

Examining Fiscal Risk for Mission-Minded Success



By Whitney Thomey

Lead Consultant & Risk Ethnologist

Resource Type: Articles, Risk eNews

Topic: Fraud and Financial Oversight

Powerful missions, community advocacy, and life-changing programs can only happen when nonprofits have sufficient financial resources and strong financial management. Sound financial decisions and financial risk management protect critical assets and make it possible for a nonprofit to deliver the services and programs that bring a charitable mission to life. However, there's another reason that nonprofit leaders should keep financial risk top of mind. Organizations must be mindful of how funds and resources are spent and tracked because of three key factors:

1. **Stewardship.** Managing nonprofit financial resources is founded on the premise of managing 'someone else's' money, from institutional to individual funders, corporate contributors, or purchases made by clients, members, and service recipients. As stewards and fiduciaries, nonprofit leaders hold funds 'in trust' for the benefit of others—the people and communities that depend on the nonprofit's work.
2. **Oversight.** In addition to the oversight provided by finance and audit committees, nonprofits are subject to scrutiny from regulatory agencies such as the Internal Revenue Service, and laws ranging from state charitable solicitation statutes, and local/state laws that impose property and sales taxes.
3. **Ethics.** Ethical leadership of a nonprofit requires that every dollar raised be spent appropriately. Leaders grounded in ethics pay obsessive attention to financial management to ensure that outgoing funds are spent in a manner consistent with the organization's charitable purpose and in support of mission-advancing activities.

NRMC asked a panel of nonprofit finance leaders to share their unique perspectives and insights on a number of pressing financial risk questions. We are grateful to the following financial leaders who generously participated in this interview:

- Holly Raymond – Senior Vice President, Finance & Support Services, [Upbring](#)
- Ed Mulherin – Founder & CEO, [eCratchit Nonprofit](#)
- Joseph Budzynski – Executive Vice President and Chief Financial Officer, [Volunteers of America](#)

NRMC: What's the biggest financial risk facing nonprofits today?

Holly Raymond: I believe the biggest financial risk to nonprofits is forecasting donor behavior emerging from the pandemic. We saw donations slow down across the board and anticipate that foundation giving will be impacted this year. Institutional donor giving tends to lag compared to individual giving. 2020 had so many 'unprecedented' events. As we move out of them, we hope that donors will feel confident enough to give at

their historical levels.

Ed Mulherin: I see three top financial risks on the horizon for organizations. First, nonprofits need access to timely, accurate financial information. Funding is a question mark. There's uncertainty around how 2020 will have impacted donor capacity and appetite, and there's an expectation that giving trends will change because of that.

Second, nonprofits must be concerned about their liquidity and, more than ever, because of funding concerns and risks, the size of their operating reserves. Finally, the adequacy of staffing and salaries will continue to be a financial risk for nonprofits. Nonprofit salaries are typically less than in the for-profit sector, and organizations compete in tight labor markets for exceptional and qualified staff.

Joe Budzynski: In my opinion, it's future revenue streams. There has been an uptick in donations, and that's been a direct result of the nonprofit sector stepping up during the pandemic to serve communities. We've also seen various CARES Act stimulus funds coming in and trickling down, which continue to support and amplify revenues from existing funders. In some areas, the funding has doubled or even tripled from pre-COVID levels. However, this extra funding is uneven state-by-state even when it's based on need and the existing social services network.

The considerable risk comes when this Federal funding drops off; then, we'll see the actual impact on state budgets post-COVID. How will the Federal government balance out the trillions of dollars to keep the funds buoyed? What choices are states going to make to continue to fund these various programs and the missions of the nonprofits in the long-term—in the next 2-5 years? There will also be unevenness on a state-by-state basis. You can expect some areas to fare well and others won't.

NRMC: What's the most misunderstood financial risk facing nonprofits today?

EM: I think nonprofits often misunderstand the need for adequate reserves and that it's consistent surpluses over time that build and enhance the Balance Sheet.

JB: Many nonprofit leaders misunderstand the importance of short-term cash flow and consistent, timely payments from providers. In our organization, we often encounter situations where provider payments lag behind the services we provide to our community. States will encourage nonprofits to maintain lines of service, even when government funds lag. Eventually, provider payments are behind—by millions of dollars sometimes! When that happens, nonprofits are expected to bankroll essential programs until the funds arrive. Nonprofits often do this despite having thin budgets and inadequate reserves or unrestricted funds.

