

# 5 KEY REASONS WHY GREAT FINANCIAL MANAGEMENT IS SO IMPORTANT FOR YOUR NONPROFIT NOW

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## INTRODUCTION

Nearly every nonprofit is going through tough financial times, right along with the rest of the country. According to recent surveying, 69% of nonprofits had already made significant cuts in their budget this fiscal year, and nearly all plan to in fiscal 2010. On a more dire note, Paul Light of the Brookings Institute has predicted that more than 100,000 nonprofits may completely fail by the end of 2010. Nonprofits in human services are, in general, dealing with not having adequate capacity to meet all the needs presenting themselves while suffering grant and donation reductions, and many arts organizations are dealing with reduced attendance and donations. Other organizations that serve the environment, education, health care and the myriad of other needed missions are also struggling to make ends meet while re-thinking their long term mission-strategy.

In short, it's a stressful time to be in nonprofit management. With all that's going on, why should you worry about the quality of your financial management program at this juncture? Isn't it more important to get through the recession in one piece? Shouldn't you be spending your time on preserving programs, or avoiding layoffs?

Sure you should. But to accomplish those tasks, and do them well, you have to have good numbers. Whether it's cash flow projections for the next six months, expenses by category over the past 12 months or ratios from your balance sheet, good financial management and reporting provides you the information to make better stewardship decisions in a crisis. In this article, we'll talk through why this is so important, give you some examples of what kind of reporting you need, and some suggestions on ways to ramp up your financial management and reporting to strengthen your ability to accomplish your mission.

To start, we have to answer the question: Why should you be concerned about the quality of your financial reporting system in the midst of a once in 70 year recession? Let's drill down a bit and investigate five key reasons.

### 1. IT'S STILL BEST PRACTICE

Even though your nonprofit may be stressed from the recession, good financial reporting is still a best practice and an expectation of funders and donors alike. For example, I know of five nonprofits who have each received significant funding from the stimulus bill, but would not have gotten a dime if they could not have demonstrated excellent financial reporting and outcome measurement. And here's the key: When the stimulus opportunity arose, the organizations didn't have time to go out, buy, and install the reporting system. It had to be already in place.

In addition to the fact that good, flexible financial reporting is crucial to those outside your organization, it should also be critical to you as a manager inside the organization. You still can't manage what you don't measure, and like it or not, financial measurements are part of the mission outcome. Certainly, not all mission measurements are financial, but making sure you get the most mission for the money requires that you look at your income and expenses in a variety of ways.

I have said for years that money is the enabler of mission. As a result of that fact, you need to be able to quickly and flexibly analyze and report the financial impact of your mission decisions as you allocate your resources.

## 2. THE BOARD IS NERVOUS

As you know, your board members are the fiduciaries of your nonprofit. They are personally responsible if things go off the rails, and having good financial reporting that they can both depend on and access quickly is crucial. Boards in general are much more knowledgeable than in past years, with more members having business experience than ever before. They are demanding good reporting of financial information (and other outcome measures) and if you don't want to spend all of your (or your CFO's) time working up those reports, having a good reporting system that is flexible enough to meet those (often changing) requests from the board will save you a great deal of frustration and effort, and make your board happier (read: less nervous!).

This brings up an important point: now may be a great time to upgrade your financial reporting system simply because we are in a crisis and the board does need good oversight capability. If you choose this path, shop carefully, make sure you don't overreach, and read my list below before you decide. I know a number of nonprofit execs who have been able to convince their boards that the systems that they avoided spending on in the past are essential now. Speaking of cost controls, your financial management system itself may have maintenance fees and other costs that should be reviewed and reconsidered. Remember, in crisis comes opportunity. I know that instinctively you'd rather spend your resources on direct mission, but if you think strategically, having the ability to track your expenses, income and cash flow in detail may well give you the ability to do more mission down the road.

