

UNDERSTANDING FINANCIAL HEALTH

April 19, 2022

REDF

An investment that **works**.

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BDO FMA



Today's Session

UNDERSTANDING FINANCIAL HEALTH

- ▶ Our money stories
- ▶ A framework for financial resilience
- ▶ Unpacking the balance sheet
- ▶ Unpacking the statement of activities
- ▶ Key liquidity indicators
- ▶ Team-based practices and understanding our audiences
- ▶ Planning for operating reserves



Money Stories

1 Click on the link to the Padlet

2

Take a moment to reflect on the following questions:

- ▶ What messages did you get from your family and/or community about money?
 - ▶ How were you expected to use your own money when you had it?
 - ▶ What beliefs do you have about spending and saving money?
 - ▶ How do these histories show up at work?
-

3

Post your responses in Padlet anonymously



Use the chat:

What do you want to
know about your
organization's financial
health?

Financial Resilience



Operating Reserves

Reserves indicate long term financial health & flexibility - our safety net and our resources to invest in change & growth

WHAT ARE THEY?

- ▶ Reserves are like a savings account
 - ▶ Liquid
 - ▶ Unrestricted
 - ▶ Net of debt

WHY DO WE NEED THEM?

- ▶ Serve the mission during downturn
- ▶ Take risks, innovate and grow
- ▶ Cover frontloaded expenses

HOW DO WE BUILD THEM?

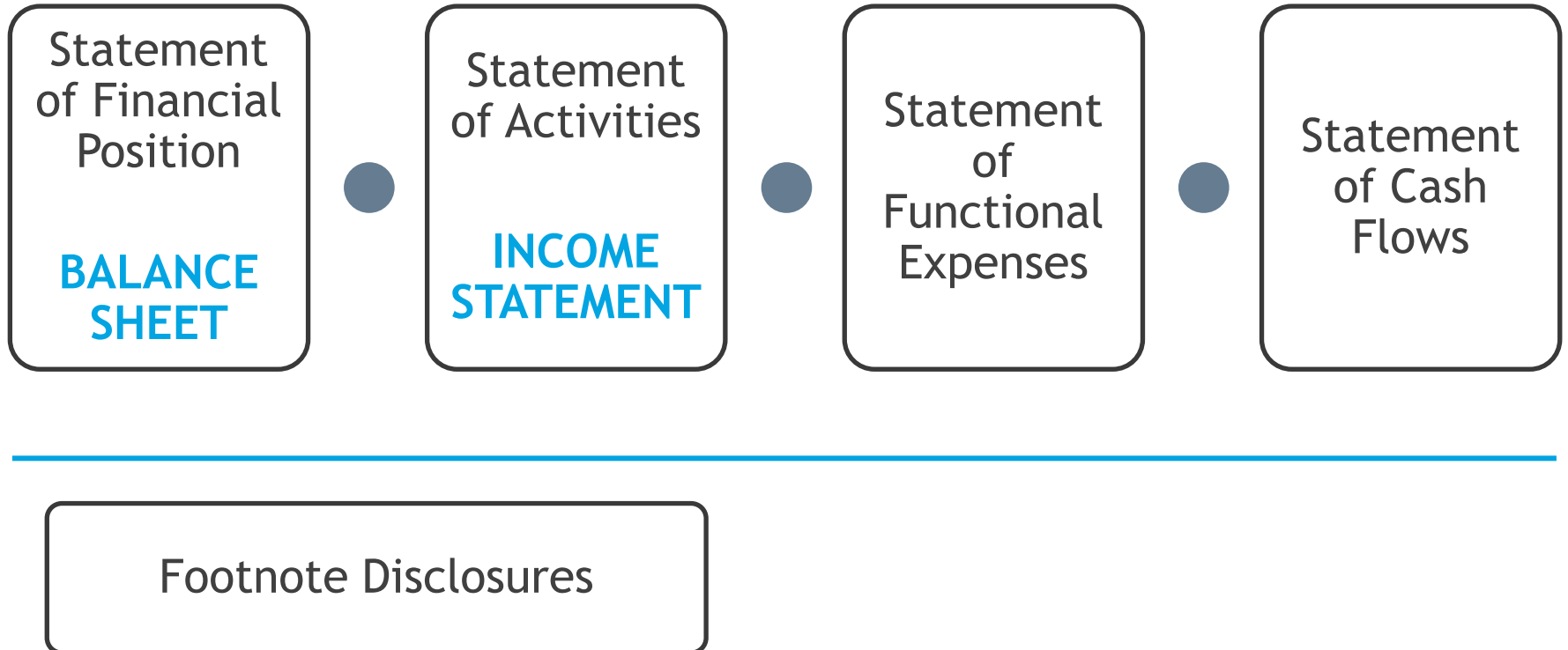
- ▶ Annual surpluses
- ▶ Fundraising campaign or investment
- ▶ Strategic budgeting



