

Managing Finances in a Changed Economy

Presented by Alice Antonelli

October 11, 2011



Overview: Nonprofit Finance Fund® (NFF)



Dedicated to keeping nonprofits in balance and in business

We're a nonprofit 501(c)(3) serving thousands of nonprofit and funders since 1980

- \$280 million in loans; \$100 million in New Markets Tax Credits; over \$1 billion in capital leveraged for nonprofits
- Over 500 customized financial consultations; 500+ Nonprofit Business Analyses; 200+ nonprofit finance workshops
- Formed hundreds of strategic partnerships to advance nonprofit sector

Nationwide network of experts in nonprofit finance

- Lending
- Financial advisory services and workshops
- Financial advocacy across the nonprofit sector

Serving nonprofits nationwide from several local offices

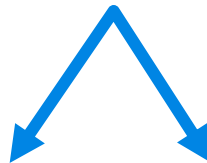
- Northeast: Boston, New York
- Mid-Atlantic: Philadelphia, Washington, DC, Newark, NJ
- Midwest: Detroit
- West Coast: San Francisco, Los Angeles

“We’re in the business of helping nonprofits run better.”

–Clara Miller, NFF
former President and
CEO

Mission and Program

What you do, and how you do it.



Capacity

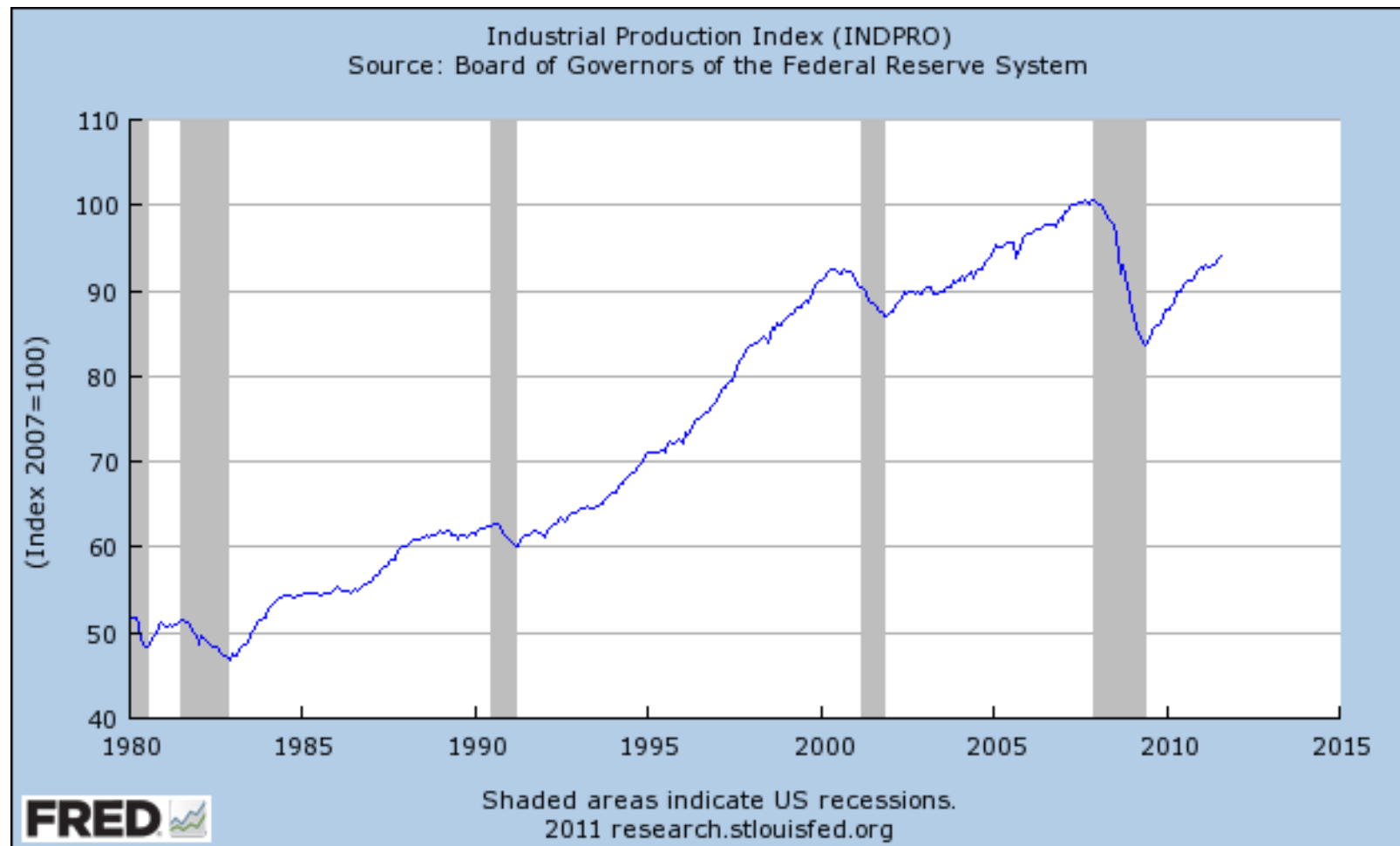
The people, space, and processes that allow you to do what you do.

Capital

What resources and assets you have to work with.

- **Some perspective**
 - **Lessons from history**
 - **Heard on the street: Experiences from the field**
- **Assessing Risk: Preparing for a sustained economic crisis**
- **Addressing Risk: Tools and strategies for planning and managing in tough times**
- **Concluding Thoughts**

On Our Way Out of the Most Recent Recession?



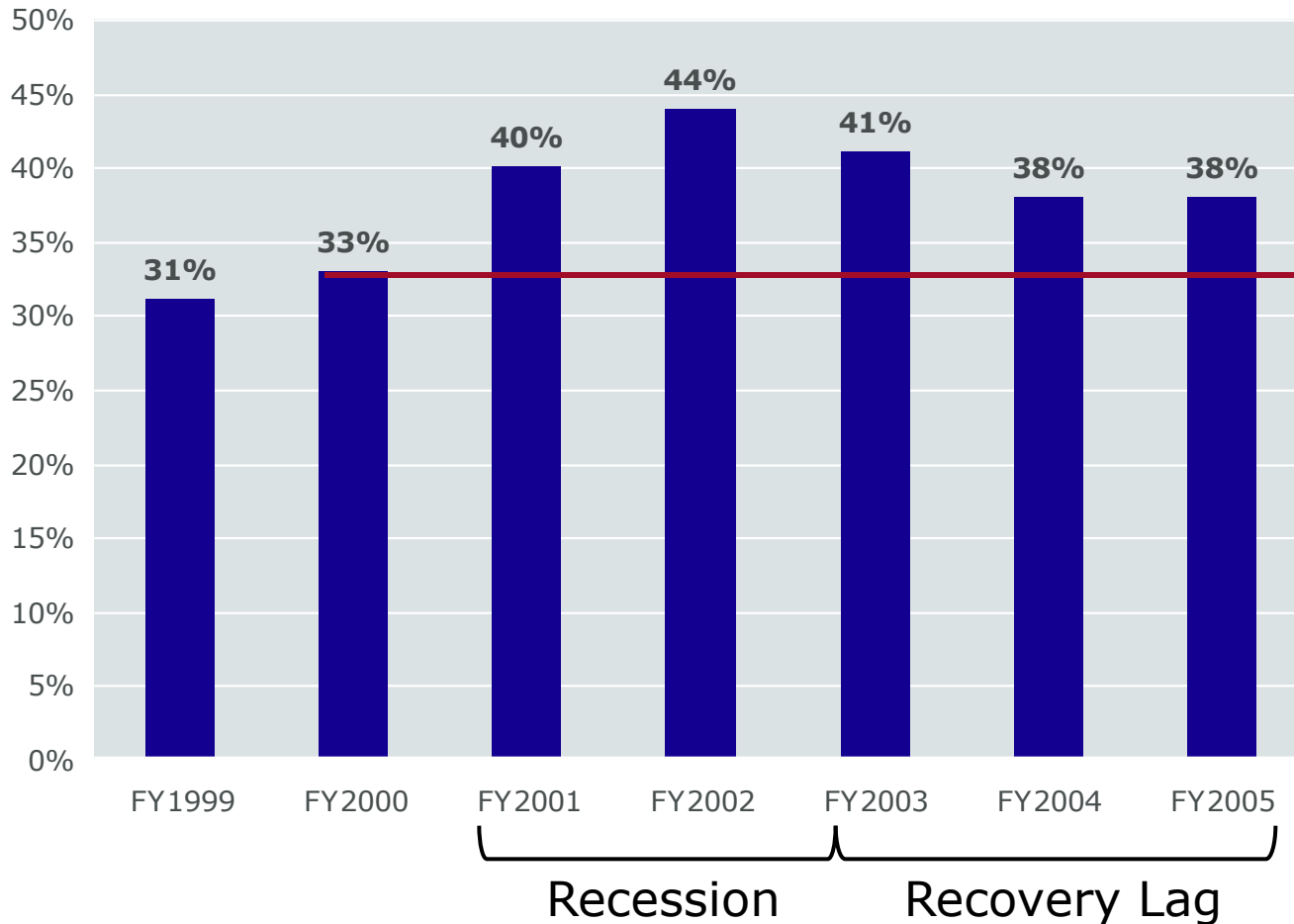
Source: Board of Governors of the Federal Reserve System, 2011 research.stlouisfed.org

