval is required for purchases over a certain amount.
		Purchasing functions are done by a person separate from receiving or shipping duties, and other accounting duties.
		Month end reconciliations are done for purchases.
		Vendor billing practices are reviewed for compliance with purchase orders.
		Staff in charge of payable functions are independent of other accounting functions.
		Accounts payable balances are reconciled monthly with outstanding invoices.
		Staff are required to report on obsolete, unusable and overstocked items before disposal.
		Accounts Receivable
		The organization has written procedures for processing receivables.
		Third party billing and related accounts receivable entries are approved.
		Monthly accounts receivable aging reports are produced and reviewed to determine uncollectible accounts.
		Credit and refund entries are approved.
		Accounts receivable balances are reconciled monthly with outstanding charges.
		The organization has a written procedure for collection on delinquent accounts.
		Asset Management (Property & Equipment)
		Board approval is required for acquisition or disposal of property.
		Property and equipment for general ledger accounts are reconciled to the control account.
		A process is in place for informing the accounting office of major changes to property or equipment.
		Assets not used for operating purposes are disclosed in the financial statements.
		All assets are protected by acquiring them in the name of the organization.
		The organization has a capitalization policy.
		Assets are adequately protected from loss due to fire, theft, vandalism or other events.
		Budgets & Capital Spending

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		The organization develops an organization-wide operating budget based on programs, fundraising and administrative costs.
		The annual budget is approved by the board before the start of the fiscal year.
		Monthly budget to actual variance reports are produced and presented to program managers.
		The organization prepares and management reviews periodic cash flow projections.
		The organization does an annual review of inactive accounts.
		Cash Receipts/Disbursements
		A segregation of duties process is set up for incoming mail.
		Post-dated checks and NSF checks are handled by staff independent of those that record similar accounting functions.
		Checks signers are independent of other accounting functions.
		The organization has a written procedure for approving cash disbursements.
		Monthly bank reconciliations are completed.
		Monthly bank reconciliations are completed by a person independent of general ledger and subsidiary ledger functions.
		The organization has a written procedure for approving and recording interbank transfers.
		The organization has a written procedure for reimbursing staff expenses.
		Computer Information Systems
		IT staff duties are periodically rotated.
		Procedures are in place to prevent live data from being used for new or upgraded programs.
		Application parameters are restricted to authorized personnel only.
		Major changes to network files and systems are periodically reviewed.
		Access to operator instruction manuals are restricted to authorized personnel only.
		Passwords for all employees are routinely changed.
		Financial data and systems are backed up daily to a secure back-up server.
		Employees
		Background checks are conducted for staff that handle money.
		Employees that handle cash are bonded.
		The organization provides ethics training to all employees.
		Employees sign a code of ethics policy.
		Up to date job descriptions are on file for each employee.

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		Financial Reporting
		The organization tracks unrelated business income (UBIT), if applicable, for IRS reporting.
		The organization files its IRS Form 990 and other applicable IRS forms on a timely basis without requesting an extension.
		The organization maintains a schedule for periodic reporting required by government contract, grant and other funding sources.
		Donor restrictions are followed in accordance with GAAP.
		Financial Statements
		Monthly financial statements are completed by the end of the 3rd week of the following month.
		Board members review monthly financial statements.
		Monthly financial statements include a budget to actual comparison.
		Financial statements are made available to funders, interested parties, and regulatory agencies.
		The organization has annual audited financial statements completed by an independent auditing firm.
		The organization receives a management letter from the external auditing firm.
		The management letter is reviewed by both management and board of directors.
		A plan for corrective action is developed if deficiencies are identified.
		Governance
		The organization has Directors & Officers liability insurance for board members and executive staff.
		The organization has a conflict of interest policy.
		The conflict of interest statement is signed annually by board members.
		The organization provides training for board members on their fiduciary obligations.
		The organization has a policy for establishing and maintaining operating reserves to cover 6 – 12 months of operations.
		Internal Environment
		The organization has a written record retention policy.
		The organization has a written document destruction policy.
		The organization has a written whistleblower policy.
		The organization has a disaster recovery plan in effect.
		Inventory
		Inventory is kept in a locked and secured area.

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		The organization has a written policy for approval to release inventory from storage or to make adjustments to inventory.
		The staff responsible for receiving, storing and issuing inventory is independent of purchasing, selling and recording inventory.
		The organization has written instructions for how to track inventory.
		Material differences in inventory counts are investigated and explained.
		Investments
		The board approves purchases and sales of investments.
		The board reviews proposed investment transactions.
		Record keeping functions for investments are performed by a person independent of other investment responsibilities.
		The organization has an investment policy.
		Payroll
		Staff in charge of the payroll function are independent of other accounting functions.
		The organization has a written procedure for handling unclaimed payroll checks.
		The organization requires identification from staff when claiming payroll checks.
		Employee timesheets are reviewed to match budgeted allocations of payroll costs.
		The payroll department follows required Federal and State regulations.
		Disbursements are tracked for contract employees requiring 1099s at year end.
		Petty Cash
		Staff in charge of petty cash are independent of other accounting functions, including staff who handle receipts.
		Checks for miscellaneous expenses are not made out to cash.
		Petty cash is reconciled by staff that do not handle petty cash disbursements.
		Petty cash staff are bonded.
		Pre-numbered vouchers are used for petty cash disbursements.
		The organization uses a lockbox service from a bank.
		The petty cash person is independent from general ledger and subsidiary ledger functions.

