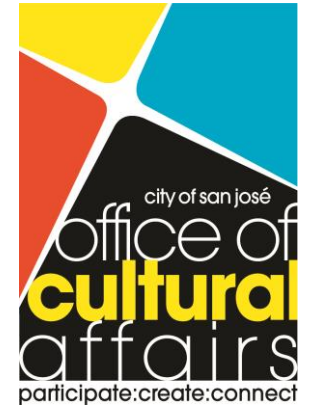


Linking Money to Mission: Nonprofit Finance Fundamentals



Presented to:



Presented by:

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Oakland, CA

February 26, 2024

Nonprofit Finance Fund (NFF) – Where Money Meets Mission

Let's Build a More Just and Vibrant Society

A nonprofit lender and consultant with 40+ years of national and hyperlocal experience, NFF helps mission-driven organizations adapt, thrive, and drive positive change.



Introductions

- Your name & pronouns
- How do you feel about finances?



A:
Excited



B:
Good



C:
Neutral

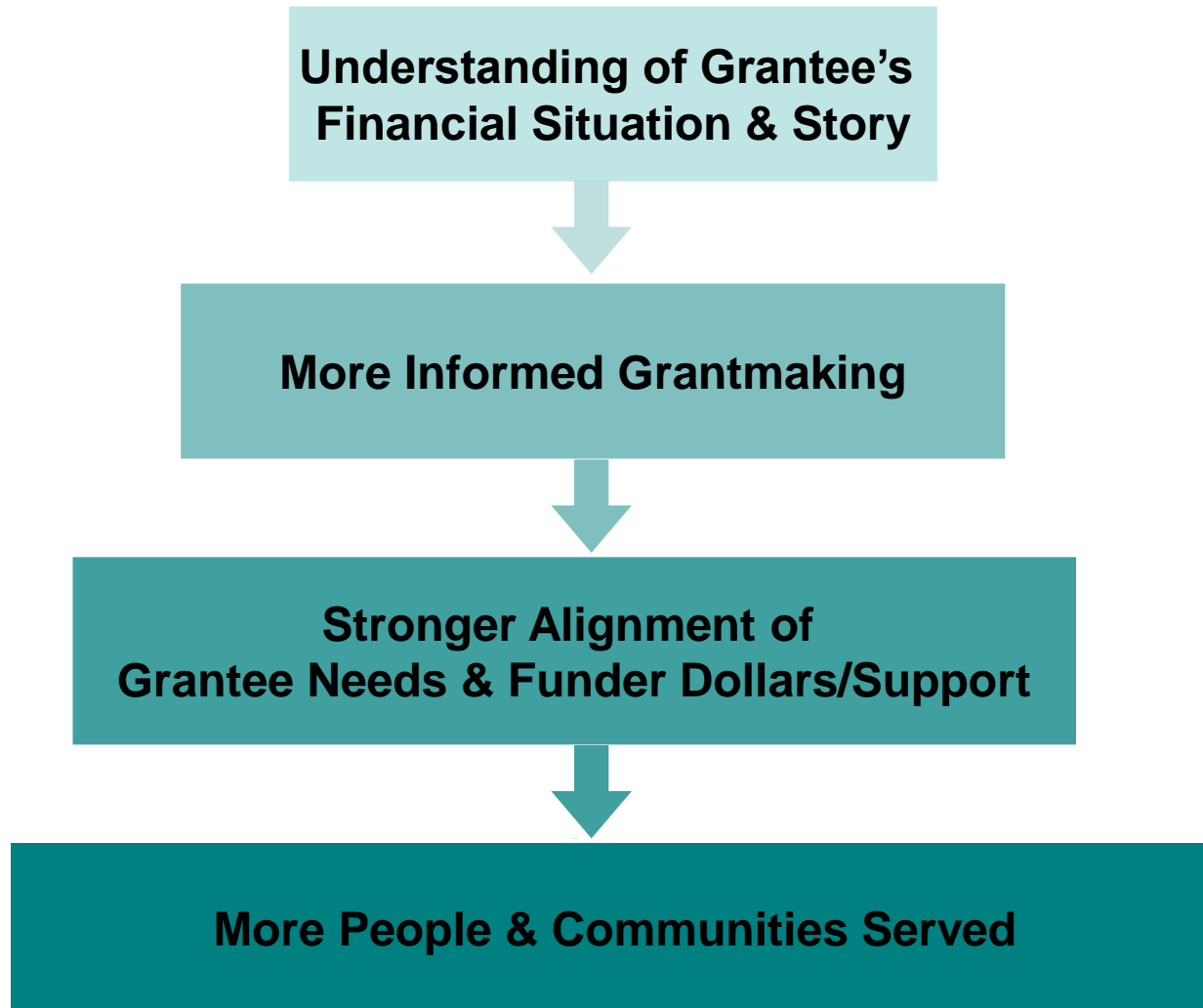


D:
Upset



E:
Dizzy

Why Focus on Finance?



Today's Learning Objectives



Discuss a few key **'rules' of nonprofit finance** and the challenges they pose to managing nonprofit financial health



Learn key components and **indicators of nonprofit financial health**



Learn how to **use financial data** to better understand SJOCA grantees' financial situation and needs

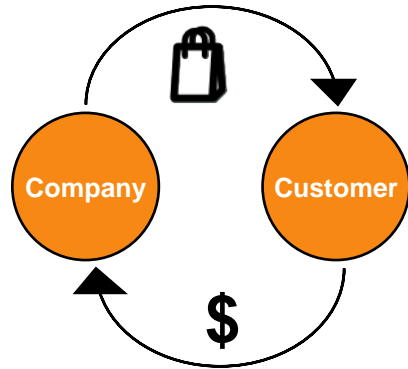
The Flawed System of Nonprofit Finance



“Rules” of For-Profit Finance

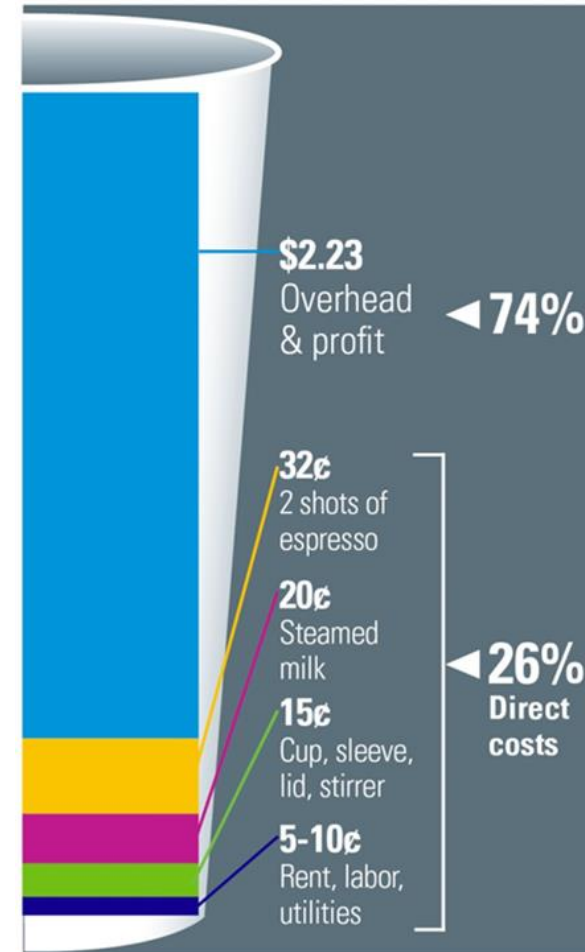
In the **for-profit** world:

- Customer buys the product



- Management decides how the money is spent
- **Overhead and profit** are included in the price, and are seen as **necessary and regular** part of the business