Poll: What Is Your Comfort Level With Financial Information?

1	Very Comfortable
2	Somewhat Comfortable
3	Neutral
4	Somewhat Uncomfortable
5	Very Uncomfortable

GAAP Financial Statements



GAAP Financial Statements

COMMONLY FOUND IN...



Audit



Review



Compilation



Internal
Reports

**formats may vary*

INDEPENDENT AUDITOR'S REPORT

Board of Directors
Nonprofit Org, Inc.
Anytown, USA

Report on the Financial Statements

We have audited the accompanying financial statements Nonprofit Org, Inc., which comprise of the statements of financial position as of June 30, 2018 and 2019 and the related statements of activities, functional expenses, and cash flows for the years then ended and related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects the financial position of Nonprofit Org as of June 30, 2019 and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

New York, NY

October 15, 2019

The IRS Form 990

DEFINITION

- **Information return** for organizations exempt from income tax
- Provides the **IRS and state charity agencies** with information to assist them in enforcing the laws governing nonprofits
- The **most publicly available document** about an organization

REQUIREMENT

- Annual gross revenue of **\$50K or less**: 990-N (E-postcard)
- Annual gross revenue of **\$200K or less & total assets of less than \$500K**: 990-EZ or 990
- Gross revenue **greater than \$200K, or total assets of \$500K or more**: 990

990 vs Audited Financial Statements

990

- No detail about **donor restrictions on revenue**
- **Board designated net assets** not shown
- **In-kind donations of services** not recognized
- Sales of merchandise, special events, and rental activities are shown **net of expenses**
- **Management & Governance** info included
- One of the most public and visible documents about our organizations

Audit

- Shows **donor restrictions**
- Shows **board designated**
- Recognizes **In-kind donations of services**
- These may also be net of expenses, not always
- Conforms to **Generally Accepted Accounting Principles (GAAP)**—not required of data in the 990

Source **GuideStar**: Retrieved from: <http://www.guidestar.org/rxg/help/faqs/financial-scan/metrics-and-data-faqs.aspx>

Statement of Financial Position (Balance Sheet)

Net worth as of a point in time

Statement of Financial Position (Balance Sheet)

What is Owned



- Cash
- Receivables
- Investments
- Fixed Assets

What is Owed



- Bills Due
- Line of Credit
- Deferred Revenue
- Debt (short- and long-term)

Net Worth



- Without Donor Restriction
 - Board Designated
 - Fixed Assets
 - Other
- With Donor Restriction
 - Temp restricted
 - Perm restricted

NONPROFIT ORG, INC.