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Sample Nonprofit Financial Ratios

- ☐ Liquidity Ratio:
  - Measures liquidity, financial strength, staying power
  - Cash plus Receivables plus Inventories plus Marketable Securities divided by Total Liabilities
  - Excludes restricted marketable investments
  - Similar to current ratio or working capital ratio in for-profit, but is more conservative because it includes ALL liabilities and not just current
  - 1:1 or greater desired; **how many times** can you cover your liabilities
- ☐ Defensive Interval Ratio:
  - A stability ratio. Measures ability to cover expenses (meet mission) with resources (current assets)
  - Cash plus Marketable Securities plus Receivables divided by Average Monthly Expenses (total annual expenses divided by 12)
  - Similar to Current Ratio in for-profit, but this measures **how much time** (not how many times)can you operate and cover expenses before running out of funds
  - Good for charities that depend on contributions from general public (vs. government contracts)
  - Look at trend. Too high-->sitting on cash or not collecting receivables (or establishing a reserve)
- ☐ Accounts Payable Aging Indicator
  - Also called A/P Turnover Ratio
  - Accounts Payable divided by Average Monthly Expenses
  - If too high (e.g. 2:1) organization is taking too long to pay bills. Why? No cash (cash management) or bills not being processed timely (stewardship)
  - If too low (e.g. 1:2) organization may not be using liquid assets efficiently (not investing)

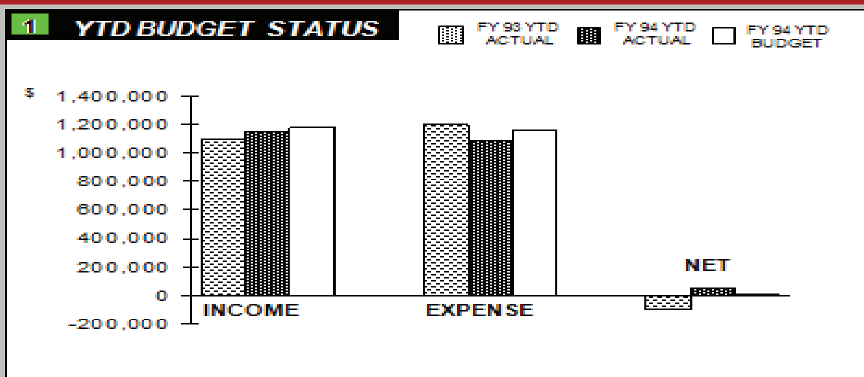
- (LT) Debt to Net Assets Ratio
  - Also called, “bankers ratio”
  - .75 or lower is desirable
  - Measures degree of borrowing
  - Total long term debt divided by total net assets

Scenario	Debt	Net Assets	Ratio
1	$1,000,000	$1,250,000	.80
2	$1,000,000	$750,000	1.33
3	$1,000,000	$2,000,000	.50

- Revenue Dependency Ratios
  - Contributions divided by Total Revenue
  - Net Special Event Revenue divided by Total Revenue
  - Investment Income divided by Total Revenue
  - Grant Revenue divided by Total Revenue
  - Look at trend
  - Disaggregated ratios
    - Foundation contributions divided by total contribution revenue
    - Corporate contributions divided by total contribution revenue
    - Individual contributions divided by total contribution revenue
- Profitability Margin
  - Net Income (change in net assets, revenue minus expense) divided by Total Revenue
  - Tells us how much is left over for every $1 earned. The higher the number the better
  - Measures pricing (not generally applicable in social service nonprofits but is relevant in hospitals, colleges & universities, etc.) and cost control (very relevant to all nonprofits)
  - Look at trend
- Program Spending Ratio
  - Percentage of total expenses attributable to program services

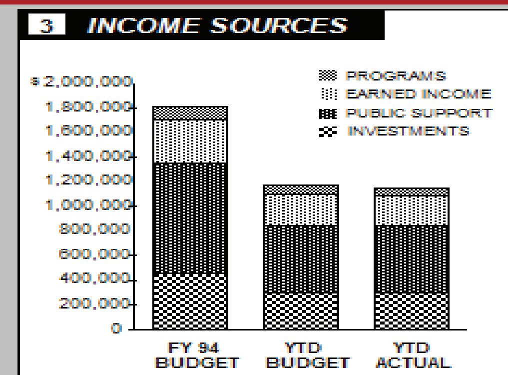
  - Total program expenses divided by Total agency expenses
  - The higher the percentage the better
- Management Expense Ratio
  - Total General and Administrative expense divided by Total Expenses
  - The lower the percentage the "better"500
- Fundraising Expense Ratio
  - Total Fundraising expense divided by Total Expenses
  - The lower the percentage the better
- Overhead (Supportive Services) Ratio
  - Management & General expenses plus fundraising expense divided by Total Expenses
  - The lower the percentage the "better" (25% is an average benchmark)
- Fundraising Efficiency Ratio
  - Total fundraising expenses divided by total contributions
  - The smaller the relationship the better (e.g. less than 1:1)
  - Ratio is better (and more accurate) if use F/S information and not 990 because 990 excludes donated services

