



NEWS from the FOUNDATION

Signs of a Financially Successful Nonprofit

by Elaine Martinez

There are a variety of signs that can indicate the financial health of a nonprofit organization, and frequently, these indicators are rooted in deeper-lying structural strengths. Therefore, in assessing financial health and success of a nonprofit, it is important to not only analyze the financial statements but also the management and culture of the organization. This assessment can be informative when deciding whether to join a board, making a personal contribution or recommending a grant.

First, here are four points to look for in an organization's financial statements:

1. **The organization is profitable.** The term "nonprofit" is misleading to the average person, seeming to convey that because the organization is mission-driven it should not be making a profit. However, an organization must experience reliable revenue greater than expenses, year over year, or it will not be able to build cash reserves or grow. Therefore, a nonprofit's financial statements should exhibit recurring annual surpluses resulting in increasing positive net assets over time.
2. **The organization has multiple ways to earn revenue.** Moderate diversification of revenue streams such as fees for goods and services, donations or private foundation grants is critical to financial health. The organization should have no more than modest dependence on government grants and contracts (which are often slow payers). Finally, too much diversification can be difficult to administer, while too little diversification can put the organization at risk of losing funding.
3. **The organization has savings.** Cash reserves should be equivalent to three to six months of operating expenses. This can be difficult to accumulate, and may take time, but extra savings can help an organization weather difficult times and delayed revenues.
4. **The organization has low debt relative to its assets.** Organizations should be very cautious to incur debt, and any debt they do incur should be an investment in future revenue streams. This investment should not only pay for itself but also provide additional revenue. Debt should not be used to pay off past deficits or the organization could quickly end up in a downward spiral.

The managerial practices of an organization are not evident in the financial statements, but are important when considering the financial health of a nonprofit. These can only be assessed by observation and speaking with the leadership team. No organization is perfect, but here are some important practices to consider.

1. **Does the organization demonstrate reasonable internal controls?** This should include: segregation of duties, cash flow monitoring, regulatory and tax compliance, annual audit and review, timely bank reconciliations, adequate insurance coverage, accurate recording of receivables and payables, and financial reporting to the board.
2. **Does the organization exhibit a cautiously optimistic outlook?** This means the organization's fundraising expectations are realistic while spending is cautious and deliberate.
3. **Does the organization accurately measure its financial and service performance?** Specifically, is the nonprofit monitoring its budget and adhering to it? Is it tracking key indicators (financial and statistical) such as: number of clients served, cost (financial and time) per client served, revenue and cost by program, and number of months cash reserve on hand? Is it tracking grant income and expense, cycles and eligibility?

Even with all of this information, financial results cannot be assessed independently from the organization's structure and culture, such as whether:

1. **The mission of the organization is clearly understood by both internal and external stakeholders.** A good mission statement should be concise and clear with a focus on why the mission is important and how the organization is going to accomplish the intended purpose.
2. **The composition of the staff and board is reasonably stable.** Do board members complete their term? Is the board diverse and representative of the mission? Has the organization demonstrated retention of staff, especially in leadership positions?
3. **Processes for decision-making and handling conflicts of interest are not only in place but are also followed.** Conflicts of interest should be appropriately disclosed and dealt with according to the policies in place. These types of controls are critical to the long-term integrity of a nonprofit.
4. **Finally, communication between board and staff is open and respectful.** Clear and considerate communication is vital to the continued success of any nonprofit organization. The boots-on-the-ground perspective of staff is as critical as the strategic leadership of the board, and each cannot be informed without the other.

There is no list that will ever fully encompass the financial health of a nonprofit organization. However, as El Pomar seeks to financially support nonprofits across the state of Colorado, these questions and key metrics provide important context and insight into the inner workings and financial sustainability of those organizations. We hope these questions and guidelines serve as a general toolkit for financial assessment and nonprofit managerial practices as we all strive to better Colorado's communities.