12-Ounce Coffee = \$3.00



Source: 2008, Matt Milletto, VP of the American Barista & Coffee School

“Rules” of Nonprofit Finance

Multi-Payor System

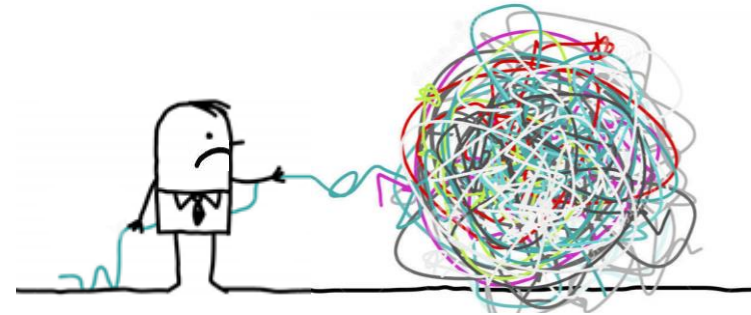
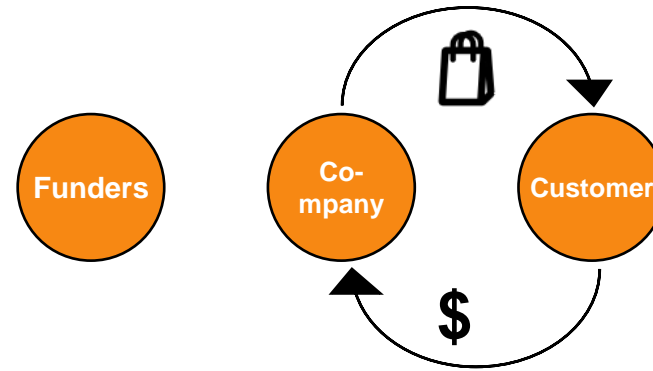
- Client often does not pay
- Third parties pay

Insufficient and Restricted Funding

- Donations must go to ‘direct services’ ...
- ...and not to ‘overhead’
- Restrictions complicate finances!

Money-Losing Business

- Nonprofits fill social needs with low/no commercial returns
- Profits are seen as unnecessary



Quiz Time! True or False?

False! True or False? Nonprofit = No Profits

- Truth: Surpluses are necessary!
- Tax Status vs. Business Model



False! True or False? The 'Overhead Ratio' measures value

- Truth: Outcomes measure value
- Overhead measures investment into the business model



False! True or False? Nonprofits can be 'self-sufficient'

- Truth: Nonprofits will always need 3rd party payors



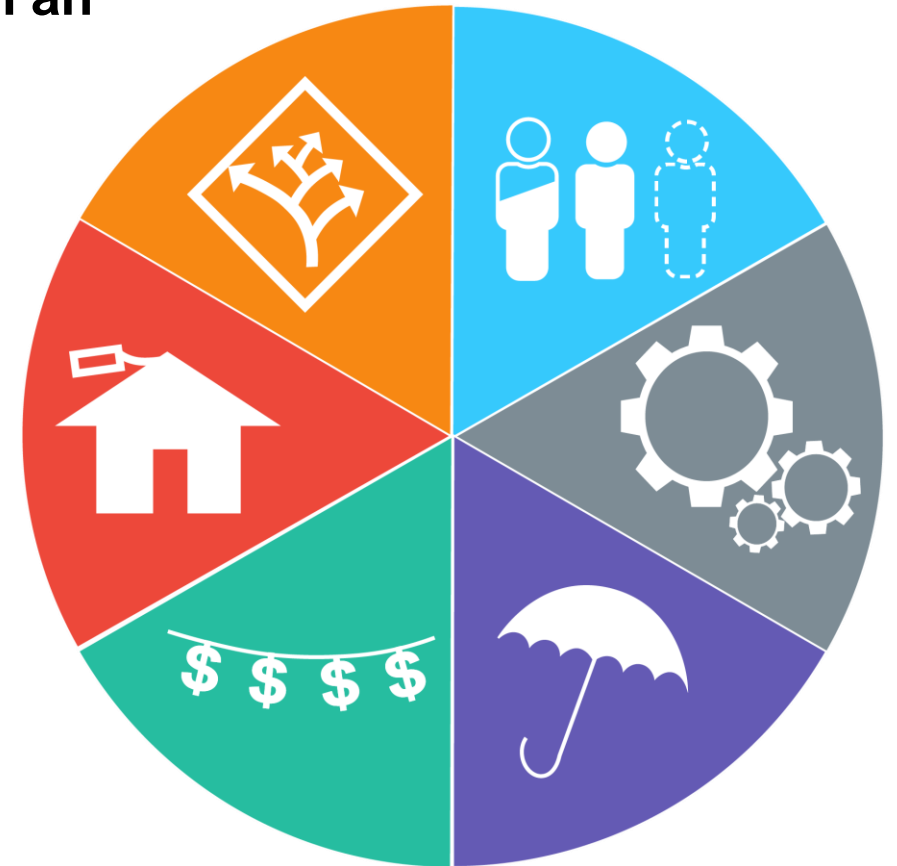
Surpluses Are Necessary to Cover the Full Cost of Doing Business

Full cost includes all the financial resources it takes to run an effective organization for the long haul

Including:

- **Total Expenses**
- **Working Capital**
- **Reserves**
- **Debt Principal Repayment**
- **Fixed Asset Additions**
- **Change Capital**

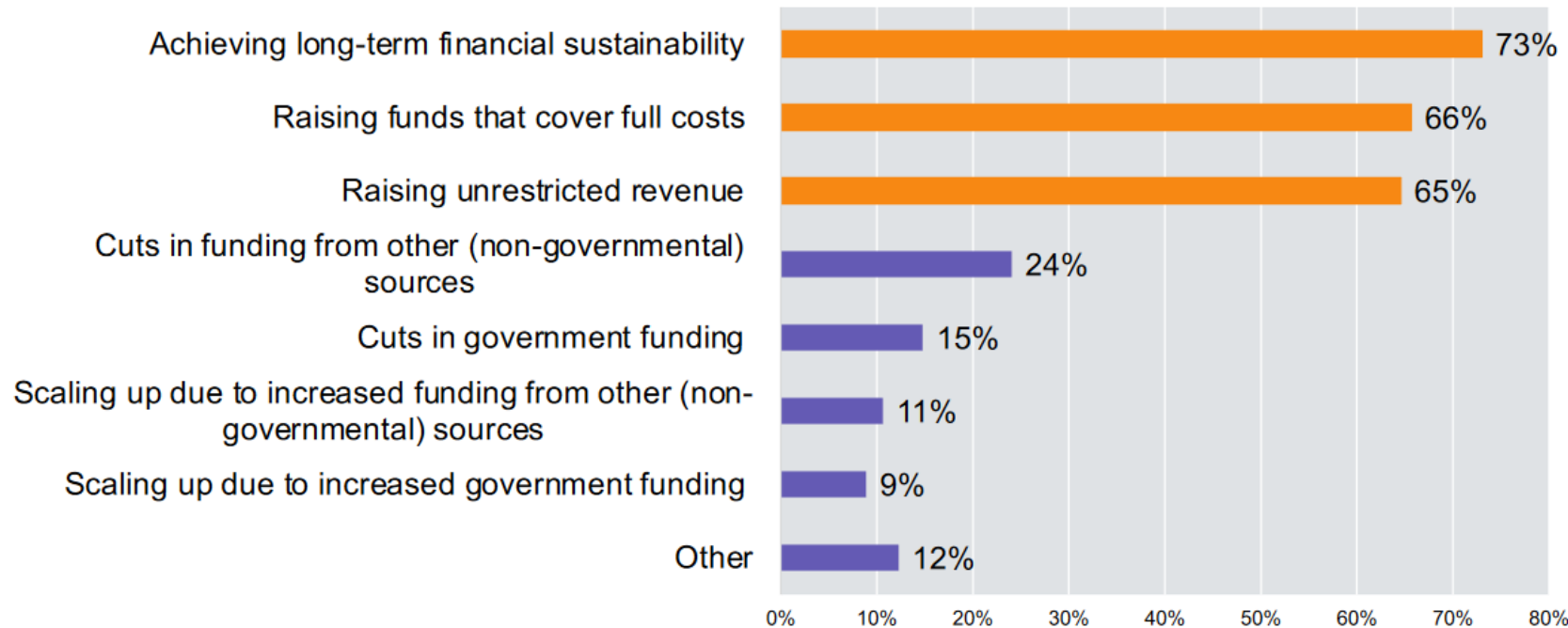
- Full Cost > Operating Expenses (the 'budget') > 'Direct' Expenses