STATEMENT OF FINANCIAL POSITION

JUNE 30, 20XX and 20XY

ASSETS			
		<u>20XX</u>	<u>20XY</u>
Assets:			
Cash		\$274,139	\$297,389
Pledges and contracts receivable		200,000	210,000
Prepaid expenses		<u>17,000</u>	<u>22,000</u>
Total Current Assets		491,139	529,389
Property and equipment, net of accumulated depreciation \$27,505		39,393	64,393
Other Assets - security deposit		<u>12,000</u>	<u>12,000</u>
Total Assets		<u>\$542,532</u>	<u>\$605,782</u>
LIABILITIES AND NET ASSETS			
Liabilities:			
Accounts payable and accrued expenses		\$ 29,578	\$140,054
Advances		51,300	78,500
Current portion of long-term debt		<u>10,500</u>	<u>9,750</u>
Total Current Liabilities		91,378	228,304
Long-term debt		<u>160,744</u>	<u>170,494</u>
Total Liabilities		<u>252,122</u>	<u>398,798</u>
Net Assets:			
Without donor restrictions		(38,427)	114,417
With donor restrictions		<u>328,837</u>	<u>92,567</u>
Total Net Assets		<u>290,410</u>	<u>206,984</u>
Total Liabilities and Net Assets		<u>\$542,532</u>	<u>\$605,782</u>

Statement of Activities

Financial activity over a period of time

Statement of Activities

What We Were
Awarded or
Earned

Unrestricted
Revenue

What We Spent

Expenses

Our Operating
Results

Surplus
(Deficit)

Indicates increasing or
decreasing resources

NONPROFIT ORG, INC.

STATEMENT OF ACTIVITIES

FOR THE YEARS ENDED JUNE 30, 20XX and 20XY

	Without Donor Restrictions	With Donor Restrictions	Total 20XX	20XY
Revenue and support:				
Government contracts	\$ 692,998	--	\$ 692,998	659,650
Grants and contributions, non-government	188,760	559,100	747,860	834,982
Fundraising event	--	11,100	11,100	12,500
Satisfaction of program restrictions	333,930	(333,930)	--	
Interest income	<u>3,915</u>	<u>--</u>	<u>3,915</u>	<u>4,578</u>
Total revenue and support	1,219,603	236,270	1,455,873	1,511,710
Expenses:				
Program A	357,953	--	357,953	387,997
Program B	118,378	--	118,378	127,738
Program C	381,238	--	381,238	380,694
Program D	<u>229,861</u>	<u>--</u>	<u>229,861</u>	<u>232,894</u>
Total program expenses	1,087,430		1,087,430	1,129,323
Supporting Services				
Administrative and general	118,058	--	118,058	128,765
Fundraising	<u>166,959</u>	<u>--</u>	<u>166,959</u>	<u>170,780</u>
Total expenses	<u>1,372,447</u>	<u>--</u>	<u>1,372,447</u>	<u>1,428,868</u>
Change in net assets	(152,844)	236,270	83,426	82,842
Net assets - beginning of year	<u>114,417</u>	<u>92,567</u>	<u>206,984</u>	<u>124,142</u>
Net assets - end of year	<u>\$ (38,427)</u>	<u>\$ 328,837</u>	<u>\$ 290,410</u>	<u>\$ 206,984</u>

Operating
Results



Understanding Nonprofit Revenue



Revenue without Donor Restrictions

- ▶ Contributions from individuals, corporations and foundations for “general operating support”
- ▶ Earned revenue
- ▶ Revenue reimbursed from government contracts



Revenue with Donor Restrictions

- ▶ Contributions from individuals, corporations and foundations with documented time and/or purpose-based restrictions
- ▶ Time restricted grants make nonprofit accounting particularly complex: we only recognize the portions we have access to as revenue

The 2 most commonly accessible types of nonprofit funding, government contracts and purpose-restricted grants, often do not fund organizations’ “true costs,” nor contribute to operating reserves or other capital.

Financially healthy organizations require other recurring unrestricted revenue

Sustainable Business Model: Revenue Characteristics



Your revenue mix:

a) Does it fund “true cost”?

b) Does it generate reserves?

c) Is your infrastructure well-matched?