Note: Shaded areas indicate US recessions.

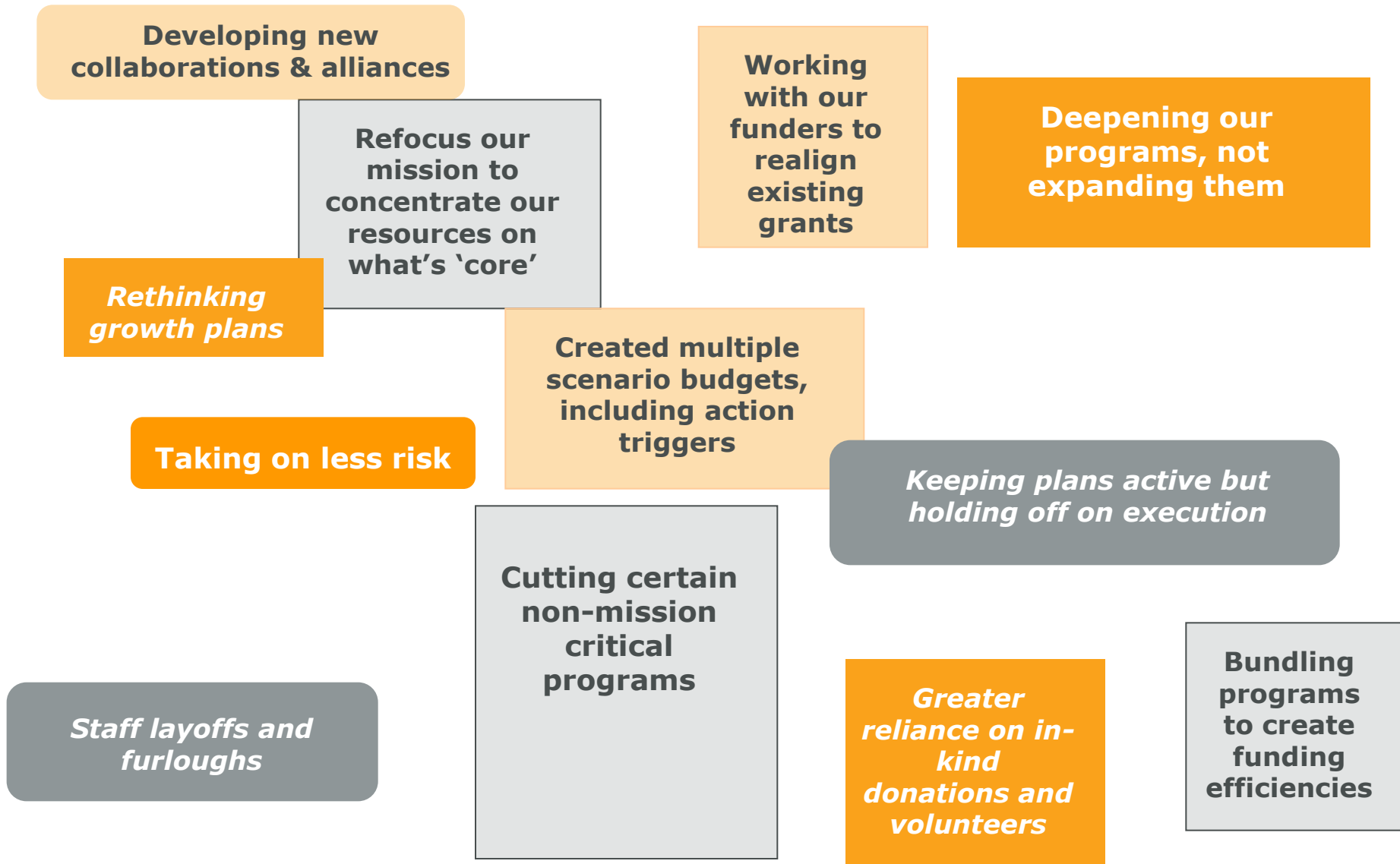
Index: 2007 = 100

More Nonprofits Experience Deficits During and After Recession

Percentage of Nonprofits Reporting Deficits (Post-Depreciation)



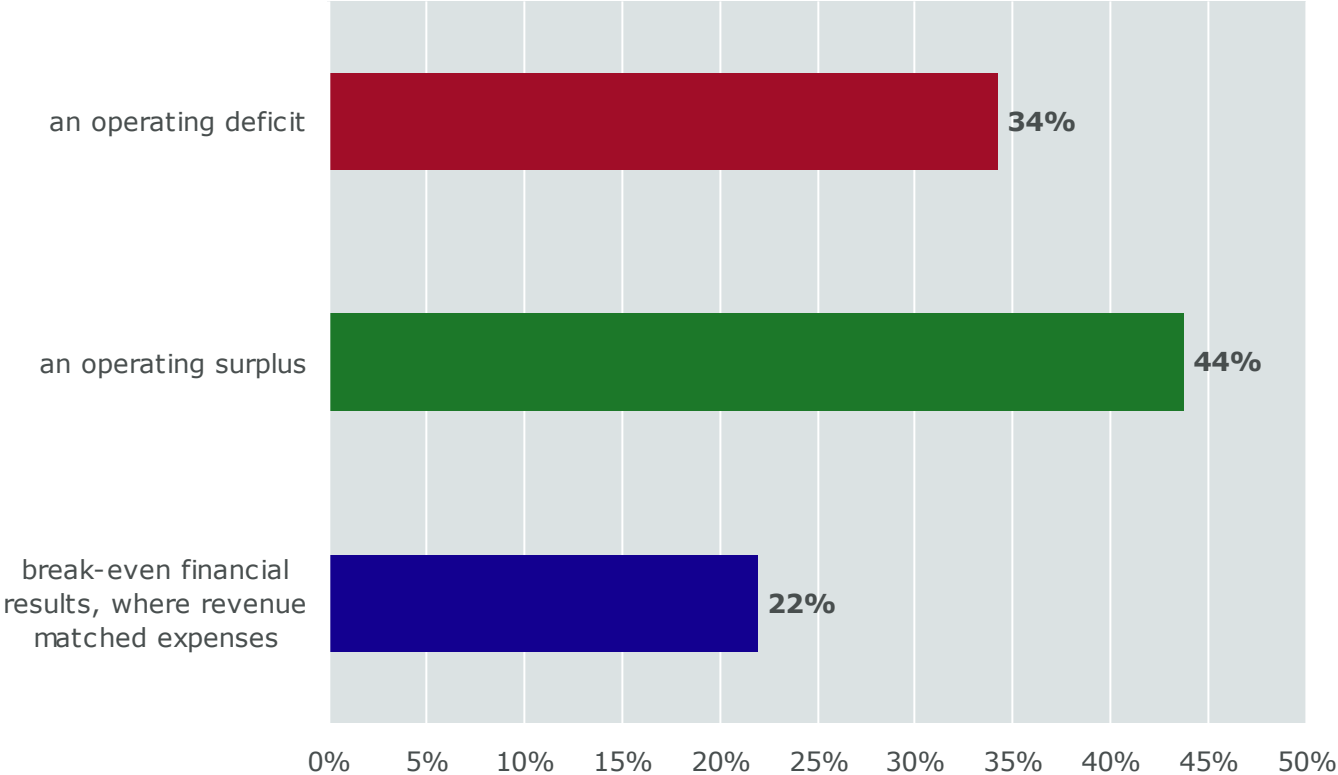
Addressing Risk: Heard From the Field...