For more information and resources on Full Cost, please visit: <https://nff.org/full-cost>

Nonprofits' Greatest Financial Challenges

Top 3 Financial Challenges

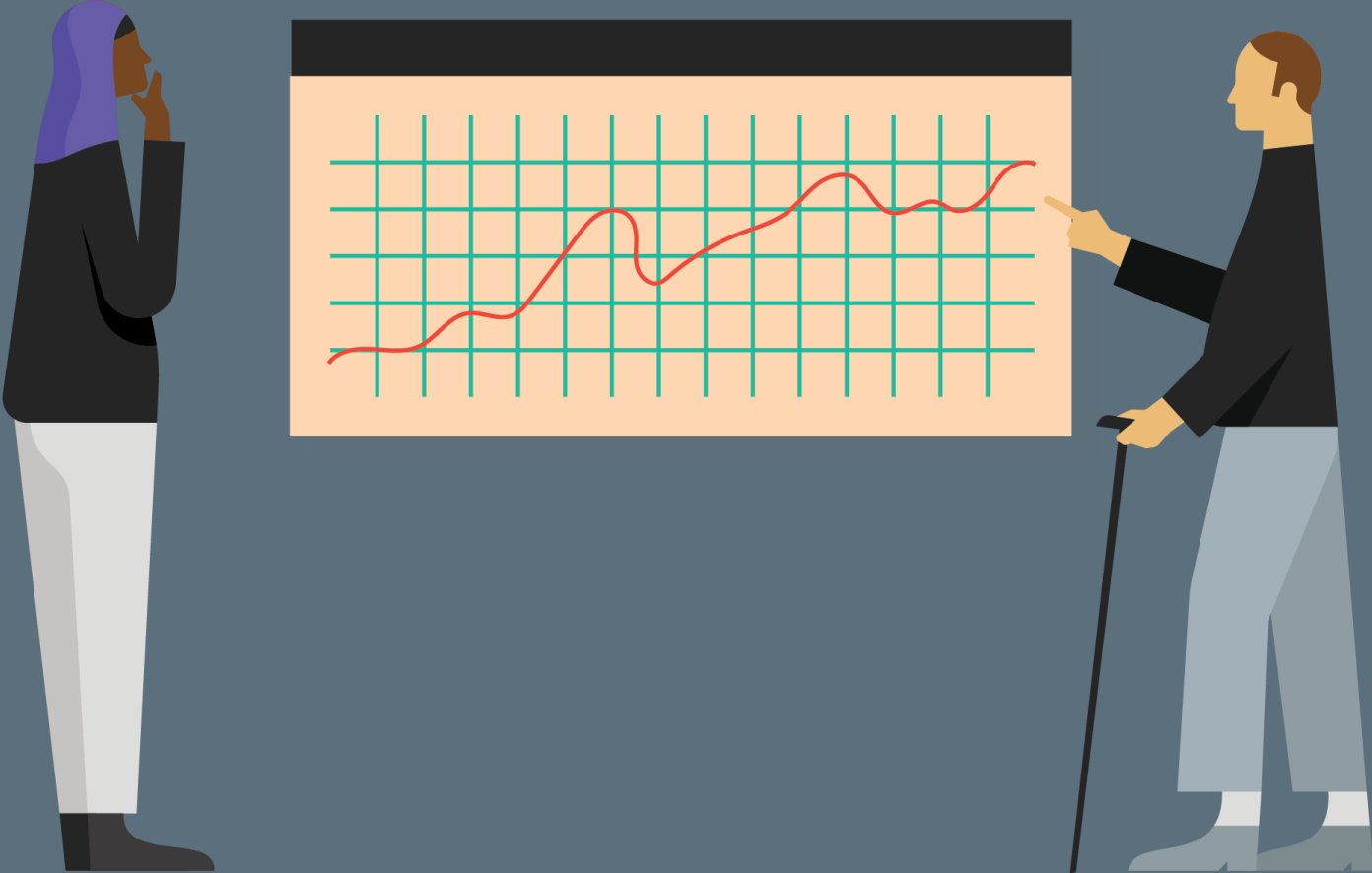


Source:

[NFF's 2022 National State of the Nonprofit Sector Survey](#) (n = 1,168)

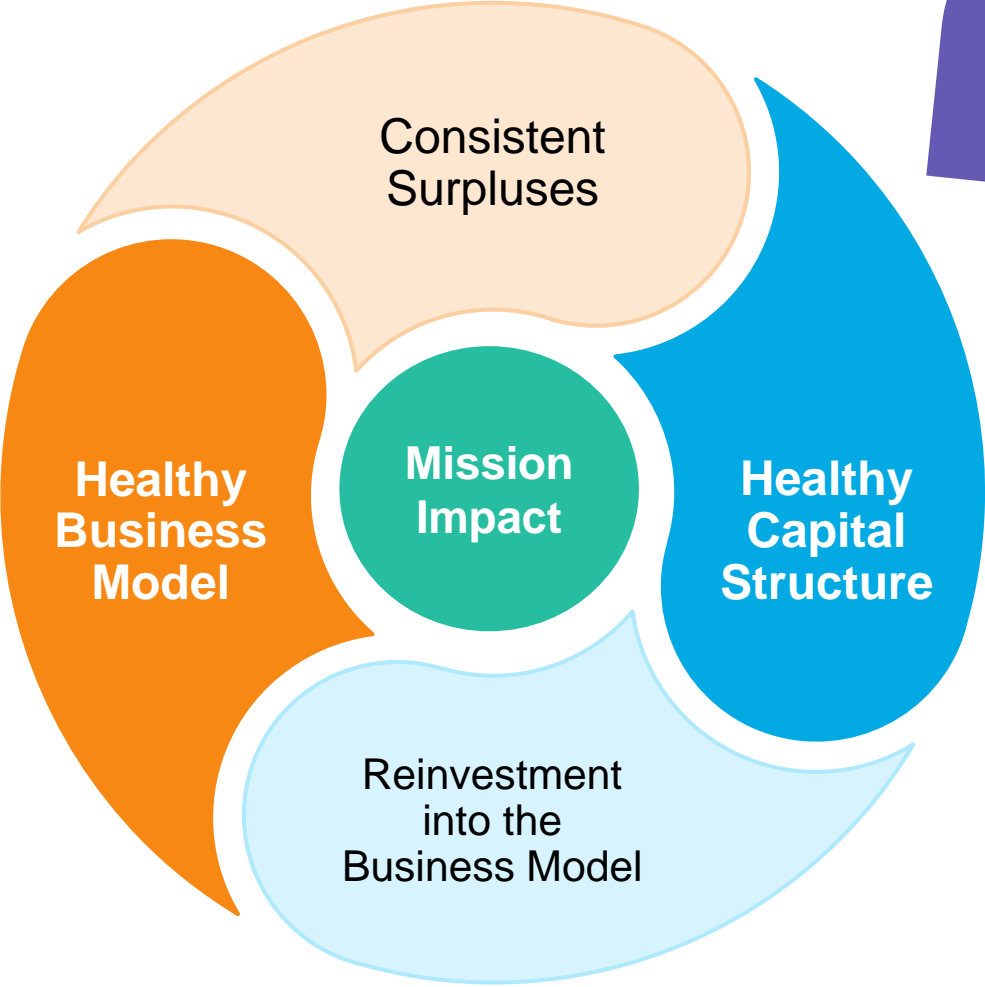
- **Limited liquidity:** 40% of nonprofits reported having of ≤ 3 months of cash on hand
- **Staffing challenges:** 51% of nonprofits reported challenges offering staff competitive pay, 55% reported challenges employing enough staff