## 3. PEOPLE ARE LOOKING OVER YOUR SHOULDER

Increasingly, we are all always connected and open for oversight. If you think your financials are the private venue of your management team and board, think again. Your IRS 990's are on public display at many nonprofit watchdog websites, such as GuideStar and Charity Navigator. With very little effort, I can find out what you and your key managers were paid a year or so ago, whether or not your organization made money or is in the hole, and review your balance sheet. Why would I bother to check your financials out online? Well, I don't want to invest funds (translation: make a donation) in a failing organization. Whether I am an individual, a foundation or a corporate giver, I have oversight of your financials online. It also bears noting that every reporter I talk to (and I talk to one or two a month about a nonprofit somewhere in the US) knows about GuideStar and has already looked at the organization's finances before we have our conversation.

You might be thinking that if the 990 federal form is what's online, what more can you do? How will having better financial reporting help here? Isn't the information on the form fixed? Well, yes, but good reporting can help you make a more focused, up-to-date and compelling mission-case *beyond* the 990, both on the watchdog sites (there's a place for you to comment on both) and, more importantly, on your own website. You need a part of your site where you not only have your *current* 990 (the watchdogs tend to lag in reporting current information), but also your most recent audit and your current annual report, with your outcomes listed not only in dollars but also in mission, and not just in numbers but in graphic form.

Transparency is no longer optional, either inside or outside the organization. You might as well have a reporting system that facilitates this easily, not one that you have to spend hours pulling numbers from.

## 4. THERE IS NOT JUST ONE AUDIENCE

You may have noticed that I just said transparency is both an internal and external issue, and it is. Transparency begins inside the organization with your board and staff. Thus, you have many levels of audience for your numbers. For example, your Treasurer and Financial Committee may need one level of reporting (very detailed), while the entire board may be fine with summary information. Here's an example of that differentiation between what the CEO might see...:

### CEO Data Sheet

	<b>Current Month</b>	<b>Last Month</b>	<b>Last Year</b>	<b>Budget or Goal</b>		
Revenue	144,533	142,456	132,677	144,000		
Occupancy (unit 1)	87.0%	88.0%	90.0%	95.0%		
Number of hours billable (outpatient)	2,435	2,490	2,680	2,750		
Staff turnover (12 months)	24.0%	26.0%	45.0%	12.0%		
Receivables (in days)	43.5	45.0	55.0	40.0		
Payables (in days)	32.1	32.0	34.1	30.0		
Current ratio	0.50	0.56	0.76	0.45		
Cash reserve (in days)	47.6	45.6	32.1	90.0		
<b>Cash Flow Summary</b>						
	<b>Month 1</b>	<b>Month 2</b>	<b>Month 3</b>	<b>Month 4</b>	<b>Month 5</b>	<b>Month 6</b>
Total receipts	144,000	144,150	149,400	134,080	120,575	265,625
Total Disbursements	133,271	132,831	134,861	180,541	133,371	216,611
Net cash flow	10,729	11,319	14,539	(46,461)	(12,796)	49,014
Ending cash balance	34,289	45,608	60,147	13,686	890	49,904

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...as opposed to what the entire board might receive:

### Board of Directors Summary Report

#### Income and Expense

<b>Line Item</b>	<b>Monthly Actual</b>	<b>Monthly Budget</b>	<b>Monthly Variance</b>	<b>% of Budget</b>	<b>YTD Actual</b>	<b>YTD Budget</b>
Total Income	144,533	144,000	533	0.4%	887,592	923,600
Total Expense	138,004	140,799	(2,795)	-2.0%	779,063	755,835
<b>Net</b>	6,529	3,201	3,328		108,529	167,765

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At the staff level, your CFO wants every dime spelled out for the entire organization in the reports he/she sees, while a program manager may really only need to see information about his/her program. Some people may want all numbers; some may want numbers and pictures (charts). Again, flexible reporting is key. Can your current system allow for this kind of flexibility?