Foundations, Corporate & Individuals

- ▶ Restricted requires strong accounting
- ▶ Inequitable access
- ▶ High-touch cultivation
- ▶ Requires adequate technology
- ▶ Giving may be inconsistent
- ▶ Fundraising, finance and program collaborate to source and vet opportunities
- ▶ Individuals require more transactional capacity

Earned Revenue & Special Events

- ▶ Unrestricted, more controllable
- ▶ Requires true cost analysis for pricing
- ▶ Potential for mission drift or drain on program staff
- ▶ Beware of rules (UBIT, charitable income tax deduction)

Government

- ▶ Large, multi-year
- ▶ Reimbursement requires other recurring source of liquidity
- ▶ Does not fund true cost - requires supplemental unrestricted
- ▶ Doesn't contribute to reserves
- ▶ Finance & program collaborate to track spend down
- ▶ Complex compliance, billing & invoicing

Funding Criteria

EVALUATE OPPORTUNITIES PRIOR TO APPLYING



PROGRAM DELIVERY

- ▶ Mission Match
- ▶ Staffing and Workload



FINANCIAL IMPACT

- ▶ Start-up costs
- ▶ Portion of direct costs funded
- ▶ Contribution to overhead costs



CONTRACT MANAGEMENT

- ▶ Relationship with funder
- ▶ Required systems
- ▶ Complexity of reporting

Thoughts & Questions

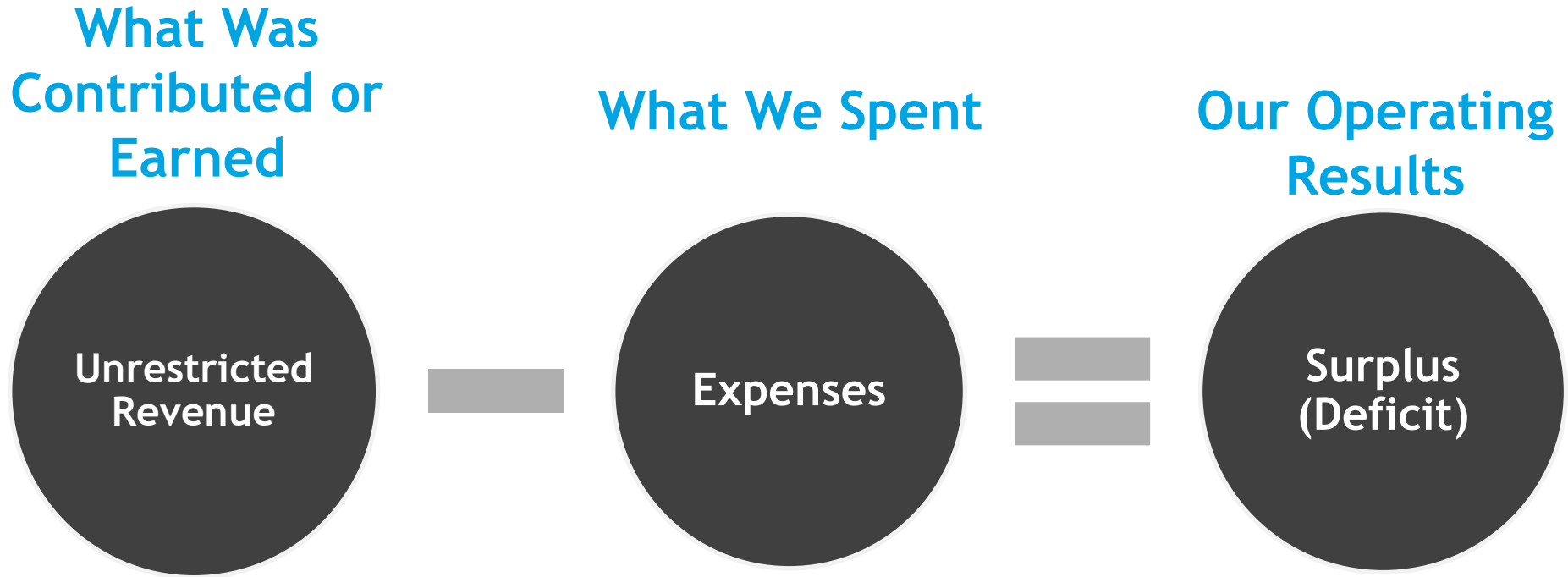




Break

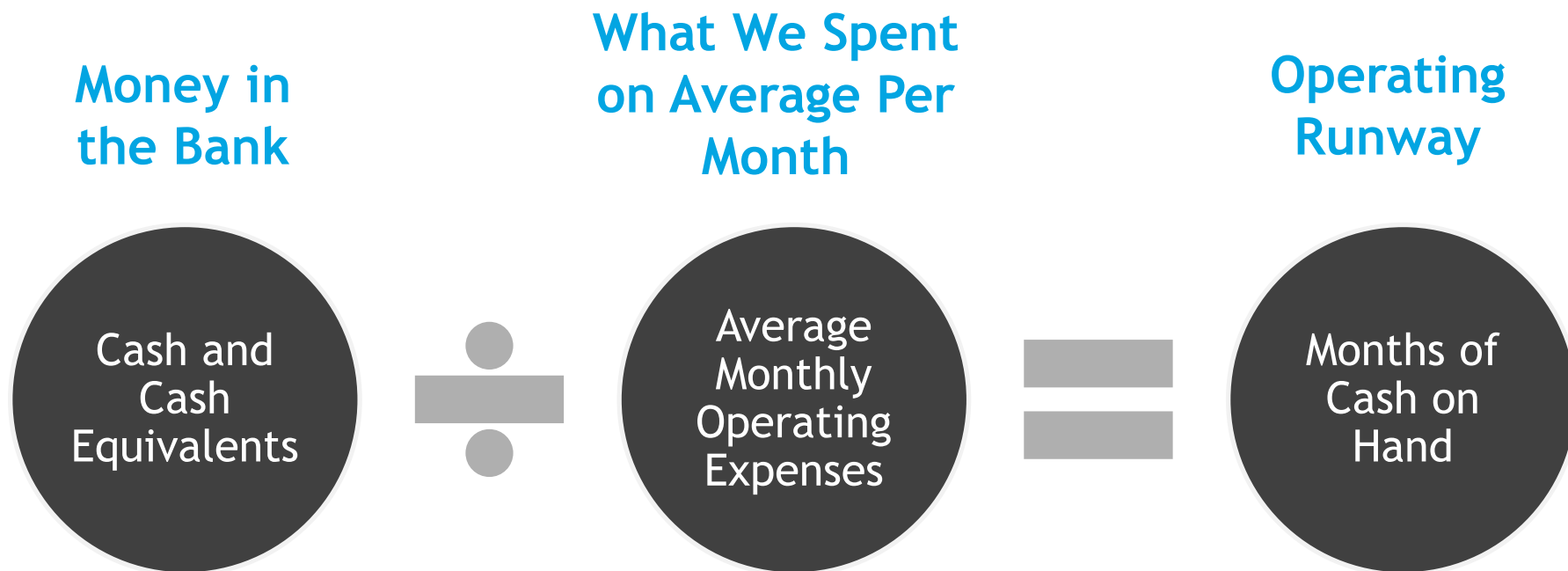
Understanding Financial Health: Three Key Metrics

Operating Results



Key financial health indicators: liquidity

Months of Cash on Hand



Calculating Months of Cash

Assets	Jun 30, 2020
Cash	1,103,580
Receivables	563,000
Fixed assets, net	47,875
Total assets	<u>1,714,455</u>

	Jul 19 - Jun 20
Revenue	
Individual Contributions	176,000
Foundations	1,478,400
Other	105,600
Total Revenue	1,760,000
Expenses	
Personnel	1,749,997
Rent	300,000
Supplies	449,999
Total Expense	2,499,996

YTD Expenses	2,499,996
÷ Number of Months	12
= Monthly Expense	208,333
Cash	1,103,580
÷ Monthly Expense	208,333
= Months of Cash	5.3

Liquid Unrestricted Net Assets (LUNA)

Our Unrestricted Net Worth

Unavailable Net Worth

Operating Reserves

Unrestricted Net Assets

Illiquid Net Assets

Liquid Unrestricted Net Assets

Differs from cash
“unrestricted”: excludes resources that are restricted
“net”: subtracts what we owe