- Nonprofit Finance Fund (NFF) recently conducted its third 'State of the Sector' nonprofit survey. The survey focused on the intersection between finance and mission: what financial strategies are nonprofits employing to keep up with ever-climbing demand for services?
- We asked nonprofit managers nationwide to assess the current financial challenges they face, and to share the coping and adapting strategies they're using to manage through these times.
- 1935 nonprofit leaders responded to our survey. Respondents stretched from coast to coast, representing 48 states. They came from large organizations and small, and from all sub-sectors.
- What did we learn from their collective reply?
While there are some signs of hope, many nonprofits are straining under year-after-year increases in service demand. As an ever-resourceful sector, they are creatively responding to these conditions.

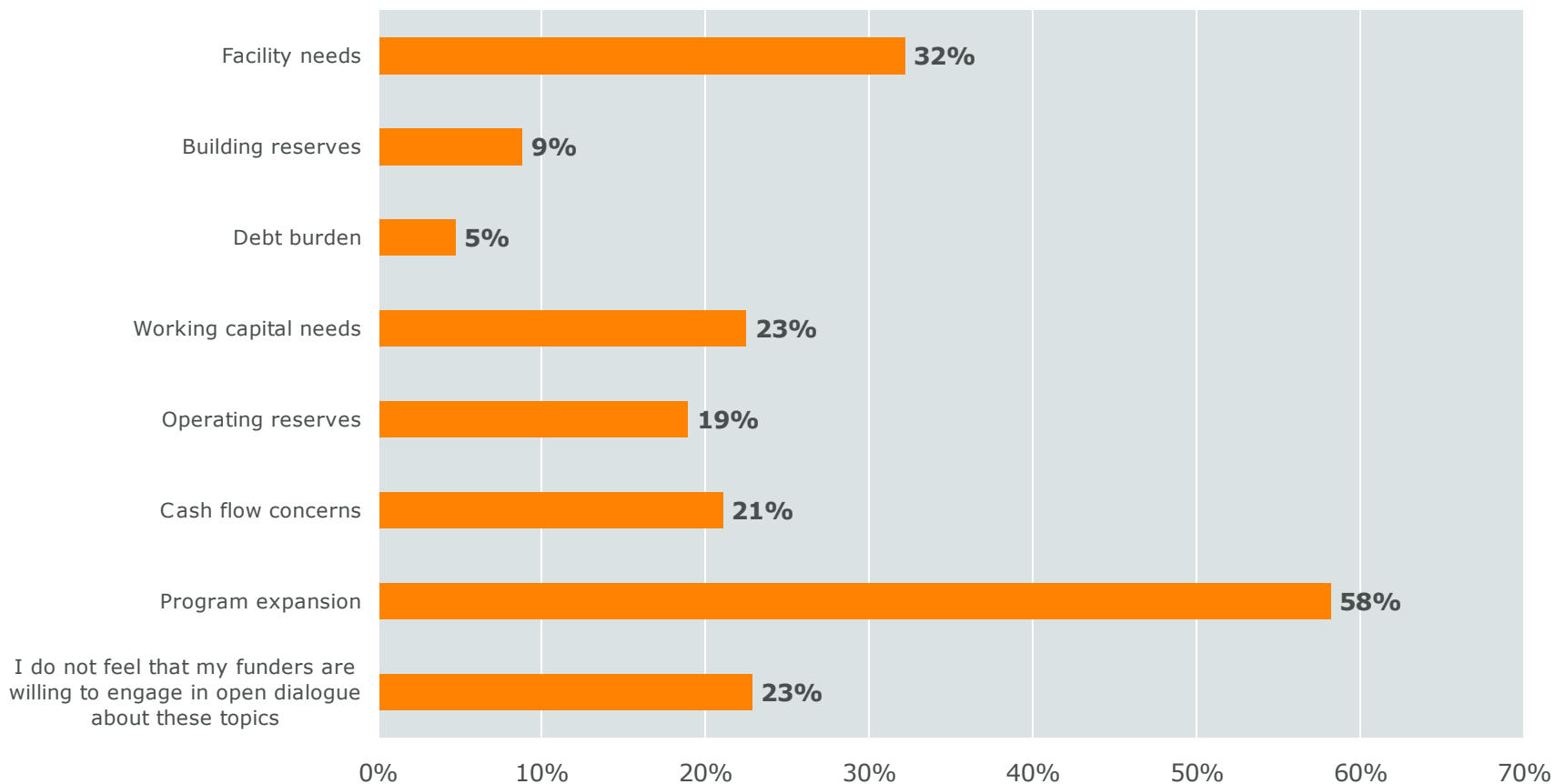
Overall Financial Health and Operating Results

We ended 2010 fiscal year with:



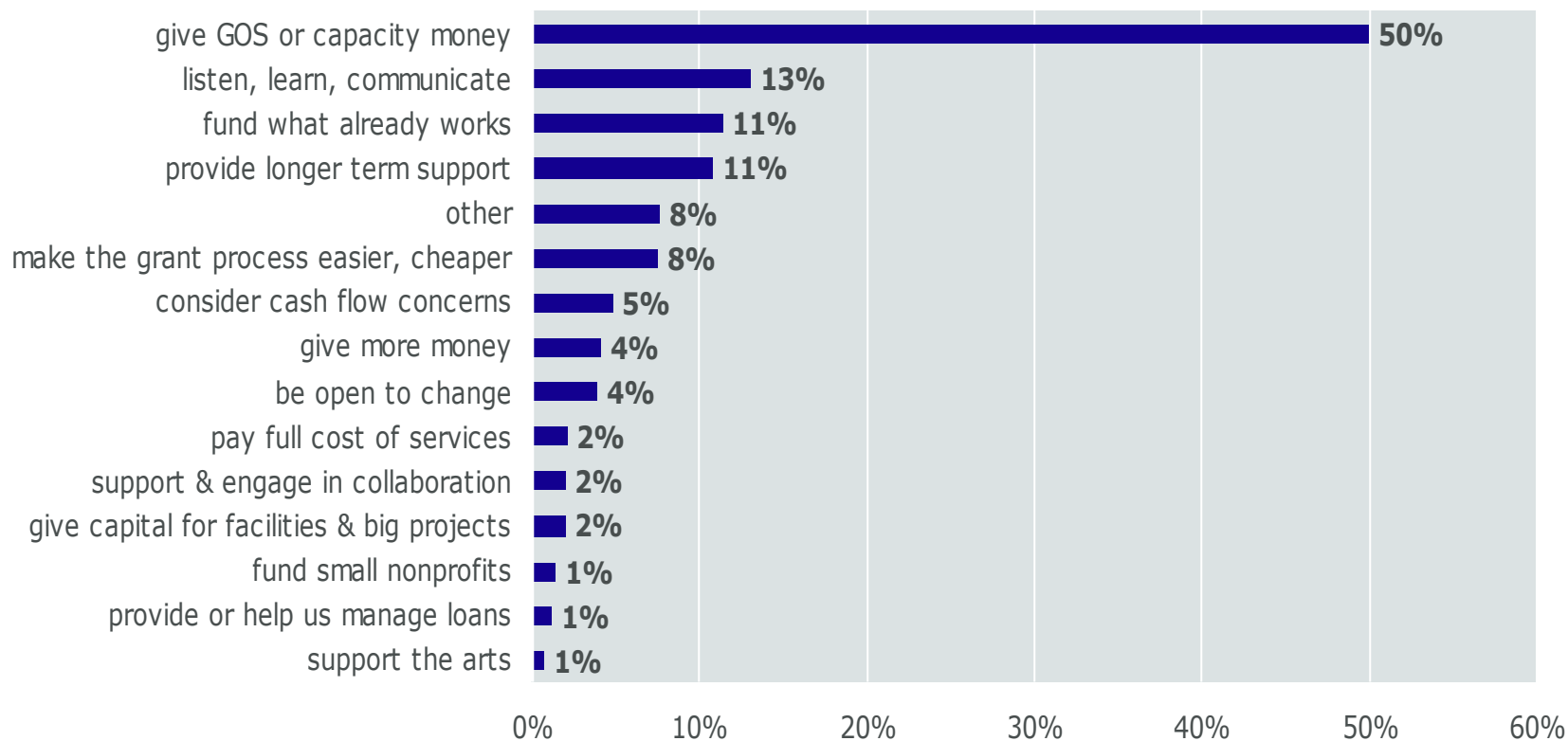
What 2010 Challenges Did NPOs Face; What can they discuss with their funders?