On the surface, everything looks good: you don't need to execute layoffs, programs and services are "right-sized," but what does the cash flow look like? Is it as you expect, or is there a significant delay from providers? This is often not part of the strategic conversation. It's simple, how long can you continue to fund programs until reimbursement funds arrive? Many nonprofits don't look at funding in that manner.

NRMC: What are the frequently missed (or misunderstood) opportunities to strengthen a nonprofit's balance sheet/improve financial health?

HR: Organizations will sometimes turn down donations, thinking, "We don't need that gift" because we're in good shape right now. Another fallacy is that continually operating at a deficit means you are more deserving or have more need than other organizations. The risk of this strategy is that continued losses are unsustainable. As a nonprofit, we can (and should!) have a positive bottom line. Financial stability helps us be sustainable in perpetuity to continue to work for our mission another day.

EM: Two things come to mind. First, nonprofit leaders often miss the opportunity to budget for surpluses! When you build a surplus into the budget, it sets a goal for building reserve funds, which can be earmarked for emergency operating expenses or an innovation fund so organizations can safely take those bold opportunities for their mission. Second, I don't think there's enough consideration for nonprofits to enter into merger deals. Looking for the opportunity for like-minded organizations to formally merge has the potential to gain efficiencies that can help congruent missions.

JB: The thing that comes to the top of my mind would be timely and accurate cash forecasting. As nonprofits operate at the speed of business and uncertainty, we all grapple with how to continue to live and emerge from COVID; knowing your current cash balances and cash forecasts are super important. I get the sense that a lot of nonprofits don't know they need to do this. Many leaders are focused on fighting a daily fire so forecasting isn't top of mind—particularly cash forecasting.

However, you need to make sure you can pay your bills, pay staff, and keep doing what you're doing to fight another day. Something all nonprofits can improve is the health of their balance sheet. No one likes to call it quits, and there's often a tendency to hold on too long. The risk here is that if there's nothing left (the balance sheet is over leveraged, the population you serve has declined, etc.), your organization is no longer attractive as a candidate for a merger.

Finally, I think that the whole COVID experience was a wake-up call to many nonprofits to take a step back and talk about reserves. Many leaders are having long overdue conversations about creating adequate reserves, including emergency funds. It's not a quick fix! It's often a multi-year effort to reach targets. When there's a windfall, you have to be disciplined to put money aside and realize that the impact of a serious downturn will affect more than one financial cycle. Another important, shorter-term strategy is to ensure you have secured lines of credit to help you weather the storm until those reserves are adequately built.

NRMC: What is a common misconception boards and finance committees have about financial management, financial forecasting, or their fiscal oversight role?

HR: I think that nonprofits often think it's relatively easy and straightforward to go out and ask for donations and be awarded grants. In actuality, it is a long, methodical process. Team members need to have dedicated attention and intention and be there to work with the organization long term. I would recommend against starting any long-term initiatives until time has been spent to vet them thoroughly. It takes time to lay the groundwork and for those seeds to bloom into something in the future.

EM: It's tricky to ensure that boards and the finance committee are striking the right balance between too much oversight and not enough. There needs to be support and counsel from the board, and at the same time confidence to allow nonprofit leadership to manage the day-to-day.

NRMC: What are the top signs that the financial house (business model, financial reporting, composition/leadership of the finance team) needs a radical renovation versus some repair work?

HR: If there has been fraud or material misstatements that led to a modified audit opinion of the financial statements, you need a radical renovation of systems and processes. Most other issues require a change in staffing or a detailed review to complete repair work.

EM: In my opinion, if your organization is having chronic cash flow issues, is late on reporting or missing reporting altogether, or if you're experiencing surprises in your finances, then it might be time to consider a radical renovation of who is leading (the organization or the finance team) or how the finance function is structured and operates.

JB: Here are some questions to ask to evaluate your organization's financial health:

- As trends are changing in your space, are you staying on top of them?
- Can your current staff pivot to those changes? If you can't, you run the risk of watching your funding sources diminish or dry up.
- Are you thinking about not just getting through today but how to manage tomorrow better? In other words, do you have reserves and a plan? And do you know when you would use those types of reserves?

The COVID-19 crisis has been a catalyst for many nonprofit leaders to have these conversations and review their financial functions. Many organizations are taking a look and realizing that we need better forecasting in sync with operations. Keeping these two functions in step provides a better understanding of what lies ahead. Annual budgets and comparing historical budgets to actuals are still important tools, but what's needed right now is a forward look rather than what's in your rearview mirror.

NRMC: Are there not-so-obvious or sometimes overlooked signs that a nonprofit's financial health is improving?

