Nonprofit Risk Management Center

Financial Sustainability: The New Frontier

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Ensuring that adequate funds are available to support the mission of a nonprofit may be the ultimate challenge facing today's nonprofit sector leaders. The clarion call to "diversify" an agency's funding sources is often heard, but ultimately hard to achieve. Uncertainty about the ability of a nonprofit to finance an ambitious menu of services remains a top concern among staff and board leaders alike.

Are We Healthy, or Just Hanging On?

Do the leaders of your nonprofit worry about whether next month's expenses will be paid, on time and in full? Is your Executive Director hesitant to support the expansion of programs due to concern about the sustainability of current funding streams? Do members of the board admit to being risk averse about growth? Although a savvy outside finance expert might be able to quickly pinpoint signs that a nonprofit is surviving, rather than thriving, those signs may be less clear to insiders. To make it a bit easier to evaluate fiscal health, let's contrast surviving and thriving nonprofits.

A financially stable, thriving nonprofit is likely to be:

- Investing financial and staff resources to improve existing programs and services;
- Exploring opportunities to build on programmatic success, such as scaling up high-demand programs;
- Open to new partnerships that could bring the mission to life faster or more efficiently; and
- Competitive with other organizations providing similar services or working with similar consumers or clients.

In contrast, a nonprofit that is barely surviving may be seen:

- Taking every available shortcut and cutting corners to trim short-term expenses;
- Allowing the workforce to shrink by leaving vacant positions unfilled;
- Freezing cost of living and merit pay increases over multiple year periods; and
- Putting pressure on program and project managers to "do more with less."

Components of Financial Sustainability

Reflecting on the fiscal health and contrasting ills of the many nonprofits we advise, several key topics came to mind as possible puzzle piece components of financial sustainability. In the paragraphs that follow we explore what we view as the five building blocks or key foundational components of financial sustainability:

- Community engagement
- Dependency awareness and analysis
- Fiscal oversight by the Board
- Timely and effective financial reporting
- Programmatic rigor

1. Community Engagement

A key component of financial stability is community engagement. Engaging with the community you serve is necessary to identifying the evolving service needs and wants of current and prospective clients, consumers and service recipients. There many different ways to gather information about the needs and wants of your clientele: reviewing published data and reports, conducting surveys, and sponsoring focus groups, are just a few. Conducting a community needs assessment and building and sustaining meaningful relationships with the people and organizations you serve go hand in hand to support long-term fiscal health.

Here are some questions to consider when performing your community assessment:

- What are the current and projected needs for your services in your community?
- Who are your potential members/ clients/service recipients? What methods are best to reach and engage these individuals or organizations?
- Who are your current and possible future competitors? What services do your competitors offer and how is your organization or service mix different? How might you differentiate your nonprofit going forward?
- How is your nonprofit perceived by current and prospective clients? What is your basis for assessing your reputation?

2. Dependency Awareness and Analysis

Understanding your dependency on key sources of revenue is fundamental to strengthening financial sustainability. With rare exceptions, organizations that rely on a single funding stream are often at greatest risk of poor fiscal health or vulnerable to a fiscal crisis caused by the withdrawal of a funding source. Yet an organization with multiple streams of revenue can also be at risk of poor fiscal health. For example, during the recent economic recession one client reported that corporate donations, fees for services, and product sales to nonprofit clients were all negatively impacted. And so despite having several streams of revenue, no stream was exempted from the negative consequences of the recession.

Here are some questions to consider to increase awareness of your organization’s degree of financial dependency:

- What are the core programs and services of your nonprofit?
- How is each core program or service funded?
- What are the realistic prospects that the funding stream for each core program or service will continue without major cuts for the next 2 years, 3 years, and 5 years?
- What programs or services are at greatest risk of a funding cut or the elimination of funding altogether?
- What programs or services are the least likely to be de-funded or face significant funding cuts?
- Has the nonprofit received notice from any funders that funding will decline or be terminated in the years to come?
- **“A board that cedes responsibility for finance issues to the staff puts the nonprofit at undue risk.”**Is 40% or more of your organization’s revenue derived from one source or stream of funding? What would happen if this source of funding was no longer available for the next fiscal year? What is the current back-up plan to replace this funding source over time, or in the event of an emergency? To what degree are the programs and services funded by this source essential to your core mission and reputation?

3. Fiscal Oversight by the Board

Another fundamental component of fiscal stability is true fiscal oversight by the nonprofit board. A board that cedes responsibility for finance issues to the staff puts the nonprofit at undue risk. The perspectives and participation of both staff and volunteer leaders are needed to ensure that the nonprofit adopts sound financial strategies that advance the organization’s mission, and ensure good fiscal health.