Basics of Nonprofit Financial Strength



The Goal: Comprehensive Financial Strength

*Periodic
Capital
Infusions*



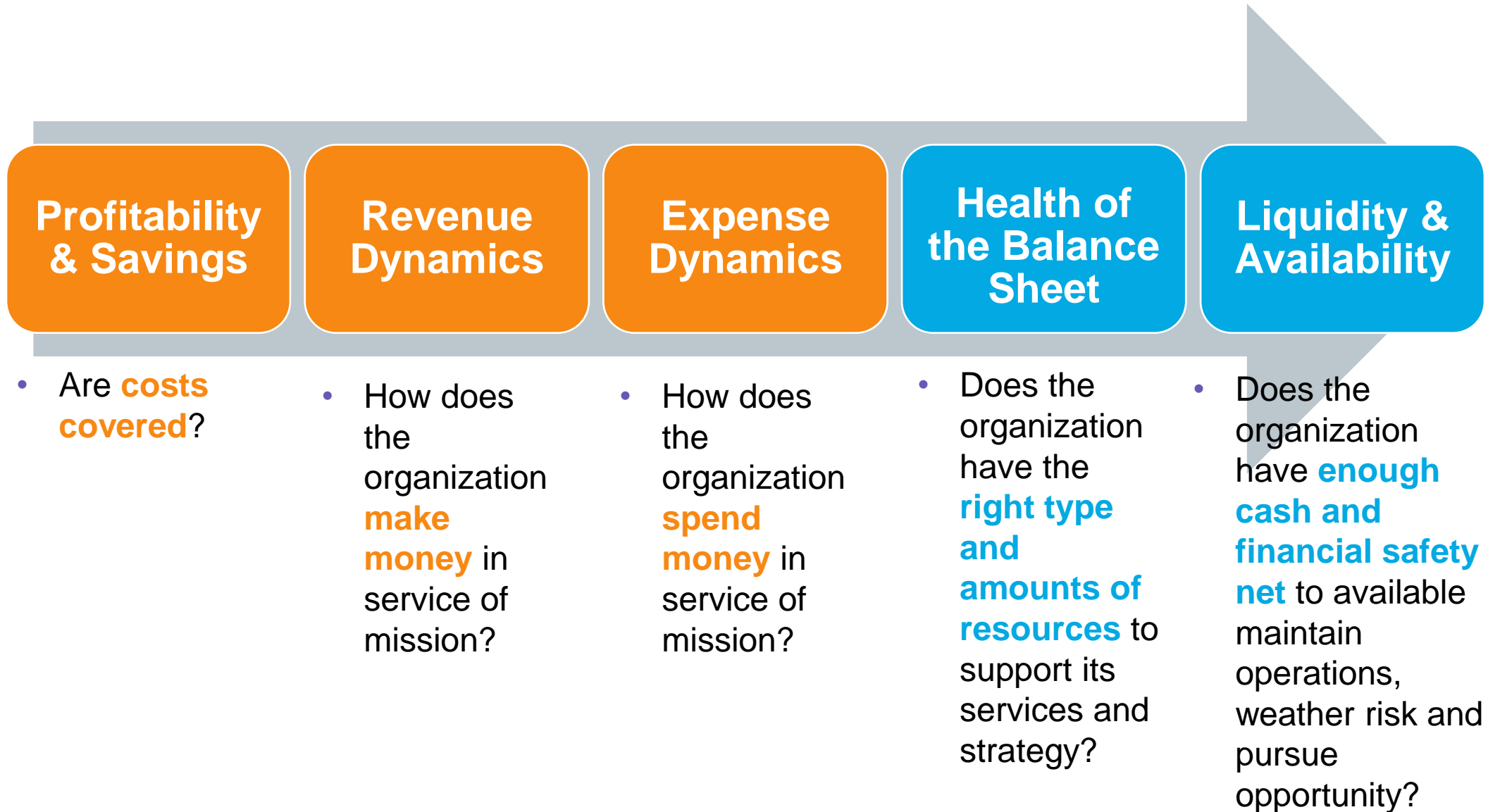
Business Model
how an organization makes & spends money to serve its mission



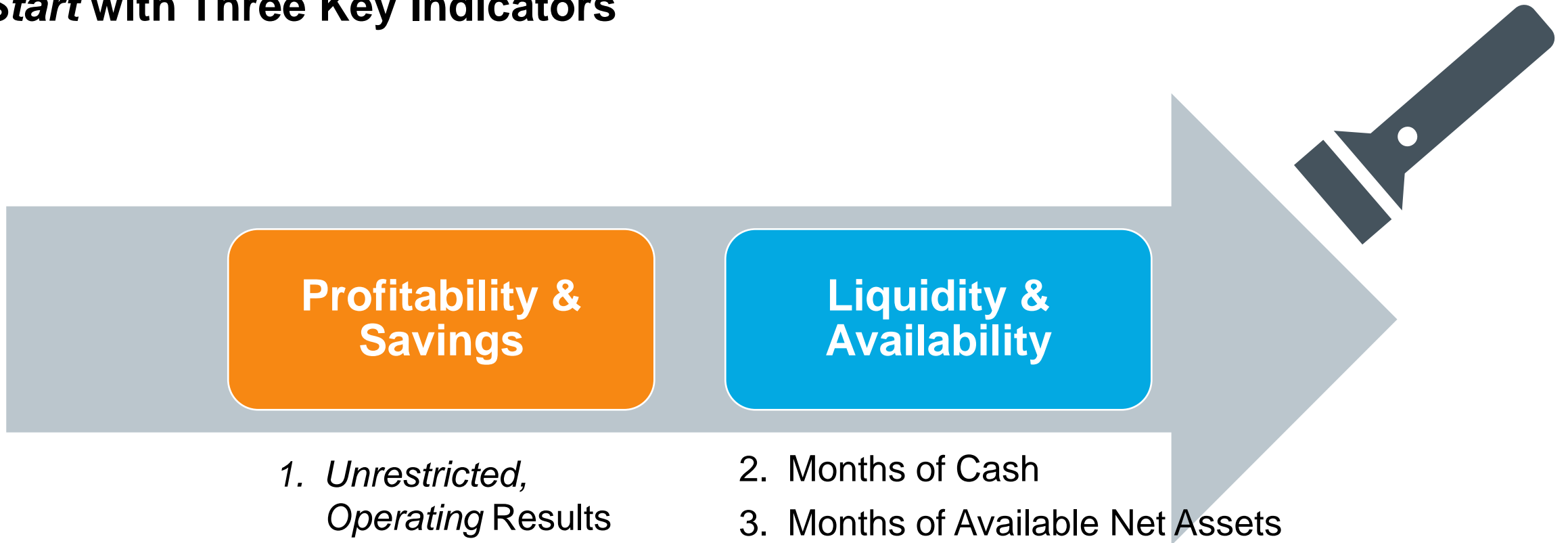
Capital Structure
the size and type of assets, liabilities, & net assets available to support an organization.