Manual calculation to exclude resources that are relatively *illiquid*

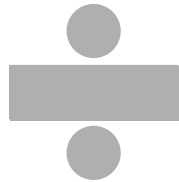
Our available, flexible resources

Months of LUNA

Operating
reserves

What is spent on
average per
month

Months of LUNA



Key indicator of financial
health and flexibility

Calculating LUNA

Assets	Jun 30, 2020
Cash	1,103,580
Receivables	563,000
Fixed assets, net	47,875
Total assets	1,714,455
Liabilities and Net Assets	
Liabilities:	
Accounts payable	340,000
Fixed Asset debt	16,000
Total liabilities	356,000
Net assets:	
Without donor restrictions	
Operations	354,455
Board designated	250,000
Total unrestricted	604,455
With donor restrictions	754,000
Total net assets	1,358,455
Total liabilities and net assets	1,714,455

	Jul 19 - Jun 20
Revenue	
Individual Contributions	176,000
Foundations	1,478,400
Other	105,600
Total Revenue	1,760,000
Expenses	
Personnel	1,749,997
Other Than Personnel	749,999
Total Expense	2,499,996
Monthly Expense (total ÷ 12)	208,333

Unrestricted Net Assets	604,455
- Board designated	250,000
- (Fix assets, net-Fixed asset debt)	31,875
= LUNA	322,580
÷ Monthly Expense	208,333
= Months of LUNA	1.5

Months of LUNA vs CASH

Months of LUNA = 1.5

VS

Months of Cash = 5.3

LUNA

- ▶ Includes cash, plus assets easily convertible to cash
- ▶ Unrestricted only (excludes resources restricted for future use)
- ▶ Net of debt

CASH

- ▶ May comingle unrestricted resources with resources restricted for future use
 - ▶ Not net of debt

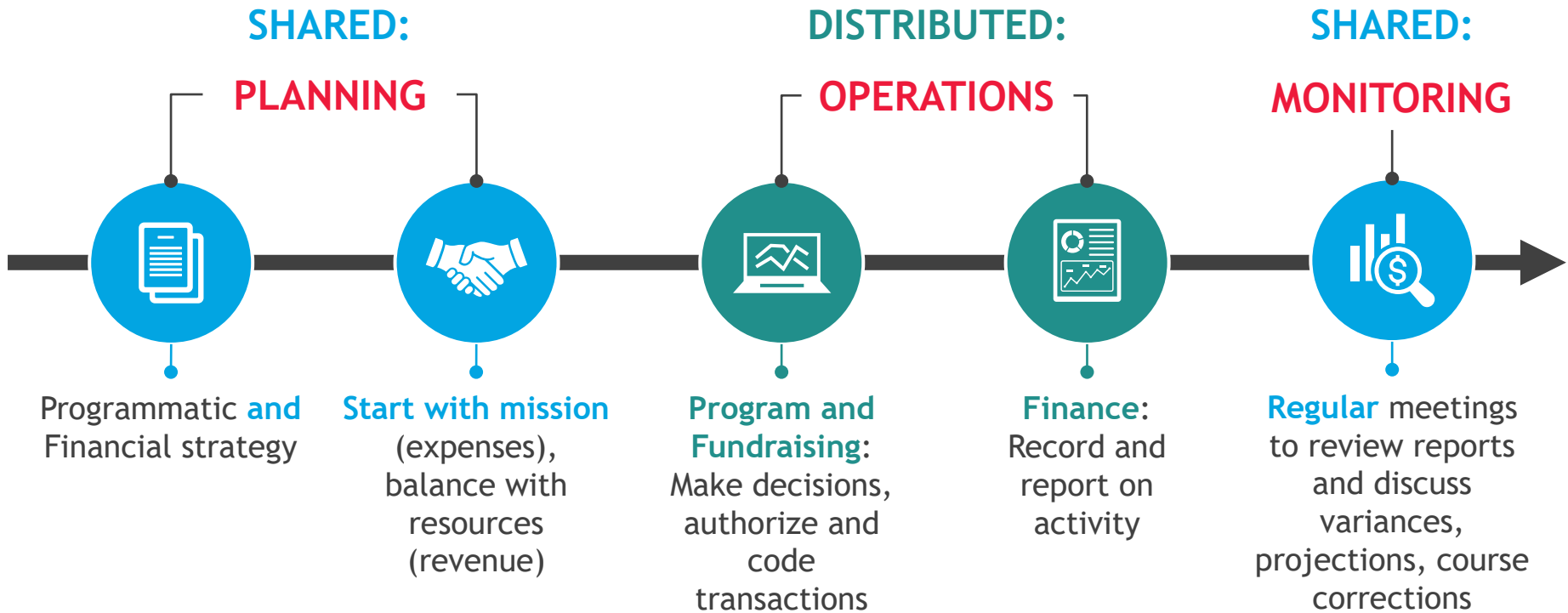
Poll: How well do you understand your organization's LUNA today?