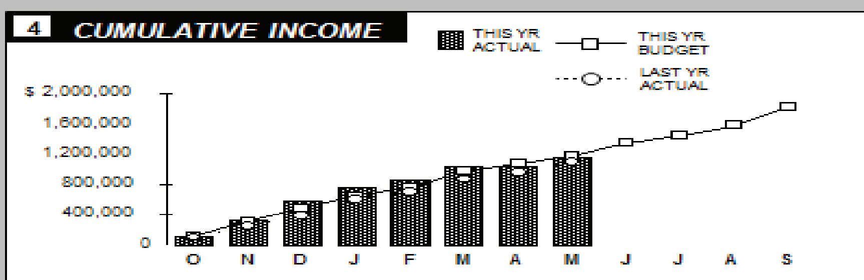
Sample Dashboard

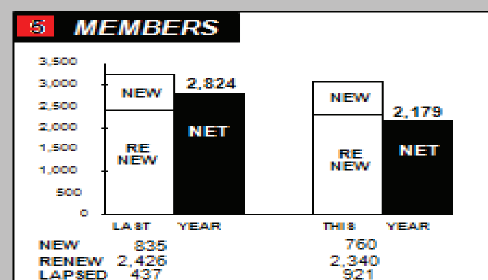


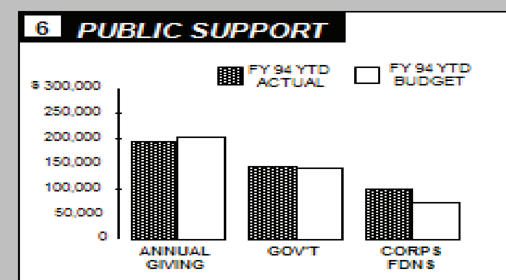
2 SUPPORTING DATA

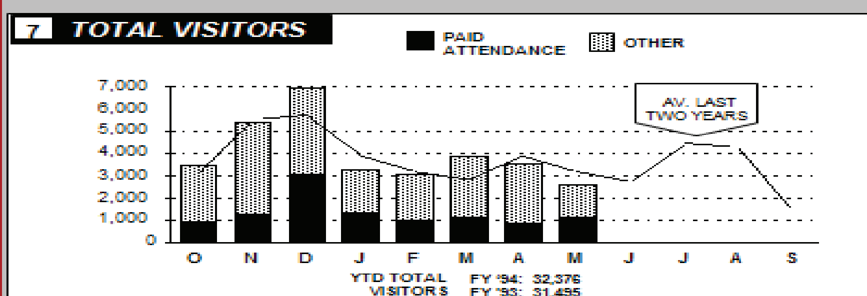
YTD $	'93 ACT	'94 ACT	'94 BUD
INC	1,099,550	1,146,569	1,174,845
EXP	1,193,264	1,090,188	1,162,444
NET	(93,714)	56,380	12,401
INCOME SOURCES			
PROGRAMS		66,343	76,730
EARNED INCOME		234,157	250,450
PUBLIC SUPPORT		542,129	543,725
INVESTMENTS		303,940	303,940











HIGHLIGHTS

5 MEMBERSHIP: Total membership declined by 645 since last year -- or 22.8%. More troubling is that over twice as many members lapsed during this period -- 921 compared to 437. Had the lapses remained constant, our membership would have declined by only 5.7%.

1 BUDGET STATUS: Income is ahead of last year but below budget. By controlling expenses, YTD net is is significantly greater than last year and almost 5x this year's budget.

Strategic Plan Scenario

Mission:	To support Georgia families and individuals from birth to 26 impacted by disabilities or special health care needs.
Long-Term Goal:	Set up 5 respite care centers/service in the next 3 years across the state (for children or in-home)
Functions (activities):	Acquire buildings Get building certifications and licenses Source respite care workers
Operations (tasks):	Enlist real estate agent Hire building construction/rehabilitation crew Hire/Contract respite workers Design care curriculum (if a children's center) Design in-home care guidelines Evaluate children's center versus in-home care
Short-Term Goals:	Raise $100,000 in year 1 Decide on facility or in-home care service in year 2 Identify 5 physical locations or service areas in year 2 Hire respite workers in year 3 (either option)

Adapted from: Markgraf, Bert. "How to Set Long- & Short-Term Goals for a Non-Profit Organization." Small Business - Chron.com, http://smallbusiness.chron.com/set-long-shortterm-goals-nonprofit-organization-61680.html. Accessed 15 June 2019.

Activity: In your groups,

- Decide whether to offer a childcare facility or in-home care service,
- Discuss the kinds of issues and information the board would be interested in tracking,
- Identify the reports that can reveal the information and
- Describe the format(s) in which the staff might present the information