Yet effective fiscal oversight isn’t simply an assignment handed out at a board meeting; it is a responsibility that grows out of a strong and trusting relationship between the board of directors and CEO. Leaders must respect one another, offer mutual support, share a passion for the nonprofit’s mission, and find ways (both large and small) to collaborate for the greater good of the organization. A strong, collaborative relationship marked by mutual trust and respect is key to empowering the board to discharge its responsibility for fiscal oversight.

To evaluate whether your board has embraced its responsibility for fiscal oversight, ask:

"The fiscal health of a nonprofit cannot be assured in the absence of accurate, timely reports comparing financial goals and forecasts to actual results. Financial reporting should be viewed as a component of financial sustainability, rather than as a routine task on the CFO's 'to do' list."

- Does every member of the board demonstrate fluency and comfort with the nonprofit's financial statements?
- Does the board actively participate in training/orientation on fiscal issues, such as a board education session on "how to read nonprofit financial statements"?
- Does the makeup of the Finance and Audit Committees change periodically, so that most board members have a chance to serve on one committee during their term in office?
- Does the Finance Committee report to the full board on a regular basis, and engage the board in a dialog about indicators of fiscal health?
- Do the Board Chair and Treasurer model the importance of engaging the full board in fiscal oversight?

The following are possible questions to help engage the board in a discussion about sustainability, as part of its larger responsibility for fiscal oversight:

- How do we envision the organization's mission evolving in the next 3, 5 and 10 years?
- How do we describe our current model/framework (or "business model") for funding the mission?
- What trends in our segment of the nonprofit sector potentially impair the current financial or business model for funding our mission or put the model in jeopardy in the next 3, 5 or 10 years?
- Are the financial/funding goals we adopted as part of the most recent strategic plan still realistic given internal and external changes and developments?
- What do we know now that we didn't know the last time around that should inform our approach to funding the mission?

4. Timely and Effective Financial Reporting

The fiscal health of a nonprofit cannot be assured in the absence of accurate, timely reports comparing financial goals and forecasts to actual results. Financial reporting should be viewed as a component of financial sustainability, rather than as a routine task on the CFO's "to do" list.

A recent trend in financial reporting is the use of fiscal dashboards. Dashboards offer a visual interpretation of financial results. The components of a dashboard depend on the issues of critical to importance to the nonprofit. For example, a nonprofit engaged in an ambitious growth plan may want to provide periodic updates on its progress during finance presentations to the board. A graphic comparing results to the growth goals is a tool for helping the board see the progress made to date and the work yet to be accomplished.

The leaders of a nonprofit's Finance Committee and staff finance team should collaborate in deciding which items will be included in committee and full board presentations. Some of the common items found in finance presentations include:

- Narrative overview of fiscal status prepared by the CFO, CEO or board Treasurer
- Statement of Financial Position (balance sheet), Statement of Activities, and Statement of Cash Flows
- Proposed changes to key financial policies, such as the Investment Policy, Operating Reserves Policy, Travel/Reimbursement Policy, Contracting Authority policy, or the position description for the Finance Committee
- Fiscal Dashboard showing results or illustrating trends in various areas, such as: progress towards growth goals, year-to-year fluctuations in revenue from various funding streams or channels, growth of unrestricted net assets, ratios comparing the nonprofit to a defined benchmark, and more.

For more information on fiscal dashboards, see "Set the Story Straight with a Financial Dashboard."

5. Programmatic Rigor

While it's true that not every program or service in your nonprofit will generate net income, it is important that staff and board leaders have a clear understanding of which programs are mission-critical, and under what circumstances beloved programs may be subject to change or elimination. It is preferable to undertake this discussion without the added stress or noise of a funding crisis. While your leadership team may agree that all programs have value, articulating the financial expectations for each program and service area is essential to ensuring not only the fiscal health of individual programs or areas of service, but of the organization as a whole.

When a nonprofit experiences a downturn in one or more revenue streams, the immediate focus is often on finding new donors, seeking new government contracts or leveraging existing revenue streams. Only after the opportunity to replace a former funding source has been exhausted, are leaders willing to consider scaling back or discontinuing existing programs or services. We use the term programmatic rigor to refer to the willingness to:

- evaluate the sustainability of a nonprofit's services on a program by program basis,
- consider the relationship of each program to the organization's mission, and
- evaluate each program's fiscal sturdiness□□before a funding crisis occurs.

Financial sustainability is a familiar goal in high-performing nonprofits. The risks of ignoring the topic are potentially severe, and include the need to eliminate programs and services with little notice to clientele who depend on your nonprofit. Yet like weight-loss, there is no inexpensive and simple remedy that suits every organization. Differences in mission, structure, culture and staffing necessitate a custom approach to ensuring financial sustainability. As you explore this important topic with your board or senior management, consider breaking it down into component parts, perhaps using the topics addressed in this article and suggested discussion questions as tools.

Melanie Herman is Executive Director at the Nonprofit Risk Management Center. She welcomes your feedback and questions about any of the topics addressed in this article at Melanie@nonprofitrisk.org or (703) 777-3504.