1	I got it!
2	I kinda get it
3	I don't get it... can we just talk in cash please?

Thoughts & Questions



Team-Based Finance Practices



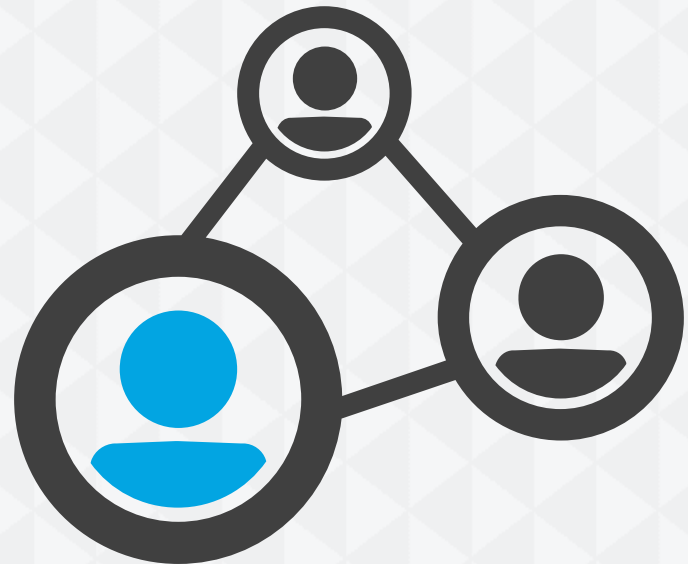
Activity: Understanding Our Audiences

- ▶ You will be placed into a breakout group
- ▶ As a group, discuss stakeholders who need to use financial information, reflecting on the following questions:
 - What are their interests?
 - What do they want to know?
 - What types of decisions do you need them to make?
 - What are their biggest concerns or fears?
 - How can you use these insights to better engage your stakeholders?

Don't forget to introduce yourselves, sharing your org and role. Use the Padlet to capture takeaways

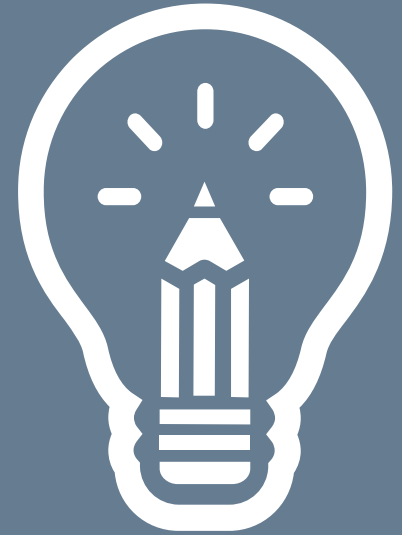
Audiences to consider:

- ▶ *Board*
- ▶ *Program Staff*
- ▶ *Fundraising Staff*
- ▶ *Funders*



In the chat

What are your biggest takeaways from your breakout discussion?



Poll: Does your organization have a documented operating reserves policy?

1	Yes
2	Yes, but it's outdated/not helpful
3	I'm not sure
4	No



Operating Reserves: So what's the right amount?

A decision made by board and staff, with a multi-year strategy for generating and maintaining the target amount.

Consider establishing a formal reserves policy as an opportunity to engage in the conversation and decision-making.

How do we decide?

