

# Local Conditions Vary: Assessing Your Nonprofit's Financial Position

by Kate Barr

## Assessment of Recession Risk and Preparedness for Nonprofit Organizations

This tool offers a quick assessment of risk in four essential areas for nonprofit organizations. The rating and guidance provided will help to start discussions, set priorities, and focus attention as nonprofits develop plans to weather the recession. This assessment is a starting point developed to indicate the level of urgency and priority. It cannot take the place of a comprehensive organizational review or in-depth analysis of financial trends and forecasts.

IN THE BLIZZARD OF HEADLINES, FINANCIAL news, forecasts, and surveys, individual nonprofits can easily get swept up by the most recent reports of impending crisis or hopeful recovery. But the conditions of another nonprofit, or even 100 other nonprofits, aren't an accurate predictor for your organization. In all forecasts, "local conditions vary," and the most relevant information is the situation at an individual nonprofit organization. Only by clearly understanding its own financial position, strengths, and risks can a nonprofit develop strategies to respond to the economy and plan for the future.

In our contact with hundreds of nonprofits in Minnesota this year, the Nonprofits Assistance Fund has worked with organizations in every degree of financial health or distress, from rock solid to previously solid to solidly in crisis. In every case, heightened uncertainty about revenue and client demand adds to the complexity of decisions. As nonprofits have had to quickly make decisions about program and staff cuts, budget reductions, and cash reserves, we've seen too many examples of organizations taking action without fully considering their "local conditions."

We have found that the information or assessment gap falls into four categories:

1. overestimating or underestimating the current financial condition of an organization;

2. relying on inadequate, inaccurate, or untimely financial information;

3. overlooking important internal and external environmental factors; and

4. leadership gaps and delays among the management team, the board of directors, or both.

To help nonprofits quickly analyze their local conditions, we developed the Assessment of Recession Risk and Preparedness for Nonprofit Organizations tool to provide a starting point for nonprofits in identifying risk factors and immediate priorities. The tool's 20 questions cover financial condition, financial information, organizational change factors, and leadership. For nonprofits in fragile financial condition, the assessment helps to identify how urgently they need to act and where to start. For healthy organizations, the assessment has been valuable for leadership team and board discussion about strengths, risks, priorities, and opportunities. Whatever your starting point, we hope you find this tool useful.

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Financial Health		1 point	2 points	3 points	Score
1	Number of the most recent three fiscal years that ended with a surplus in unrestricted funds (positive change in unrestricted net assets)	3 years	2 years	0 or 1 years	
2	Percentage of contributed income included in the budget that is committed or highly reliable	75% or more	50%–75%	Less than 50%	
3	Percentage of contracts and earned income included in the budget that is committed or highly reliable	75% or more	50%–75%	Less than 50%	
4	Percentage of variance between budget and actual results for total income for the most recent year	Less than 10%	10%–18%	More than 18%	
5	Number of months in the past year in which cash flow challenges required out-of-the-ordinary steps such as delayed payments or use of reserves	None	1 or 2 months	3 or more months	
6	Number of months of operating expenses available in unrestricted cash (whether designated as reserve or not)	More than 3 months	1 to 3 months	1 month or less	
7	Percentage of annual budget supported by income paid from an endowment	Less than 5%	5%–15%	More than 15%	
<b>Financial health risk total</b>		9 or less: lower risk; 10–12: moderate risk; 13 or more: high risk			

Financial Information		1 point	2 points	3 points	Score
8	Budgets and actual financial performance, including full program costs, are understood and monitored for each significant program	Yes	Somewhat	No	
9	Financial reports prepared by staff or outside contractors are accurate and available every month within 30 days of month end	Always	Usually	Sometimes	
10	Accurate cash flow projections are prepared and used for management decisions	Monthly	Quarterly	Irregular or never	
11	Financial information identifies and tracks use of grant funds received for restricted purposes	Always	Sometimes	No	
12	Annual audit is completed in a reasonable time after the fiscal year	Within 4 months	4–7 months	More than 7 months	
13	Required reports and data submissions for funders are prepared and submitted on schedule	Always	Almost always	Inconsistent	
<b>Financial information risk total</b>		8 or less: lower risk; 9–10: moderate risk; 11 or more: high risk			

Organizational Change		1 point	2 points	3 points	Score
14	Length of time the executive director or CEO has been in the position	More than 3 years	1 to 3 years	Less than 1 year	
15	Significant changes in program or strategic direction have been implemented in the past two years	No	Some change	Major change	
16	Level of increase (or decrease) in quantity or level of program services provided in past 12 months that were driven by external changes	Typical	Above average	Significant	
17	A capital campaign or building project is currently under way	No	Small project	Large project	
<b>Organizational change risk total</b>		5 or less: lower risk; 6–7: moderate risk; 8 or more: high risk			

Leadership Engagement		1 point	2 points	3 points	Score
18	All staff leaders understand the organization's financial condition and risks and their role in addressing the current situation	Yes	Somewhat	No	
19	The majority of board members understand the organization's financial condition and risks and their role in addressing the current situation.	Yes	Somewhat	No	
20	Tangible action has already been taken to prepare for and respond to the downturn and prepare for a tougher economic environment	Yes	Minimal	No	
<b>Leadership engagement risk total</b>		4 or less: lower risk; 5: moderate risk; 6 or more: high risk			

## Using the Risk Assessment Scores

### Financial Health Risk Level

**High:** The financial weaknesses allow little breathing room and require urgent and decisive action and short-term planning.

**Moderate:** Scenario planning is important using conservative assumptions for highest-risk items. Test all assumptions.

**Lower:** Strong financial health allows for longer-term planning and affords opportunities for innovation and strategic partnerships.

### Financial Information Risk Level

**High:** Smart, timely decisions can't be made without reliable information. The first priorities are tracking cash flow and budgets.

**Moderate:** Focus on improving areas of weakness, especially understanding true program costs, restricted grants, and cash flow.

**Lower:** If budgets are reduced, try to maintain the infrastructure for reliable financial information to support management.

### Organizational Change Risk Level

**High:** Multiple, simultaneous changes require diligent oversight, a focus on strategic goals, and a willingness to say no.

**Moderate:** Big changes put pressure on everything and require balanced decisions based on level of risk in other areas.

**Lower:** Because major change is not yet a factor, stay focused on managing uncertainty in other areas.

### Leadership Engagement Risk Level

**High:** The organization urgently needs a leader to step forward to call attention to the challenges, even if it causes discomfort.

**Moderate:** Champions within the organization need to work together to bring others up to speed and focus them on taking action.

**Lower:** Leaders who have taken steps to plan and manage challenges can help develop others in the organization.