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STREETSMART NONPROFIT MANAGER

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Green Yellow Red

Color coding to test your financial health

Green means "go."
Yellow means "slow."
Red means "no."

Financial records are things of deep, distant mystery -- and little interest -- for most people working at a nonprofit. There is a tacit understanding that the CEO and CFO are responsible for an organization's fiscal health. In medium to large-sized organizations the bosses are often supported to some degree by a small group of similarly-trained specialists (assuming the organization can support this amount of overhead).

In a well-run internal financial shop there is an appropriate number of financial specialists who interact with each other regularly according to the task at hand and the nature of the hierarchy. For internal control purposes, many tasks require that those completing them need to interact with the program service side of the organization.

The problem with this idealistic portrait is that it rarely works because the two groups are, almost literally, on two completely different wavelengths. This breakdown tends to happen because the two groups' staff often have differing ideas of what financial management means. For instance, many CEOs are not necessarily skilled in financial matters. In some cases, they would prefer not to have much contact at all with financial types. (The reverse can be true, as well.)

The answer to this dilemma is that both sides need to understand clearly what the other side is saying. Here are some useful and easy-to-understand formulas that will help make the best use of the talents of both financial and non-financial staff members -- including board members.

NUMBERS IN CELLS

Begin with this unfortunate statement of fact. Financial records are obscure to most people even though they contain valuable data. What makes this situation worse is that just one or two numbers can communicate a large amount of information if one understands how to interpret them. But in most nonprofits, those who could most readily use the information are likely to be internal record-keepers and perhaps a senior manager or two.

Unfortunately, in many organizations only the financial folks are comfortable with the numbers and what they mean.

To give some depth to the range of financial calculations, the following is a small number of them, unbundling the numbers in each case. The material is from the Internal Revenue Service's (IRS) Form 990 that most nonprofits have to annually submit. This form is standardized for all nonprofit public charities and it offers a wealth of fiscal information as long as the users know how to work with the data.

PROFITABLE?

Start with an easy question: Did the organization have a surplus at the end of the year, or did it lose money?

To answer this question, look at the first page of the Form 990 and find line number 19. Look at the number in the cell to the furthest right. If the organization had a deficit, there will be a "-" before the number, which is bad news because it means that the organization lost money in that year (red flag). If there is no negative sign before the number, it means the organization made money in that year.

Note: In spite of what some say, nonprofits are absolutely allowed to make a profit each year (unless the profit comes exclusively from state or regional government and is subject to confiscation by these sources). They almost certainly will increase the risk of their demise if they don't create a sufficient profit regularly enough by the end of each fiscal year (yellow, closing on red).

BALANCED?

Go to Page 11 and look at the far right column. Add all the items in the column from line 1 to line 9. Do the same thing for lines 17 through 19. If the sum of lines 1 to 9 are equal to or larger than the sum of lines 17-19, your organization should be in a desirable position (green). If the liabilities (note the vertical labels on the far left side of the page) are equal to or greater than your assets, it's a sign of trouble (red).

HOW MUCH CASH ON HAND?

Also on Page 11 you can get a good idea of how "liquid" your current assets were as of the last day of the fiscal year. A rough, though not universally accepted, test would be to see how long your organization could survive if it could only use the dollars in lines 1 and 2.

These are the classic sources of cash, because everything below those two lines don't offer immediate cash capacity. From line 3 downward, expect to have to take some time to turn, say, accounts receivable (line 3), into cash.

Do this crude test if you want to gauge how long it would take your lines 1 and 2 to be depleted if no more cash came in. Go to the bottom of page 10, column A, line 25. Divide the number in box 25A, (total expenses) by 365.

The result will be how much you "spend" on average each day. This is a simplified calculation because it doesn't take asset depreciation into account. It's good for rough approximations.

DO CURRENT ASSETS MEET OR EXCEED CURRENT LIABILITIES?

For a quick insight into your short-term operations, add the numbers on page 11, Column B, lines 1 through 4. Those four categories all represent short-term assets, or things of value because they can be sold or exchanged for something else of value fairly quickly.

To see how solid your short-term operations are, divide the total of lines 1 through 4 by the total of lines 17 through 19 (again, all in Column B). If your total of lines 1 through 4 meet or exceed the total of lines 17 through 19, consider your organization to be in decent financial shape, at least for the short term (green).

HOW OLD IS YOUR PROPERTY, BUILDINGS, AND EQUIPMENT

In a sentence, the Accounting Age tells you how consistently you have re-invested in your property and equipment. The calculation is among the easiest of its kind, and it can tell you a lot about your financial management success. The Accounting Age is a simple yet powerful formula.

Find line 10b on Page 11, or "accumulated depreciation" (ignore the numbers in Columns A and B). Divide the accumulated depreciation by the depreciation charge on page 10, line 22A.

The result, usually a simple number such as 7.4, is considered your organization's overall "age of property and equipment," meaning that all of your tangible physical assets (such as buildings, vehicles, desks, etc.) are, on average, 7.4 years old.

You might be able to find guidelines for your type of organization to see if your own average age of equipment is viable. One observation is solid, however: The older your physical assets, the harder it could be to replace them with new or at least less tired assets (yellow).

DEBT TO NET ASSETS

This ratio is simpler than it sounds. The technical description of debt is money that has been loaned to your organization for any purpose with a payback period longer than one year. In practice, payback periods fit the nature of the purpose in borrowing. Automobiles often have a payback period of three, four, or five years while buildings typically are funded by mortgages which must be paid off in 10 to 20 years or more.

Net assets is the term used to describe money that is "left over" after one subtracts total liabilities from total assets. A simpler term for it is the organization's net worth. In the old days it was called fund balance. At a minimum, subtracting liabilities from total assets should result in a positive number. A nonprofit isn't expected to be a money-making machine, but on the other hand it needs to at least keep its metaphorical head above water.

There are many other ratios and financial calculations that can be used to inform nonprofit executives and managers. Competent CFOs will be able to put together a group of calculations, explain what they mean, and help senior staff and board members understand the implications for financial health and well-being. *NPT*

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