## 5. IN A CRISIS, DECISIONS OFTEN NEED TO BE MADE FAST, AND WITH REAL NUMBERS

When you're in crisis mode, things tend to speed up. This includes your need to make prompt Return on Investment (ROI) decisions as you allocate your resources. You often can't wait until the monthly or quarterly Income and Expense reports are generated to decide. Flexibility and fast turnaround are key, and this ability needs to be part of your reporting system.

Remember that, as a nonprofit, you need to look at not only Financial ROI, but also Mission ROI. These two different returns are closely related. If a particular service is contributing a great deal toward the success of the mission, it may not be essential for it to make money. Conversely, if a service is not contributing directly to the success of the mission, it better be a profit center. A good example of the latter kind of service for most nonprofits might be a fundraising event that does not provide services directly to constituents, but does bring in more funds than it spends and contributes those excess funds toward the direct servicing of constituents.

Here's a visual demonstration of this concept:

F I N A N C I A L  R E T U R N	HIGH	<u>Consider</u> , based on strategic plan.	<u>Proceed</u> , if it matches a core competence.
	LOW	<u>Avoid</u> , if at all possible.	<u>Consider</u> , based on strategic plan.
		LOW	HIGH

That said, you need *accurate* numbers to measure financial ROI, and here most nonprofits are behind the curve due to what's called "cost-shifting." Cost-shifting arises when one funder says they'll pay for direct costs, but not indirect, on a particular project. So, you shift the indirect costs out to a different cost center. Another funder pays for 50% of the CEO's time, and so you move her expenses there, even if she really spends 90% of her time on the project for a while. After 10 different funders weigh in with their particular reporting needs, the cost picture is so muddled, that you can't really tell what your real costs are, unless you back out the adjustments.

Can your reporting system do that? Can it tell you what a particular service or grant is *really* costing you? Can it track the source of funding separate from the program cost, while still allocating to the appropriate funding sources? Without that information, the staff and board can't make an informed stewardship decision. In addition, this information needs to be available often with greater frequency than just monthly. Doing the homework now on your ability to quickly respond in a prudent fashion is key.

## WHAT DOES YOUR FINANCIAL ACCOUNTING AND REPORTING SYSTEM NEED?

Obviously, the list above necessitates a completely ramped up financial reporting system for many nonprofits, while just tweaks are needed for others. If you are thinking of upgrading your system, do your homework, talk to current users, ask peer organizations what they are using, go online for user reviews. Consult with your auditor. Make sure that any system you invest in has at least the following capabilities, and that those capabilities can be used *easily*.

1. **Meets all the reporting requirements of the new IRS 990, 990N, and 990T.** No sense in not being able to turn these documents out easily. The same caution goes for your state reporting.
2. **Can provide the needed information to your auditor.** The less time the auditors have to spend digging out what they need, the lower your audit bill should be.
3. **Can report flexibly to different audiences.** As noted above, this is increasingly important. Most board members don't want to dig through a 20 page printout. Most staff don't need to. The ability to differentiate is key. Also, graphs and charts are really important for some users. This capability should be built in, and not require exporting to a spreadsheet.
4. **Can report in real time.** Waiting to the end of the month is just so....last century, and can leave you in the lurch.
5. **Can back out cost shifting.** You need to make your resource allocation decisions based on real data. And, cost shifting situations can, over time, get so complicated that you do not want to require some poor staff person to do this by hand.
6. **Can generate reports for online review.** Mostly, this means that the reporting system can develop documents in .pdf format, but check with your webmaster to make sure that this is easy, and easily updated.
7. **Can easily integrate with other database and reporting systems.** For example, your financial system should be able to connect seamlessly with your grant management and donor tracking system.

Good financial reporting is a key part of good stewardship. Now more than ever, it is essential to have the ability to be responsive to financial inquiry, whether from inside or outside your nonprofit. Make sure you have the right tool for the job.

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