My NPO can have open dialogue with funders about:



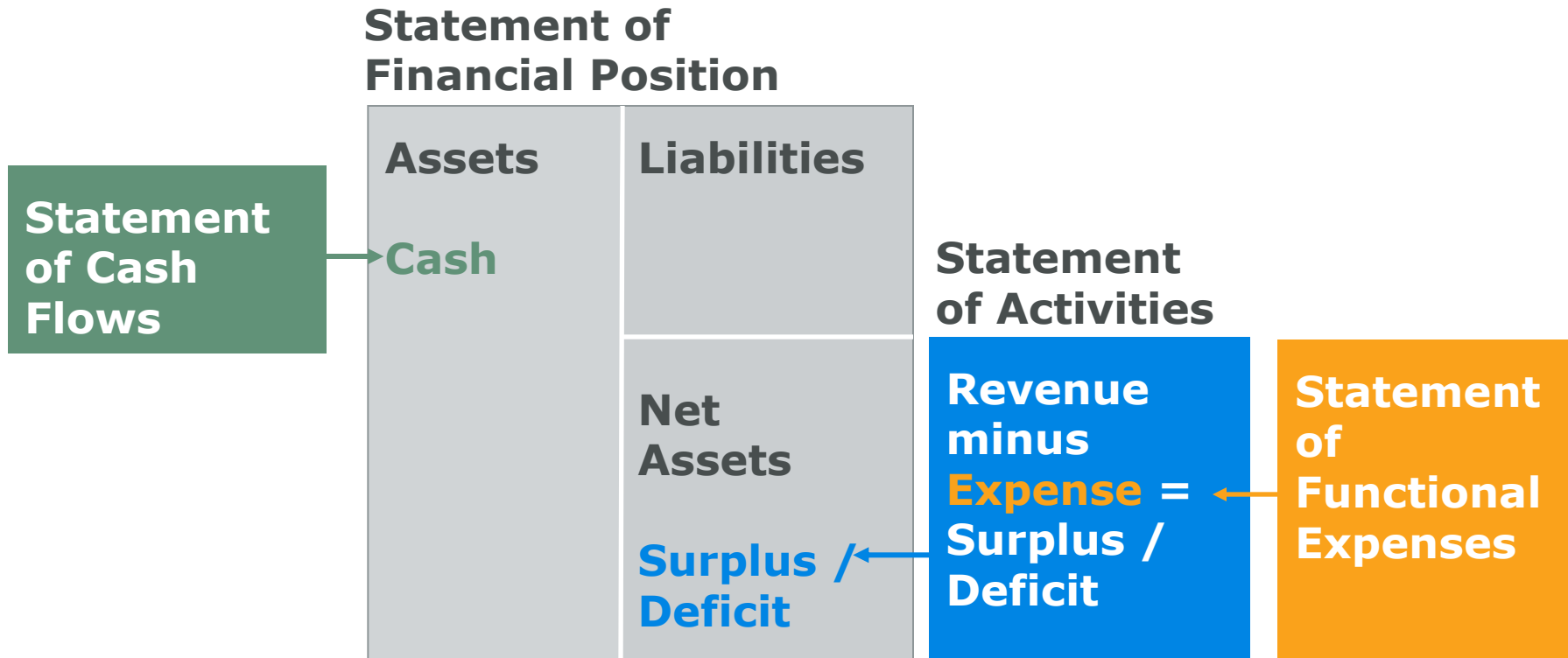
What Nonprofit Managers need from funders...

What can funders do differently?



- **Some perspective**
- **Assessing Risk: Preparing for a sustained economic crisis**
 - **How might your revenue and expenses be affected?**
 - **Where money meets mission: the importance of capital structure**
 - **Evaluating exposure to risk and risk tolerance**
- **Addressing Risk: Tools and strategies for planning and managing in tough times**
- **Concluding Thoughts**

