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THOMAS A. MCLAUGHLIN

Your Sustainability Checklist

Simple math can determine your solvency

The term "sustainability" is a roaring success, if one measures its frequency of usage. And, why not? It's a tribute to our relatively recent interest in examining our impact on things ranging from the environment to organizations.

For the latter, it's a pathway to managing tangible and intangible resources in such a way as to gain maximum assurance that an organization will be around tomorrow.

The task grows a bit simpler when it comes to financial sustainability, although it might not always seem that way. Here are four indicators, in order of immediacy, to help you keep your nonprofit on a solid financial footing. Work your way through the plain English of these indicators and you'll be taking a great step toward ensuring that your organization will be around for a long while to come.

Each of these indicators can be found on an Internal Revenue Service's federal Form 990, the yearly filing document required for most nonprofit public charities. Each indicator will be referenced in terms of its page number and description on the Form 990. The indicators will be described in order of a range of immediacy beginning with the very short-term indicators and ending with a long term indicator.

At the top of Page 11 is a line described as "Cash -- non-interest bearing." This is one of the most fluid and most important of the sustainability indicators because no cash, no mission. Think of it as the group's checking account, which it probably is.

Below that line is a similar sounding "Savings and temporary cash investments." This means that this amount of cash is almost as available as the non-interest bearing cash in the first line. Supplementing the cash balance of the first two lines is "accounts receivable," which is the money that outside people and organizations owe the nonprofit.

Nonprofits that score well in this indicator usually do so because they have a steady stream of revenue that is at least slightly more than its overall expenses. To get a rough idea of how well off you are, add the amounts in Column B from line 1 through line 9, then divide that number by the sum of line 17 through line 19. Pat yourselves on the back if you get a number greater than "1." Your short-term assets are at least equal to and might be greater than your short-term obligations.

The official name for the calculation above is the "Current Ratio." It compares the cash and near-cash assets you have against the obligations you have incurred for the short term. Overall, this is a good indicator of sustainability. It says that one's short-term assets are equal to or more than one's short-term liabilities.

Incidentally, corporate entities of all kinds -- including nonprofits -- share a common desire when it comes to financial indicators: They want to look good. As a result, they try to pick a fiscal year that leaves them looking as sound as possible. For example, a university might choose a fiscal year that begins on July 1. There are probably multiple reasons, but consider the economic benefits:

• Most of the faculty is not being paid during the period;

• Some of the last semester's tuition revenue might not have been spent yet;

• Summer school revenue is in hand and not spent; and,

• Some early payments for the upcoming semester might have already been received. The balance sheet and income statement won't look as good for another 11 or 12 months, so this is a good time to end the year.

PROFIT, PAGE 1

They're called nonprofits, but this is one of the most misleading aspects of nonprofit management. A more accurate (and clunkier) description would be "not organized for the purposes of profit." Still, nonprofits have to make a profit if the group wants to be around next year and the year after that. This is a good place to look for slightly longer-term sustainability than the cash indicator above. Happily, the IRS requires nonprofit public charities to put the amount of profit from the fiscal year on the front page of the Form 990.

This indicator is blandly described as "Revenue Less Expenses" on line 19. To get the percentage of total revenue this indicator communicates, divide "Current Year" line 19 by "Total Revenue" line 12 and you'll have your nonprofit's profit margin. Just don't call it a profit margin in polite company.

Why do nonprofits need to make a profit as regularly as possible? It's because it's one of the few aspects of nonprofit sustainability that is mostly under management's control. Profitable yearly results help build the capital structure of a nonprofit -- a kind of financial bone mass for fiscal strength and durability. The flip side to this indicator is that the absence of a profit can be a sign that sustainability is slipping quickly out of reach.

LONG TERM DEBT, PAGE 11

Look on Page 11 again to understand the claims that outsiders might have on your assets. Lines 20 through 24 give information about various ways a nonprofit might borrow money from others. Once borrowed, this money turns into an obligation to repay it, thereby putting a burden on future managers to come up with the payment each year.

To get a sense of how much of a burden your existing debt could be, divide the total of Column B, lines 20 through 24 by Column B line 33, "net assets." The latter term is the nonprofit equivalent of the corporate world's net worth: different words, same idea.

Various analysts have differing opinions about what constitutes a desirable amount of debt. One thing is certain. If the amount of your long-term debt is anywhere near the same amount -- or greater -- than your net assets, it's time to get your debt under control. Nothing will crunch sustainability more quietly over time than excess debt.

NET ASSETS, PAGE 11

The last indicator is also the ultimate mark of sustainability for your nonprofit. That's net assets, of course. This one is a bit hard to characterize in a vacuum since so much of what makes the net asset number significant are the other indicators as shown above. Still, more is better up to a point. Think of the net asset amount as being the lasting evidence of sound fiscal management -- a kind of running score sheet.

Net assets used to be called the fund balance. This indicator calculates the amount of value that would be left over if the organization shut down as of the date of the Form 990. In simple terms, a shutdown means that the assets (Page 11, Column B, lines 1 through 15) would be sold at the highest value and the liabilities (Page 11, Column B, lines 17 through 25) would be paid off by the sale of the assets. In theory, the amount left over would be the amount in Column B, line 33 – Net Assets.

Can net assets ever be a negative number? Absolutely. The term for a nonprofit that has negative net assets is insolvent. The term is not as well known as the term bankrupt. The difference? Being bankrupt involves a bankruptcy court decree, and the state of bankruptcy is technically known as a protection intended to allow an entity (for profit or nonprofit) to reorganize its affairs.

A nonprofit has to be extremely stressed to have negative net assets. But, it happens more frequently than one might think. The troublesome part of this is that nonprofit leaders in this situation don't always respond with the skill and fierce determination necessary to fix the problem. By contrast, a reader whose nonprofit has reached a workable level of sustainability will find that the items on this checklist are filled with flashing green lights. *NPT*

Thomas A. McLaughlin is the founder of the nonprofit-oriented consulting firm McLaughlin & Associates and a faculty member at the Heller School for Social Policy and Management at Brandeis University. He is the author of "Streetsmart Financial Basics for Nonprofit Managers," published by Wiley. His email is: tamclaughlin@comcast.net