JB: I think there's often a temptation to only look at the bottom line. Nonprofit boards are often staffed from the for-profit sector, and they recognize the benefit of a positive bottom line. Nonprofits are *mission-focused*, and this fact extends out timelines and makes the question of improving fiscal health more complex. It's vital to take into account what an organization is doing and whether the *right things* are happening. Financial dashboards should show strategic metrics and measure outcomes. These dashboards should be showing what impact the organization is having on the population they're serving, along with the financial results. This will help evaluate if your organization is hitting targets you set and whether resources should be allocated differently based on what you want to change in the community.

Because of the nature of mission-focused work, boards should strive to consistently ask questions such as: "Are we doing the right thing and maximizing our precious resources to have the best impact? Could we explore a different partnership to leverage resources even if it means we have to give up some control?"

NRMC: What should readers of the Form 990—or financial statements in general—be looking at specifically to best understand the financial health of a nonprofit?

HR: I think it depends on why someone's reading the 990. If you mainly need to understand a nonprofit's financial health, there are two places you should look. First, look for any endowments and related disclosures. Second, to understand overall revenue, you should examine assets and fundraising activities. And while it isn't a primary indicator any longer, you can calculate the functional expense allocation. Finally, if you're interested in joining their team, I recommend looking to see how much they pay their top staff.

EM: Too often, organizations look at their income statements for a single year, when, really, it's best to look at a trend over 5 years and focus on the balance sheet.

NRMC: What are some of the most important lessons managers and boards are poised to learn during tough economic times?

HR: Very simply, not every nonprofit is going to make it through the pandemic. We've seen closed doors and dramatically changed operations. The most important lesson is never to lose sight of your revenue wheel. Ask questions like:

- Are you too heavily weighted in any area?
- How nimble are you when situations require it?
- What will it take to make the tough decisions?

Balance and flexibility are essential. Federal and state funding didn't waver during the pandemic. However, individual donors, events, and foundations have been fickle.

EM: You really can't ever have too much in reserves. Strive for at least 6 months, but more is better. Another sound tactic is to establish a Line of Credit in advance. Setting it up before you need it will ensure that it's available to help you weather tough times.

JB: I think you have to make it a priority when you're building your budget year-over-year that there's enough to cover and protect your employee costs. All nonprofits are labor-intensive; most spend between 50-70% of their total budget on employee compensation and related expenses. Staff should be a priority! They are what keeps the organization alive, and ensure that mission work happens.

Difficult economic times put a strain on this area of the budget. Often, you'll see hiring freezes, no bonuses or pay increases, and even layoffs. However, the programs and services don't stop, so staff must keep doing the work. Sometimes, especially in the social services sector, these programs are even more vital for a community and require 24/7 program support to clients. It's essential that nonprofit leaders think about how employees are being compensated. Questions like:

- Are all staff being paid a fair and equitable wage?
- Has your organization made DEI a priority?
- What are you asking staff to endure?

How you prepare financially from a recruiting and retention standpoint affects the quality of service you provide and your mission's success.

NRMC: What question about financial risk and health should we have asked you?! What else do you want our readers to know?

EM: I can't emphasize this enough: you don't want to be surprised by your financials! That means nonprofit finance leaders should establish strong budgeting practices by program and by month, and there should be consistent variance analysis to surface anomalies as early as possible. Finally, I recommend using income statement forecasting to help the leadership team understand whether cash flow is strong, stable, or weak.

JB: Looking at the past 12 months as a catalyst, I've learned that it's imperative that the Finance department work more closely with Operations. That relationship is crucial to understanding challenges, thinking through strategy, timing, and implementation, and being nimble to take advantage of opportunities or mitigate losses.

Another thing to be mindful of is the shifts in the price of insurance. Whether you're talking about healthcare or non-healthcare insurance, the costs are crippling. Organizations are becoming numb to the increases. I worry about a hardening market and carriers stepping back and dropping coverages. That creates a huge financial exposure, especially if your organization struggles with having adequate reserves. The way to avoid this is to partner with a good broker who knows who you are, what your mission is, and truly works toward getting your organization appropriate coverages.

Additional Reading

- [Financial Risk Management: A Guide for Nonprofit Executives](#)
- ["Understanding Reserves"](#) (VIDEO) Propel Nonprofits
- ["Top 5 Trends Impacting Nonprofits' Fiscal Health in 2021,"](#) Concannon Miller
- ["Nonprofit Finance in 2021 – setting the new course in the post-pandemic era,"](#) Diginomica

Whitney Thomey is Project Manager at the Nonprofit Risk Management Center. She welcomes your follow-up questions about any of the topics covered in this article at 703.777.3504 or Whitney@nonprofitrisk.org.