Focus on the Balance Sheet: Determining Your Risk Tolerance



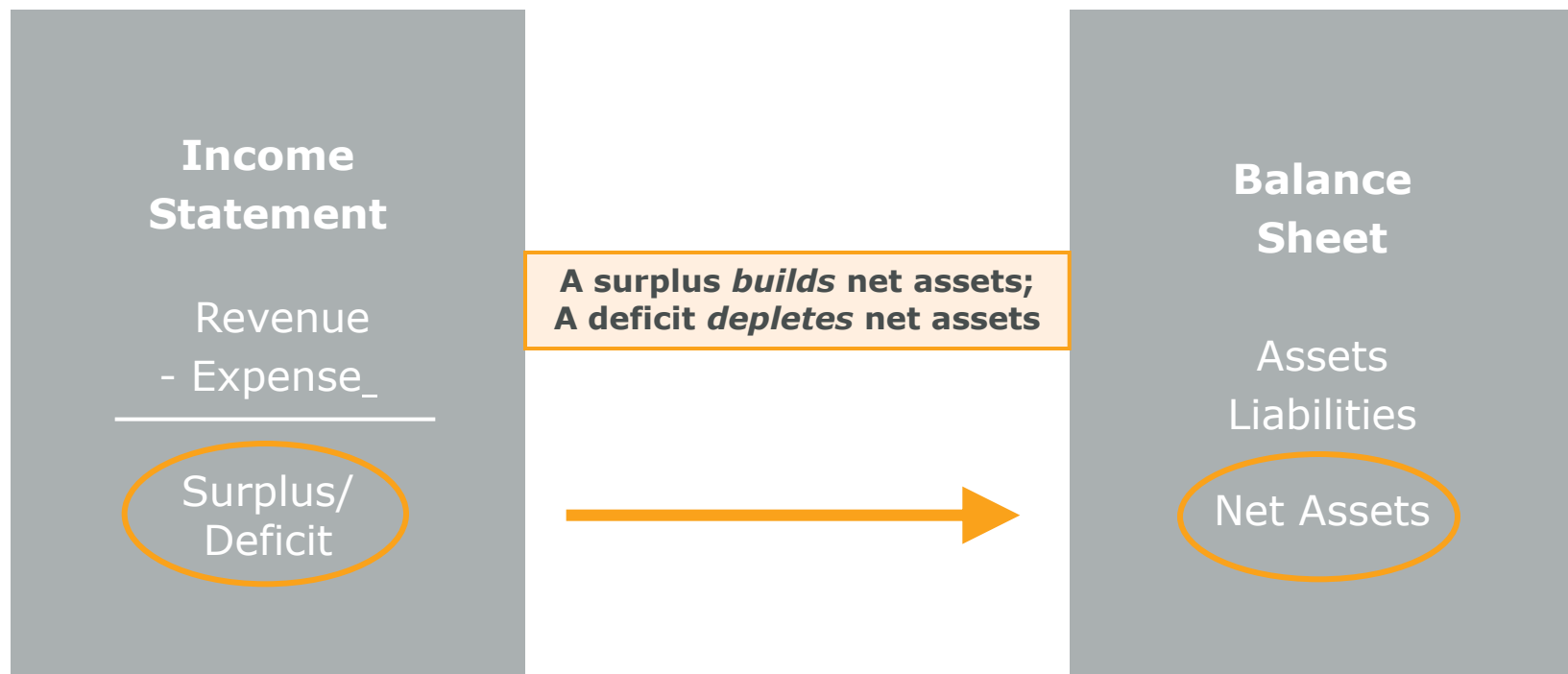
The Two Bottom Lines

Income Statement (Statement of Activities): Surplus/Deficit

- Income Statement reflects the annual results of your core business

Balance Sheet (Statement of Financial Position): Net Assets

- Balance Sheet provides a picture of overall financial health



Assess Performance: Know your Income Statement

Revenue Dynamics

- Where does the organization's money come from?
- Is it reasonably diversified or at risk?
- Do revenue streams appear reliable/consistent?

Cost Dynamics

- What does the organization spend on operating activities?
- Are expenses adjusted in line with revenue changes?
- Note: Statement of Activities will not present expenditures on capital items or debt principal repayments.

Profitability and Savings

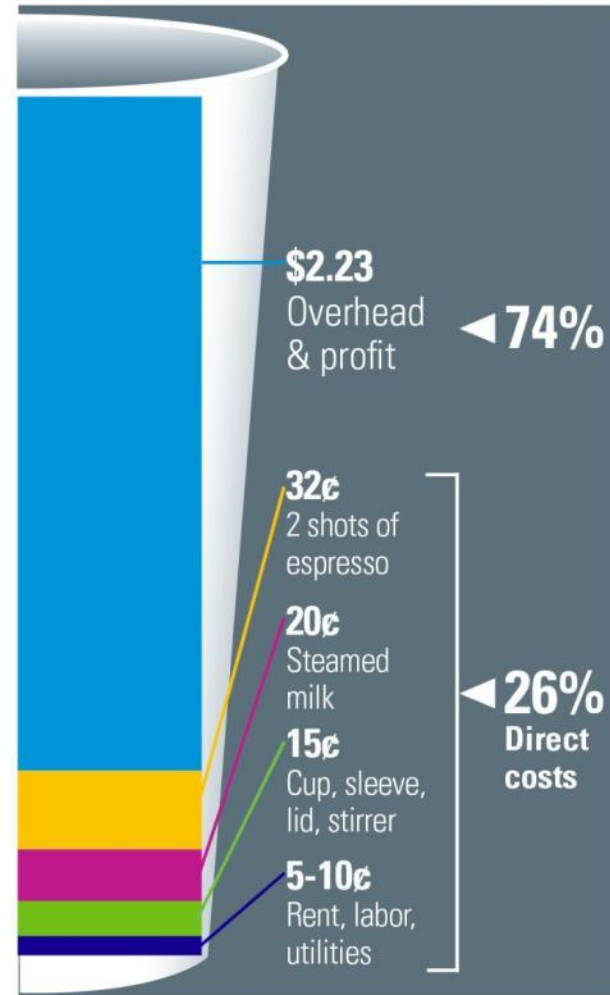
- Does the organization cover its costs?
- Are surpluses sufficient to meet balance sheet obligations?
- Is the agency saving? If so, is it enough?

A Pretty Bad Best Practice: ...Obsession with Overhead

12-ounce latte = \$3.00

**In the for-profit world,
everybody is fine with
covering full costs with
revenue...including
overhead and profits!**

**They are seen as a
necessary and regular
part of the business**



Mission Support (a.k.a. Subsidy) Business

Since nonprofits can rarely charge prices sufficient to cover the full cost of their core mission programs, they require support businesses (a.k.a the “subsidy” business)

Nonprofits use subsidy to make up the money lost on every “widget” → required “dependency”

When program growth or change occur, one of two things happens:

- more subsidy
- financial chaos

Common subsidy businesses include:

- Sweat equity (underpaying, overworking, using volunteers)
- Fundraising
- Investment income
- Real estate (rental income)
- Earned income ventures

Assess Risk: Know your Balance Sheet

Know where you stand

Assets	<p>Cash – How much? How “liquid?”</p> <p>Receivables – Are they slow to collect? Are any at risk for collection?</p> <p>Fixed Assets – How do you address maintenance issues?</p>
Liabilities	<p>Line of Credit – How do you manage cash flow? Are you using debt appropriately?</p>
Net Assets & Reserves	<p>Unrestricted Net Assets – Do you own more than you owe?</p> <p>Temporarily Restricted Net Assets – Do they fully support your core programs?</p> <p>Reserves – Do you have them? Are they suitable to your needs? Agreement on use?</p>

Balance Sheet	
Assets	Liabilities
	Net Assets

$$\begin{aligned} \text{Months of Cash} &= \frac{\text{Total Cash}}{(\text{Total Expenses} / 12)} \\ \text{Months of Liquid Net Assets} &= \frac{\text{Unrestricted Net Assets} - (\text{P\&E} - \text{P\&E Debt})}{(\text{Total Expenses} / 12)} \\ \text{Months of Working Capital} &= \frac{\text{Current Assets} - \text{Current Liabilities}}{(\text{Total Expenses} / 12)} \end{aligned}$$

Months of Liquidity: Rule of Thumb

What is the right amount for YOUR organization in this economy?

Months of Expenses Covered by Liquidity	Operating Situation
0	Crisis – Scrambling for cash, delaying payment to vendors, overdrawing checking account. Reactive thinking.
Less than 3 months	Cash is tight – Relying on line of credit, delaying payment to vendors.
3-6 months	Room to breathe – Can do some long-term thinking. Some room for “rainy days.”
6+ months	Handles more risk – Able to withstand increasingly acute shocks such as large facility repairs, funding cuts and possibly recessions.

Assess Risk: Know Your Balance Sheet

An organization's **adaptive capacity** is directly tied to the health of its capital structure

If your balance sheet has...

- No cash or receivables
- A fully drawn line of credit
- Little or no reserves available to management
- Significant wear-and-tear of fixed assets

...There are no dollars immediately available to draw on in challenging times

- Borrowing to replace lost income is rarely appropriate

Risk – Cash = Crisis

Budgeting for Balance Sheet Needs: Savings and Reserves

Surpluses are necessary to the long-term health of a nonprofit

By generating operating surpluses over time, organizations can build cash reserves