As a first step toward determining the amount of reserves to have on hand, identify any revenue and spending risk factors specific to your organization. For example:

Revenue Risk Factors	Expense Risk Factors
Our organization relies on x number of funders for x% of its revenue	Our organization is the key community resource for many of our members who are facing unprecedented need
Our community is facing an economic crisis and individual contributions are trending downwards	Our organization could not easily downsize in a budget crisis without sacrificing services
Our foundation and government grants do not provide general operating support	Our organization has several multi-year funding/spending commitments



Evaluate risk

- ▶ If you've identified minimal risk, 3 months worth of operating expenses may be sufficient
- ▶ If you've identified significant revenue or spending risks, consider 3-6 months worth of operating expenses
- ▶ If you've identified significant revenue **and** spending risks, consider 6-12 months worth of operating expenses



Poll: What threshold seems right for your organization?

1	Less than 3 months
2	3 months
3	3-6 months
4	6+ months

Poll: Does Your Organization Own a Building or Have Other Significant Fixed Assets?

1	Yes
2	No
3	Unsure

Capital & Facility Reserves

Saving for inevitable repair and replacement of fixed assets

WHAT ARE THEY?

- ▶ Reserves specifically allocated for future (un)expected capital and facilities costs

WHY DO WE NEED THEM?

- ▶ Significant fixed assets
- ▶ Ongoing maintenance
- ▶ Deferred maintenance

HOW DO WE BUILD THEM?

- ▶ Annual surpluses
- ▶ Fundraising campaign or investment
- ▶ Budgeting for depreciation

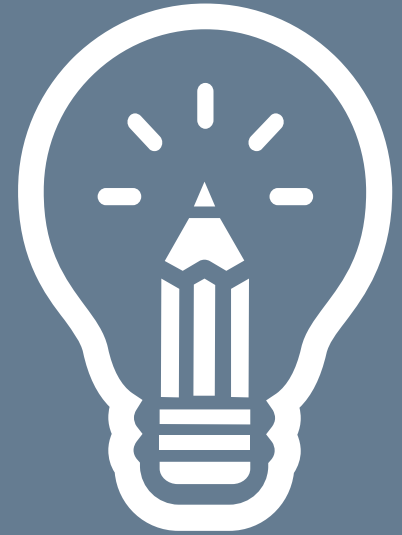
Thoughts & Questions



Resources & Wrap Up

In the chat

What is your biggest takeaway
from today's session?



Financial Management Resources

In collaboration with the Wallace Foundation, FMA created a library of free tools and resources to help organizations become “fiscally fit”.



Funding Opportunity Tool

FREE TOOL TO GUIDE THE EVALUATION PROCESS

1. Which of the following is most true about the program or service that is the subject of this contract?	<input type="checkbox"/> It is core to our current mission, vision and values	<input type="checkbox"/> It is complementary to our mission goals even if it is not fully within the core mission	<input type="checkbox"/> It is outside our mission focus, but other benefits from this contract could support organizational goals
2. In the event our organization's application for this contract is unsuccessful:	<input type="checkbox"/> We will still provide (or seek to provide) this specific program/service	<input type="checkbox"/> We will not seek to provide this specific program/service	
3. If we do not provide this program or service in the community:	<input type="checkbox"/> It is unlikely another organization will provide a similar service	<input type="checkbox"/> At least one other organization provides a similar service	<input type="checkbox"/> Several organizations provide a similar service
4. Do we have, or can we obtain, the physical space we need?	<input type="checkbox"/> Yes	<input type="checkbox"/> It will be challenging to identify/renovate/construct the facilities	<input type="checkbox"/> It is unclear how we obtain the space
5. Do we have the personnel and expertise on staff necessary to manage and deliver the program?	<input type="checkbox"/> We have staff with expertise and capacity to both manage and deliver the program	<input type="checkbox"/> We have staff to manage or deliver but not both	<input type="checkbox"/> We will need to hire staff to manage and deliver the program

Additional Resource

Reserve Fund Policy Template and Guide



About BDO FMA

BDO FMA exists to build a community of individuals with the confidence and skills to lead organizations that change the world.

- ▶ Established in 1999 to serve not-for-profit organizations around the country – combined with BDO in 2021
- ▶ Provides customized financial management, accounting, software, organizational development, and other consulting services
- ▶ Works directly with organizations or through funder-supported management and technical assistance programs



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