Five Steps to Understanding the Financial Story

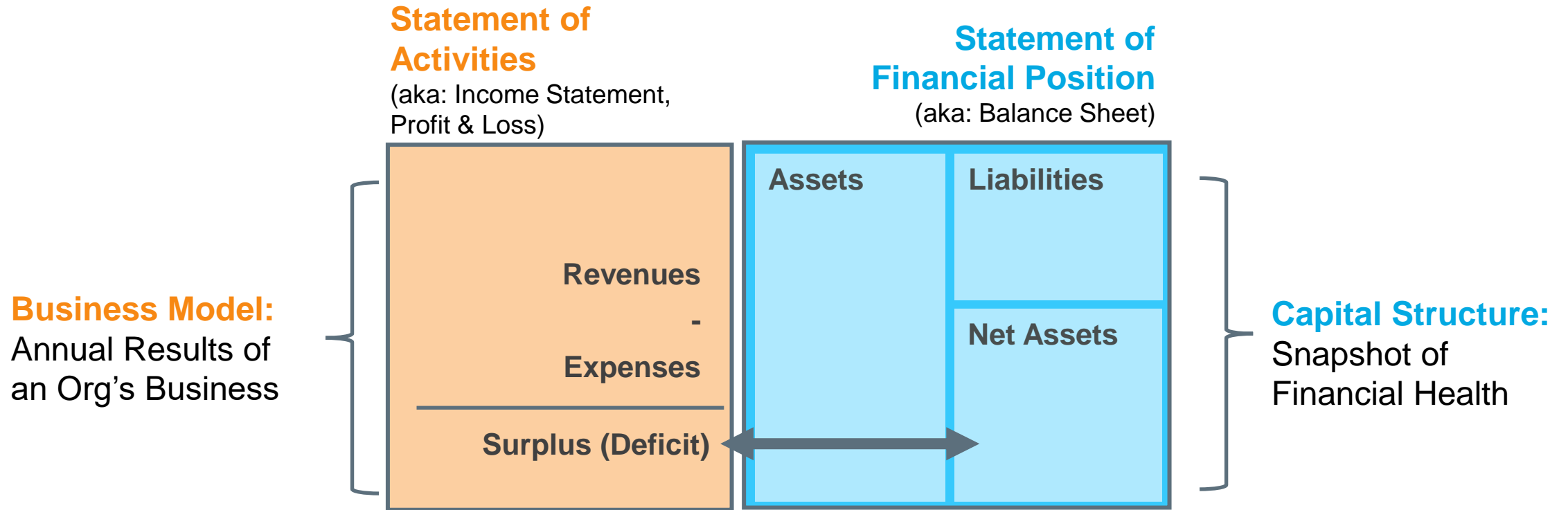


Start with Three Key Indicators



- Financial data is best reviewed over time (i.e., 3-5 years)
- Numbers only tell part of the story! Conversation is critical to understanding the context behind the data.

Using Financial Data to Understand the Financial Story



- Different forms of financial data (audits, IRS Form 990s, budgets) use different lenses to summarize the financial story. Categorization of items, treatment of restrictions and other aspects will vary from source to source.
- When using audits, don't forget to scan the notes, which can offer a wealth of information beyond the numbers.

Understanding the Business Model



Unpacking the Business Model: Is the Org Able to Cover Costs? How Does It Make & Spend Money in Service of Mission?

Statement of Activities

Revenue

Earned Income
Contributed Income
 Gov't
 Foundations
 Individuals

Other Income

Expenses

Personnel
Professional Fees
Occupancy
Program Costs
Admin Costs
Other

Surplus (Deficit)

Revenue Dynamics

- What are the main funding sources?
- How much is restricted?
- Are revenue streams reliable or at risk?
- Is seasonality a factor?
- Is any funding one-time?

How **reliable and repeatable** is revenue? Each revenue source has its own strengths, risks, and associated costs to manage.

Expense Dynamics

- How does the org spend money?
- Are expenses predictable?
- Are expenses “flexible”? Fixed?
- Are any costs one-time?

How **predictable and manageable** are expenses? Knowledge of **cost “levers”** can help orgs manage expenses within the context of revenue reality, mission and values.

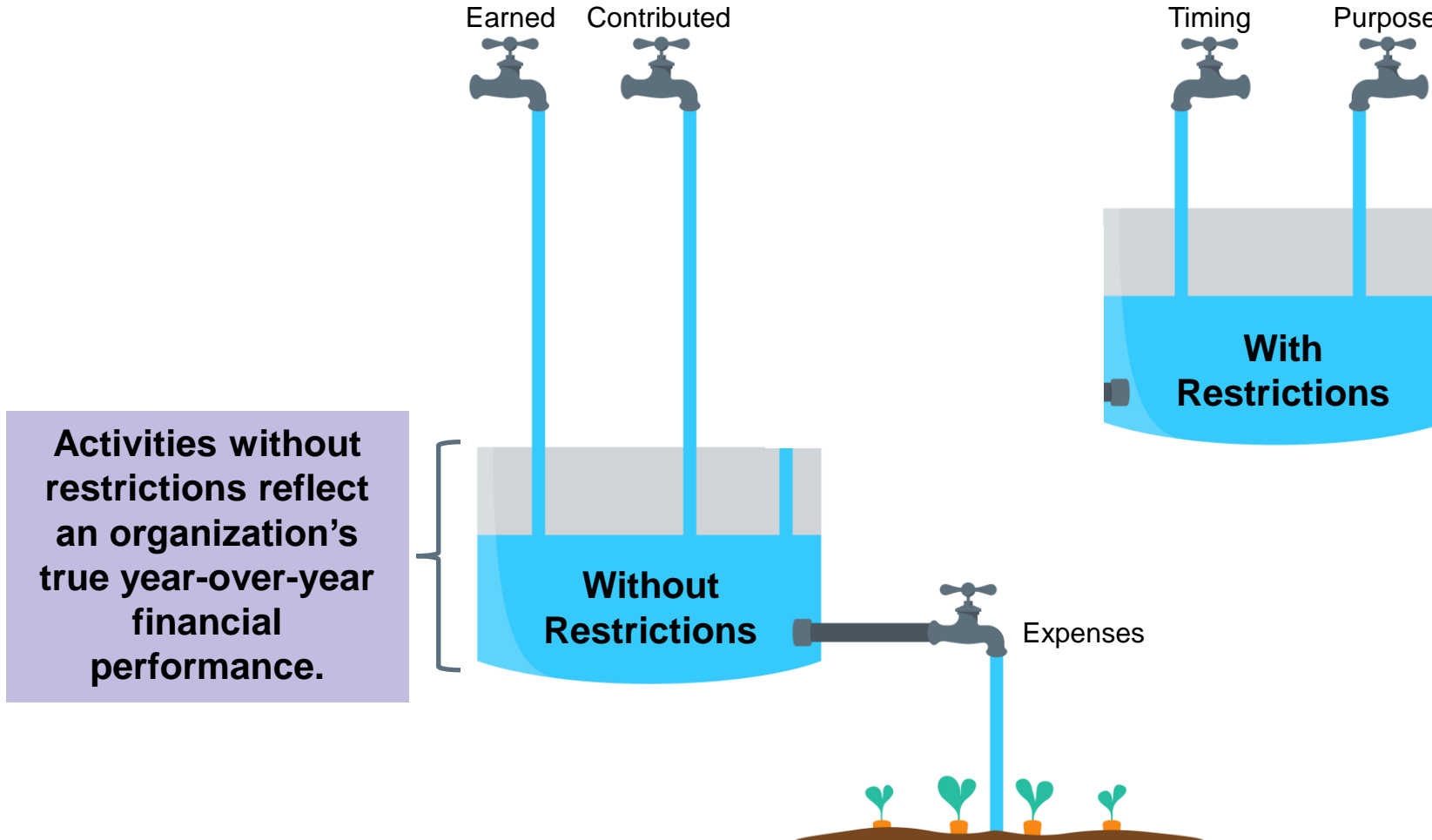
Profitability & Savings

- Are costs covered on an *unrestricted, operating basis*?
- Is there enough left over to build savings?