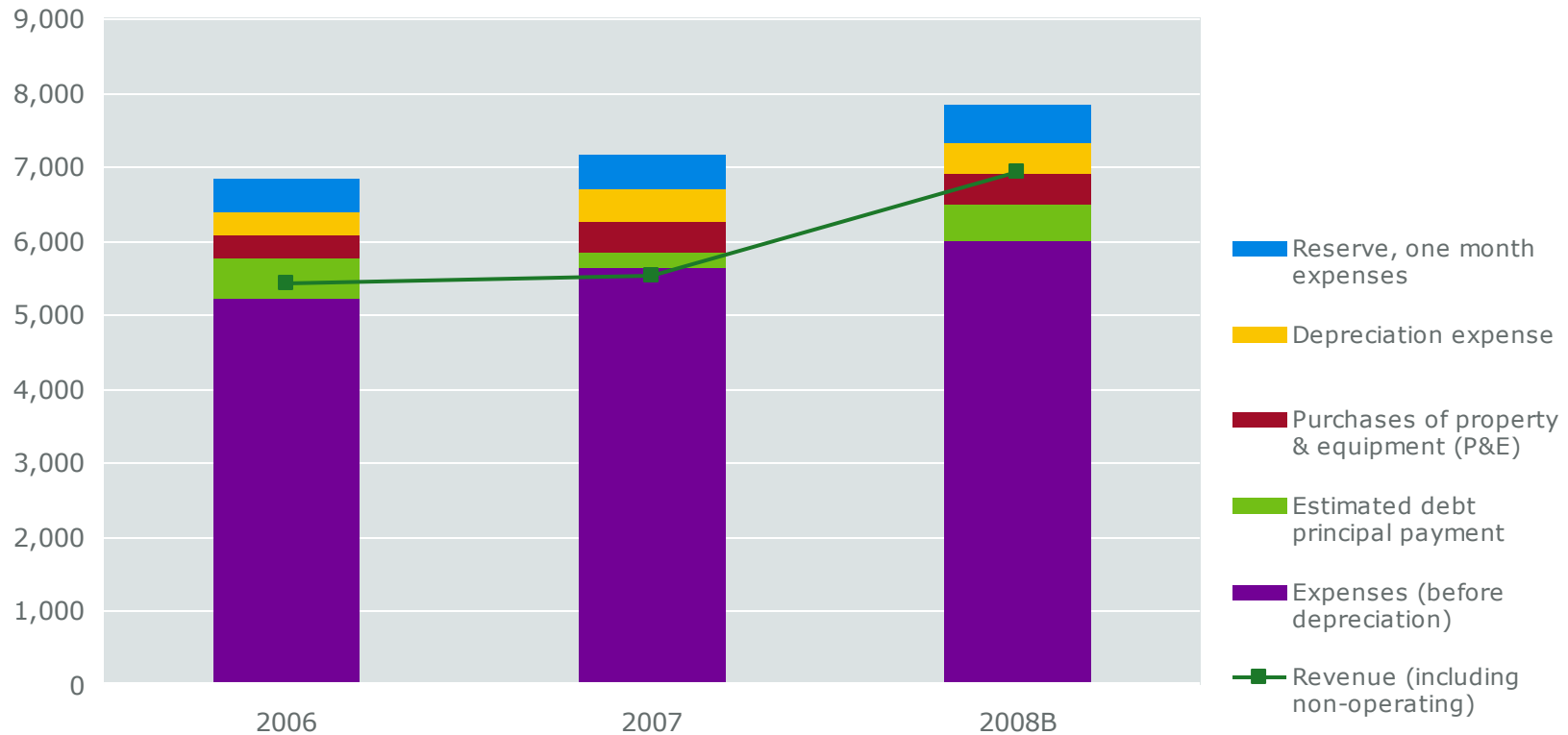
To plan for future needs, estimate total reserves goals

Savings can be allocated to board-designated reserves, helping to illustrate thoughtful, disciplined use of the surpluses

Budgeting for Operations and Beyond: Cover the Full Cost of Business

Total Cost of All Business Activity

(\$ in thousands)



Evaluating Your Current Financial Health and Risk Tolerance

The urgency and type of action leadership should take depends on the organization's current financial position

Understand Operating Performance

How well is your organization expected to do?

Will it generate a surplus/deficit? What changes will you have to make?

Determine Strength of Balance Sheet

Are you operating *now* from a position of strength or weakness?

Can you afford a deficit and if so, how large?

Acknowledge Ability to Handle Risk

What is your risk tolerance?

What is your capacity to address risk?

Plan Response

What tools do you use to do so?

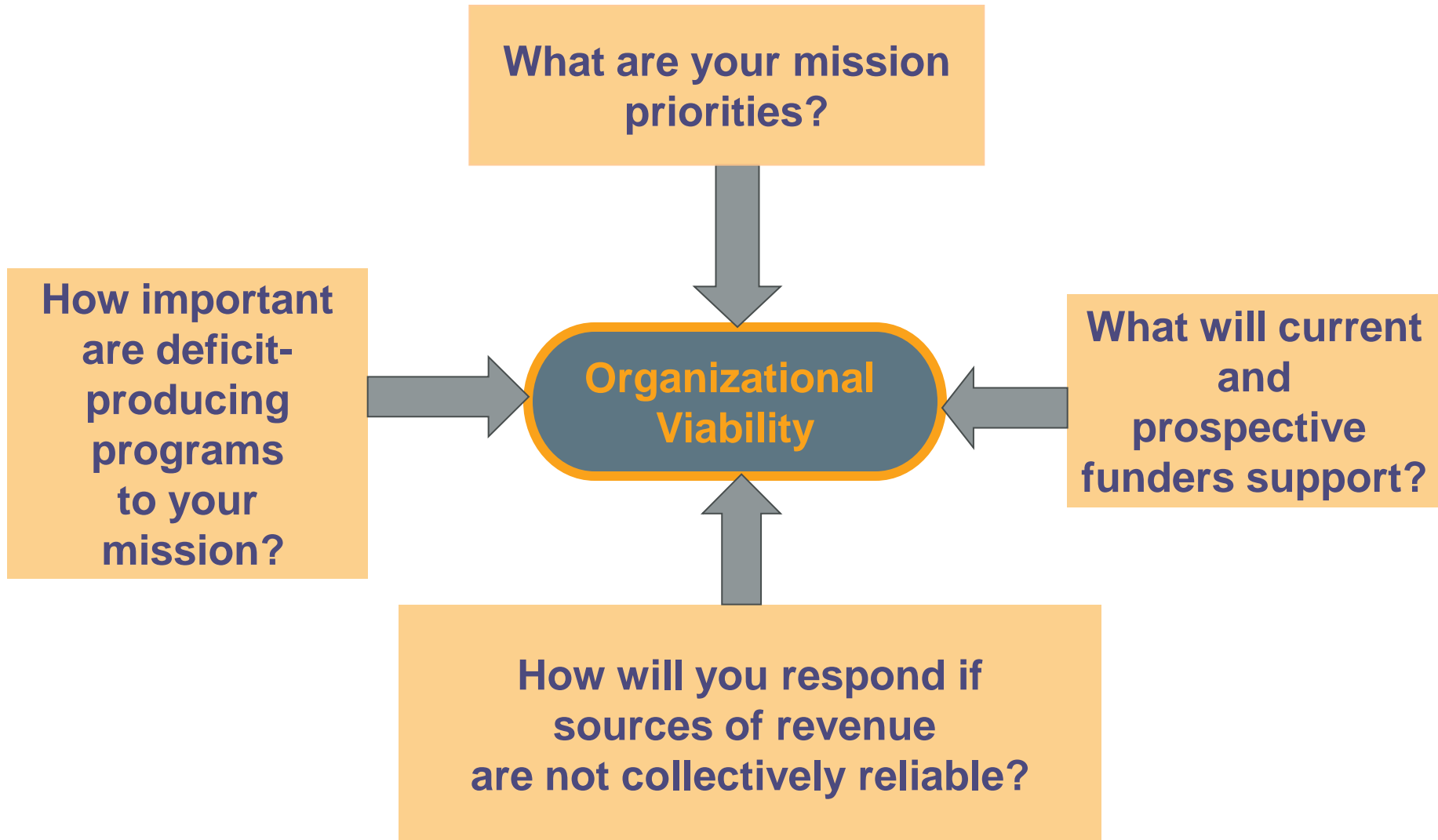
- **Some perspective**

- **Assessing Risk: Preparing for a sustained economic crisis**

- **Addressing Risk: Tools and strategies for planning and managing in tough times**
 - **Defining what's core**
 - **Quantifying your options**
 - **Developing your response**
 - **Communicating with stakeholders**

- **Concluding Thoughts**

Can You Answer The Tough Questions?



Using Program Profitability Analysis to Assess Risk

Assessing underlying program economics informs strategic decisions about:

- Whether and how to cut costs
- Where to focus fundraising efforts
- Whether to sustain, grow or cut/change programs
- How to respond to operating changes
- How to allocate resources among competing priorities

Nonprofits often make decisions to maintain deficit programs critical to their mission

The key is to understand the size of, and identify the source for the subsidy needed to cover, these deficits

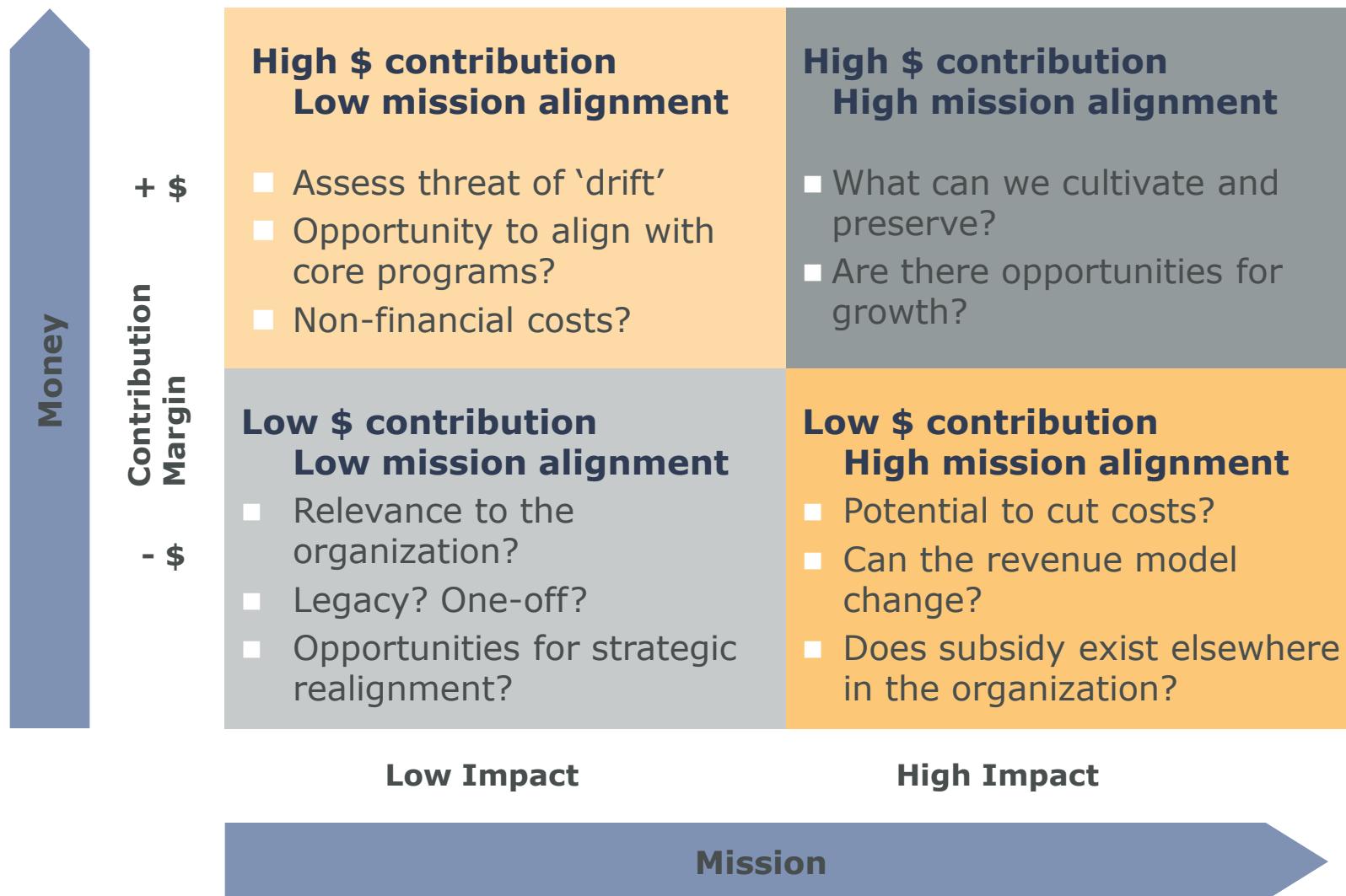
Not a cost allocation exercise

Sample Program Profitability Model



	Programs				Program Subtotal	Capacity				Capacity Subtotal	Total
	After School	Youth Program	Literacy	Senior Services		Fundraising	Special Events	Program Mgmt	Admin.		
Revenue											
(A) Earned											
Government contracts	\$457	\$110		\$800	\$1,367					\$0	\$1,367
Ticket Sales					\$0					\$0	\$0
Client Fees	\$156			\$100	\$256					\$0	\$256
Subtotal	\$613	\$110	\$0	\$900	\$1,623	\$0	\$0	\$0	\$0	\$0	\$1,623
(B) Contributed											
Foundations & Corporations	\$113		\$120		\$233	\$10				\$10	\$243
Government	\$27				\$27	\$80				\$80	\$107
Individuals	\$85				\$85	\$704	\$242			\$946	\$1,031
Trustees	\$12				\$12	\$152	\$185			\$337	\$349
Subtotal	\$237	\$0	\$120	\$0	\$357	\$946	\$427	\$0	\$0	\$1,373	\$1,730
Total Revenue	\$850	\$110	\$120	\$900	\$1,980	\$946	\$427	\$0	\$0	\$1,373	\$3,353
Expenses											
Salary & Benefits	(\$441)	(\$80)		(\$525)	(\$1,046)	(\$188)		(\$85)	(\$475)	(\$748)	(\$1,794)
Consultants & Contractors	(\$239)		(\$100)	(\$172)	(\$511)	(\$20)	(\$175)			(\$195)	(\$706)
Professional Fees					\$0	(\$48)	(\$85)		(\$13)	(\$146)	(\$146)
Occupancy	(\$112)			(\$259)	(\$371)		(\$62)		(\$46)	(\$108)	(\$479)
Office & Supplies	(\$3)	(\$12)		(\$5)	(\$20)					\$0	(\$20)
Program	(\$85)	(\$8)		(\$10)	(\$103)					\$0	(\$103)
Interest					\$0				(\$20)	(\$20)	(\$20)
Miscellaneous	(\$15)			(\$29)	(\$44)	(\$44)	(\$15)		(\$102)	(\$161)	(\$205)
Total Expenses	(\$894)	(\$100)	(\$100)	(\$1,000)	(\$2,094)	(\$300)	(\$337)	(\$85)	(\$656)	(\$1,378)	(\$3,472)
Surplus/Deficit	(\$45)	\$10	\$20	(\$100)	(\$115)	\$646	\$90	(\$85)	(\$656)	(\$5)	(\$120)

Program Profitability Analysis: A Visual Tool



By building a financial model using **alternate case scenarios**, you can project a range of outcomes to inform decisions

- Scenario testing provides a means to explicitly and transparently communicate in financial terms the viability of plans for the future

Determine how and under what circumstances you will **mid-course correct**

- Consider which expenses you can reduce, eliminate or postpone
- Evaluate how cuts will impact delivery of mission and economic viability
- Consider ways to increase revenue, if once reliable sources seem questionable.
- Ensure new revenue opportunities are “net” positive

Planning Your Response: Scenario Testing

Determine the **triggers that lead to Plan B, Plan C, etc.**

- For example: if X% of revenue doesn't arrive by Y, we will cut Z% of expenses

Plan for a worst-case scenario

- Easier to add back later than to be forced to take drastic action without a thoughtful plan

Plan for the impacts of scenarios on programming

- What is the impact on specific program metrics (i.e., clients served)

Can be as complex or as simple as needed:

- What would we do differently if budgeted revenue dropped 10%? 20%? 30%?
- What is the likelihood of receipt for each revenue source within each program? What adjustments will we make within these programs and to our supporting capacity?