A Deeper Dive on Revenue: Not All Revenue is Equal! Restrictions Affect the Flow and Availability of Money

Revenue Without Restrictions

Revenue With Restrictions



Key Metric #1: Unrestricted, Operating Results

ABC Arts Statement of Activities

Year ending June 30, 2023 (\$ in thousands)

	W/o Restrictions	With Rest.	Total
Revenues, Gains and Other Support			
Support			
Foundations	113	58	171
Government	57	-	57
Corporations	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

Where do we look to find the “bottom line”?

\$445K *unrestricted* surplus = 35% of expenses

Nonprofit Accounting Can Mask Non-Operating (One-Time or Extraordinary) Activity

ABC Arts Statement of Activities
Year ending June 30, 2023 (\$ in thousands)

	Operating Activity		
	W/o Rest.	With Rest.	Total
Revenues, Gains and Other Support			
Support			
Foundations	113	58	171
Government	57	-	57
Corporations	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 Activity			
Capital Campaign releases	597	-597	-
Net gain (loss) on sale of assets	-	-	-
Change in Net Assets	445	-691	-246

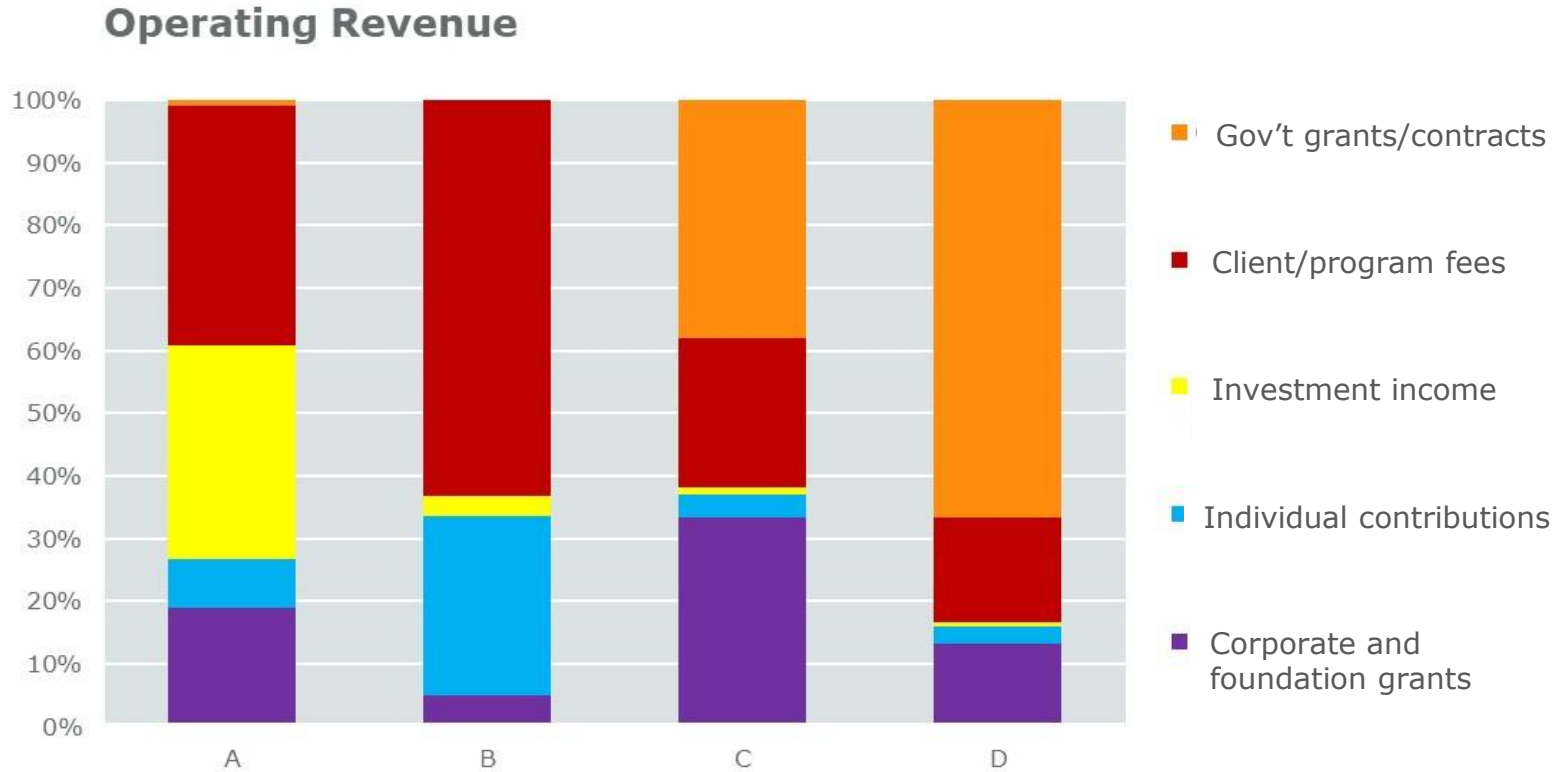
Determine true
Operating Results

Non-operating revenue placed
"below the operating line"

Comparison of Common Nonprofit Funding Streams

Type	Characteristics	
Foundation Grants	<ul style="list-style-type: none"> • Often restricted • May be unreliable year-to-year 	<ul style="list-style-type: none"> • May not reliably cover core programs
Earned Income (e.g. ticket sales/ subscriptions, tuition and fees)	<ul style="list-style-type: none"> • Often requires upfront investment of time and money • Can be very seasonal • Timing of revenue may differ from associated expense 	<ul style="list-style-type: none"> • May cause mission drift • Important to track NET income, not just gross revenue
Individuals	<ul style="list-style-type: none"> • Not all organizations have access • Mission may not be conducive to this strategy 	<ul style="list-style-type: none"> • Usually requires special individual fundraising strategy • Not usually significant amounts
Special Events	<ul style="list-style-type: none"> • May not always generate a <i>profit</i> • Can be very seasonal 	<ul style="list-style-type: none"> • May require significant upfront money and staff time
Program Fees	<ul style="list-style-type: none"> • Usually only covers small portion of service 	<ul style="list-style-type: none"> • Not all service recipients can afford to pay
Government Contracts	<ul style="list-style-type: none"> • Typically, only accessible to larger nonprofits • Often reimbursement-based, requiring more upfront cash • May require more infrastructure to manage than is covered by contract 	<ul style="list-style-type: none"> • Notoriously slow to pay and can limit cash flow • Doesn't pay full cost of running program • Often underpaid staff • Heavy reporting requirements • Low overhead, if at all

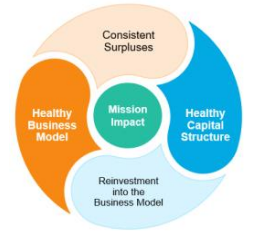
Example: Same Business, Different Revenue Models



- What might the different revenue models say about each organization's **financial priorities**?
- About each organization's **ability to generate a surplus**?
- How might each be internally structured to manage their business?

Quick Reference: Positive Indicators and Areas of Inquiry

Business Model (Statement of Activities)



Positive Indicators

- Consistent ***unrestricted, operating*** surpluses
- Surpluses that are sufficient in size to contribute to/cover full costs such as contribution to working capital for cash flow, savings/reserves and purchase of new fixed assets
- Revenue that is reliable and repeatable
- Costs that align with the organization's services and scale of operations



Areas of Inquiry

- Steadily declining operating results or operating deficits over the course of several year (especially if large in relation to the organization's operating budget)
- Significant swings in revenue composition from year to year without a compelling explanation from the organization



Understanding Capital Structure



Why Capital Structure Matters



Great art is often created without lots of money and can be enjoyed for many years.

Great arts *organizations* without the right kinds and amounts of money, however, often struggle to see another day.

“A strong balance sheet means artistic freedom.”

- Megan Wanlass
Former Executive Director,
Saratoga International Theater Institute

Unpacking the Balance Sheet: Does the Organization Have What It Needs to Support Core Operations, Weather Risk & Pursue Opportunity?

Balance Sheet

Assets

Is there enough of what the org needs for its core operations?

- **Cash in Bank**
How much? How much is w/o restrictions?
- **Accounts Receivable**
Are they slow to collect? Are they at risk?
- **Property and Equipment (P&E)**
Is the org prepared to deal with maintenance issues?

Liabilities

Are obligations manageable?

- **Accounts Payable**
How is cash flow managed?
- **Debt**
Is there a plan for repayment?

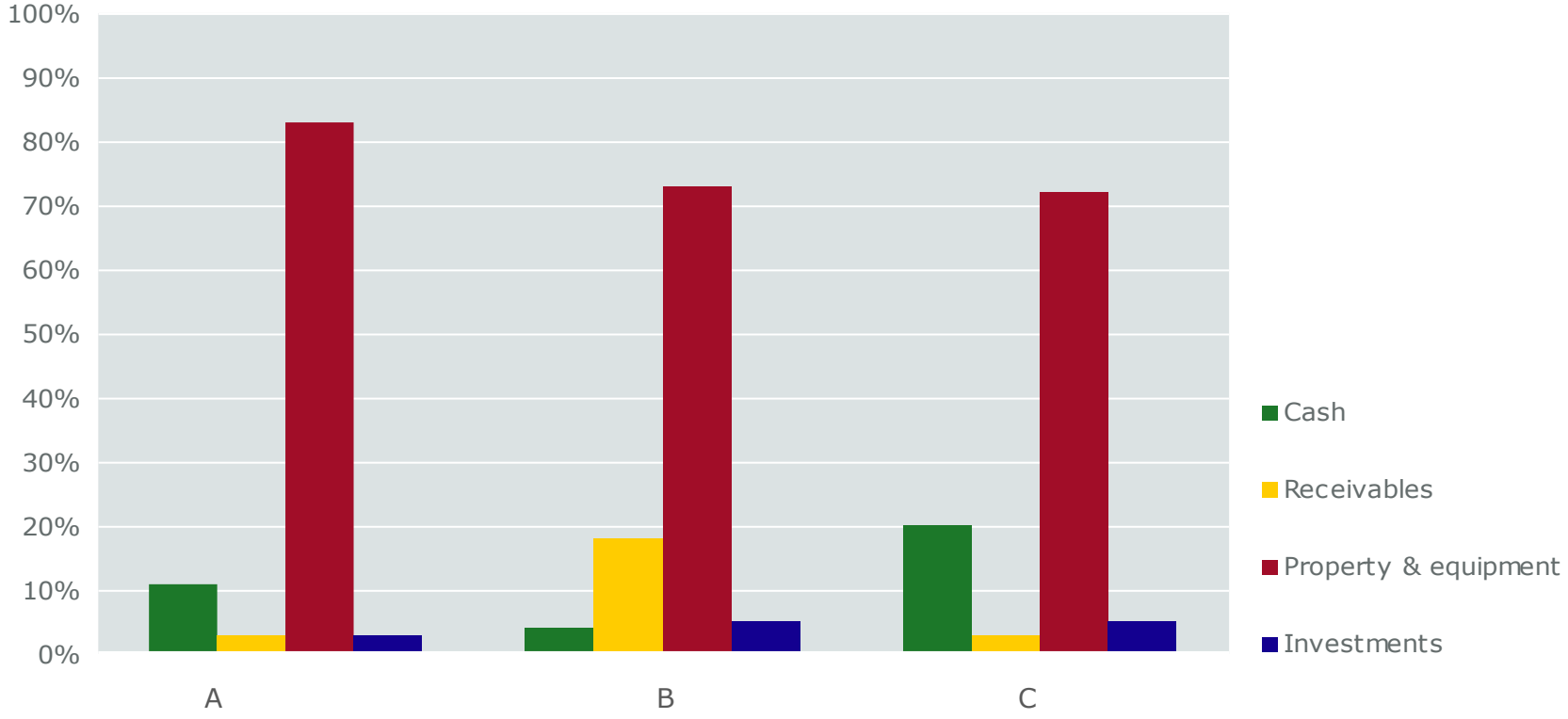
Net Assets

Is there enough net worth to support the org?

- **Net Assets**
How liquid?
How much is w/o restrictions?
Does the org have reserves? Are they suitable to needs?

Example: Different Sectors, Similar Core Operations

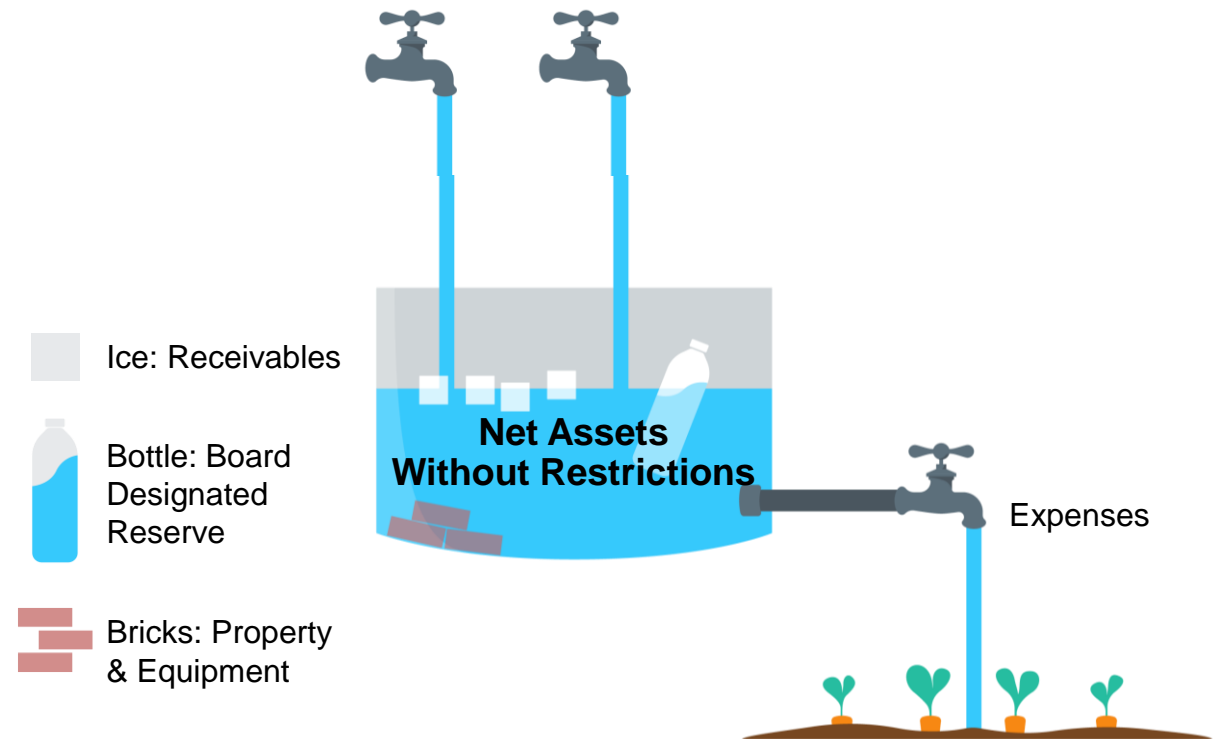
Composition of Assets



Key Metrics #2 & 3: Months of Cash and Months of Available Net Assets

NFF uses two measures of liquidity:

- **Cash**: ability of an organization to cover short term obligations and day-to-day expenses
- **Available Net Assets (ANA)**: an organization's financial safety-net, ability to navigate risk and pursue opportunities
- Calculate these two measures as absolute dollars AND **in terms of months of expenses ('burn rate')**. The latter provides insight into cash and ANA relative to an organization's budget size and over time.