Budgeting for Different Scenarios

Name of Nonprofit: PA Center

Period Analyzed: **FY 2011**

11/15/2010 22:30

Numbers in 000s	2011 Budget
Revenue	
Memberships	\$137
Education	\$68
Program Fees	\$76
Government	\$34
Foundations	\$85
Other	\$43
Donations	\$62
Fundraisers	116
Total Revenue	\$621

Change from Budget Revenue

%	
\$	

Expenses

Wages & Benefits	\$436
Marketing & Public Relations	\$15
Automobile Expense	\$5
Special Event Expense	\$30
Insurance	\$13
Office Supplies	\$12
Postage & Delivery	\$5
Printing & Signs	\$20
Janitorial Expense	\$4
Security	\$8
Other	\$34
Repairs	10
Utilities	24
Total Expenses	\$616

Change from Budget Expense

%	
\$	

Surplus / (Deficit)	\$5
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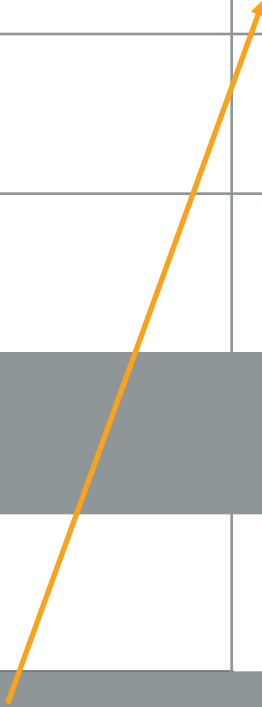
Quantify the Challenge: Cash Flow Projections

Ensure more visibility into the future by developing a physical landscape of the timing and reliability of cash in and cash out

- Distinguish between **“cash flow”** issues (timing of receipts) and **“cash”** issues (shortage of cash overall)
- Estimate how much cash to keep on hand and, if appropriate, how much **short-term debt and/or reserves** you will need to access during low cash months
- Provide a better understanding of financial health with regards to:
 - Working capital and Liquidity
 - Balance sheet strength

Monthly Cash Flow Projections: A Basic Worksheet

	Month 1	Month 2...
A. Beginning Cash	100	120
B. Operating Cash In	50	
C. Operating Cash Out	20	
B-C Net Cash From Operations	30	
D. Net Non-Operating Cash	-10	
A+(B-C)+D Ending Cash	120	
	100+(50-20)-10	



Monthly Cash Flow Projections



Monthly Cash Flow, Based on Current Annual Forecast														
(\$ in Thousands)	2009 Budget	Jan. Plan	Feb. Plan	March Plan	April Plan	May Plan	June Plan	July Plan	August Plan	Sept. Plan	Oct. Plan	Nov. Plan	Dec. Plan	Total 2009
Cash (Opening Balance)	\$126	\$126	\$426	\$859	\$611	\$583	\$764	\$1,457	\$805	\$454	\$441	\$112	\$83	\$126
Cash In														
Government Grants and Contracts	\$4,572	\$570	\$200	\$51	\$200	\$600	\$500	\$120	\$99	\$580	\$0	\$100	\$751	\$3,772
Developer fees	\$271		\$11		\$10		\$17		\$75		\$43		\$115	\$271
Foundations, corporations, other	\$2,400	\$450	\$142	\$293	\$0	\$100	\$520	\$20	\$0	\$0	\$50	\$100	\$200	\$1,875
Individuals	\$0													\$0
Special events	\$48											\$40		\$40
CM Scholarship	\$0	\$8												\$8
Grants Receivable	\$0	\$187	\$500		\$250		\$250							\$1,187
Contribution Receivable	\$0	\$300	\$200	\$100	\$31									\$631
Total Cash In	\$7,291	\$1,515	\$1,053	\$444	\$491	\$700	\$1,287	\$140	\$174	\$580	\$93	\$240	\$1,066	\$7,784
Cash Out														
Salaries and benefits	(\$6,009)	(\$445)	(\$445)	(\$445)	(\$445)	(\$445)	(\$445)	(\$668)	(\$445)	(\$445)	(\$445)	(\$445)	(\$668)	(\$5,786)
Professional services	(\$160)	(\$75)	(\$1)		(\$1)		(\$2)	(\$15)	(\$8)		(\$4)		(\$12)	(\$116)
Program Costs	(\$417)	(\$31)	(\$31)	(\$31)	(\$31)	(\$31)	(\$31)	(\$46)	(\$31)	(\$31)	(\$31)	(\$31)	(\$46)	(\$402)
Interest Expense	(\$9)	(\$1)	(\$1)	(\$1)	(\$1)	(\$1)	(\$1)	(\$1)	(\$1)	(\$1)	(\$1)	(\$1)	(\$1)	(\$9)
Administrative costs	(\$472)	(\$21)	(\$27)	(\$54)	(\$27)	(\$27)	(\$54)	(\$41)	(\$27)	(\$54)	(\$27)	(\$27)	(\$67)	(\$452)
Occupancy	(\$330)	(\$7)	(\$15)	(\$47)	(\$15)	(\$15)	(\$47)	(\$22)	(\$15)	(\$47)	(\$15)	(\$15)	(\$55)	(\$315)
Accounts Payable	\$0	(\$413)	(\$100)	(\$100)										(\$613)
Accrued Salaries	\$0	(\$223)												(\$223)
Total Cash Out	(\$7,397)	(\$1,215)	(\$620)	(\$678)	(\$520)	(\$519)	(\$580)	(\$792)	(\$526)	(\$578)	(\$523)	(\$519)	(\$848)	(\$7,917)
Net Cash In/(Cash Out) From Operations	(\$105)	\$300	\$433	(\$234)	(\$28)	\$181	\$707	(\$652)	(\$352)	\$2	(\$430)	(\$278)	\$218	(\$132)
Cash Ending Balance (Before Special Items)	\$21	\$426	\$859	\$625	\$583	\$764	\$1,471	\$805	\$454	\$456	\$12	(\$167)	\$301	(\$7)
Special Items														
Line of Credit (\$350 available)											\$100	\$250	(\$100)	\$250
Principal Payment(s) on Loan (\$57)				(14)			(14)			(14)			(14)	(\$57)
2010 Revenues Rec'd in Cash in 2009													\$100	\$100
Cash Ending Balance (After Special Items)		\$426	\$859	\$611	\$583	\$764	\$1,457	\$805	\$454	\$441	\$112	\$83	\$286	\$286

Building Your Cash Flow Projections: Tips and Techniques

Be disciplined and conservative, but not too conservative – an unrealistic cash flow projection is useless

Prepare cash flow projections monthly (if not weekly in times of crisis) and continually update based on actual results vs. projection

- Revisions to your projections will be necessary. Each month, check for anomalies and subject them to further review

Look for trends in the end of the month cash balances:

- How do projections stack up against actual cash balances?
- Which months end with positive/negative cash levels?
- What are the patterns?

Lines of Credit

- Address periodic or recurring **CASH FLOW** issues
- A bridge for timing gaps between expenditure and receipt of offsetting revenue

By securing a line of credit, particularly when times are good, you build your banking relationship and credit history

Conversations with your banker must be ongoing, deep, and fully transparent. Be prepared to discuss:

- Leadership team with the ability to lead through changing economic and funding environment
- Short- and long-term organizational plans
- Contingency scenarios for potential reductions or loss in funding
- Funding commitments/contracts for the next 12 months
- Evidence of reporting/processes in place to measure progress against budget and ability to course correct

- **Some perspective**

- **Assessing Risk: Preparing for a sustained economic crisis**

- **Addressing Risk: Tools and strategies for planning and managing in tough times**
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- **Concluding Thoughts**

Communication: Leadership Requires Making Decisions



Good financial decision-making requires timely, accurate and transparent financial information

- Be prepared to work with and adapt to imperfect information

Tools are only as good as the assumptions behind them

Tools are not a substitute for making difficult decisions

Being honest first with ourselves allows you to begin the exercise of discovering options

External communication and buy-in are essential but not before you've done your internal due-diligence

Rinse & Repeat

Engage staff in conversations about options. Valuable source of creative ideas and solutions

Bring alternatives to the Board for decision making. Remember: Board has a fiduciary duty to safeguard the organization's assets

Stay in front of donors—don't pull back. Be candid about the continued impact of the economic climate on your programs and organization

Thank you!

**To learn more about NFF,
visit us at nonprofitfinancefund.org**

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