Two Liquidity Metrics, Different Stories

Statement of Financial Position

FYE 6/30/23 (\$ in thousands)

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

Average Monthly Expenses (“Burn Rate”) = \$1,262 / 12 = \$105

Months of Cash

Total Cash	\$191
/ Average Monthly Expenses	\$105
= Months of Cash	1.8

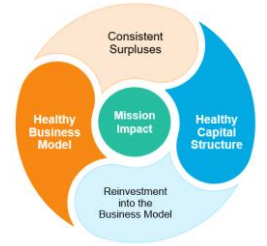
Months of Available Net Assets

Total Net Assets w/o Rest.	\$771
- Board Designated	\$0
- (P&E – P&E Debt)	\$760
= Available Net Assets	\$11
/ Average Monthly Expenses	\$105
= Months of ANA	0.1

While this organization technically has cash on hand, once you remove debt and restricted cash, it has no financial safety net.

Quick Reference: Positive Indicators and Areas of Inquiry

Capital Structure (Balance Sheet)



Positive Indicators

- Cash of at least three month's expenses
- *Available net assets* of at least three month's expenses
- Current assets exceed liabilities
- Evidence of ability to manage debt
- Evidence of reinvestment in fixed assets



Areas of Inquiry

- Low or declining liquidity, as measured by months of cash or available net assets
- High amount of liabilities (e.g., debt, payables) relative to total assets



Financial Strength Profiles Point to Different Management Implications*

	“Need to Take Action”	“Vulnerable to Shocks”	“Making It Work”	“Room to Plan”	Strategic Transition
Overall Financial Characteristics	Weak operating model, Heavily leveraged balance sheet	Unpredictable operating model, thin balance sheet, uneven profitability or breakeven	Working operating model, modest balance sheet, modest surpluses (on average)	Stable operating model, healthy balance sheet, resources to adapt	Shifting operating model, Complex balance sheet, may look like a concern
Unrestricted Operating Results <i>(Surplus (Deficit))</i>	Regular or sizable deficits	Variable operating results that include deficits or breakeven	Small surpluses, not able to cover long-term balance sheet needs	Consistent operating surpluses sufficient to cover long-term balance sheet needs	Significant swings in revenue and expense, may be in flux from year to year.
Liquidity & Reserves <i>(Months of Cash & Avail. Net Assets)</i>	Low to negative liquidity (<1 mo) & trending downward. No reserves.	Limited liquidity (1-2 mo). Little to no reserves.	Access to liquidity (2-5 mo*) but insufficient reserves.	Positive liquidity plus reserves sufficient for business model (typically 6+ mo*)	Liquidity is in flux; may or may not have reserves to fund the change.
Management Implications	No room for error, opportunities should focus on ways to avoid deficits while maximizing mission impact. Nimble decision-making is crucial.	Little tolerance for risk, opportunities can be risky to stability. Need to focus on nimble decision-making to generate surpluses while maximizing mission impact.	Limited ability to withstand risks and pursue opportunities. Can surpluses be maintained so that long-term sustainability is not affected?	Can tolerate risk and jump on opportunities. Are there possibilities for growth?	Consider wide-ranging risks associated with change, need to distinguish one-time from ongoing activities and timeline to establish a “new normal.”

* The above is a guide, not an absolute benchmark. Numbers must be contextualized with the organization's experience.

Wrap Up



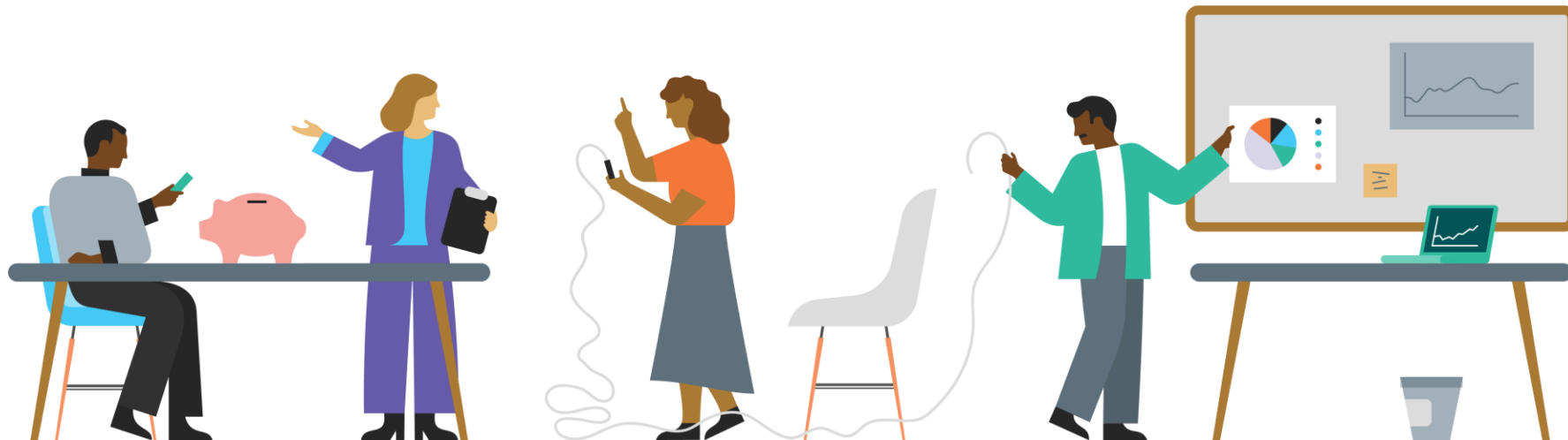
Key Takeaways

- **Nonprofits need profits** to reinvest in the organization.
- Understanding the **systemic and structural challenges** of the sector you understand a nonprofit's financial story and their needs.
- Financial data, considered in context, can provide insights into an organization's **business model, capital structure** and related management implications.
- A central element of mission success is a healthy business model that generates **sufficient surpluses** to cover the full cost of producing positive outcomes for the community.
- A healthy capital structure with **sufficient available and liquid resources** helps an organization adapt, reinvest in its business, manage risks, and take advantage of opportunities.



Resources

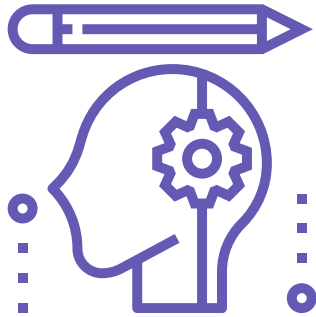
- **Full Cost:** [NFF's Full Cost Website](#) (including the conversation guide and workbook)
- **Financial Management Webinars:** <https://nff.org/fundamental/nonprofit-financial-management-webinars>
- **Budgeting:** <https://nff.org/fundamental/nonprofit-budgets-how-get-started>
- **State of the Nonprofit Sector Survey:** <https://nff.org/learn/survey>
- **Additional Resources** for Nonprofits and Funders: <https://nff.org/learn>



Head, Heart, Feet

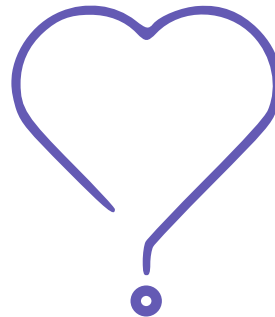
Head

What did you **learn** from this workshop?



Heart

How did this workshop make you **feel**?



Feet

What **actions** will you take?



Thank You!

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Keep in touch!

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