

## **Mistakes nonprofit organizations make in their financial operations.**

By Nick Eoloff November 2006

In researching the topic of nonprofit finances, I found several articles highlighting missteps by organizations that impede their financial success. Here are some of those unintended, but common practices that all organizations must realize could harm their overall financial health.

### *All the eggs in one basket*

A good example of this expression is exemplified in the Enron fiasco, in which all of its employees had their future pensions tied to the company. This parallel is no different for the nonprofit sector. Many nonprofits are dependent upon government funding as a single source of revenue. Diversity is a positive circumstance especially when it comes to revenues. Have a broad base of funding sources, both private and public and assume that nothing is stable and that everything could change. Organizations should have at least 5% of their revenues coming from endowments or interest-bearing cash reserves.

### *Cash flow analysis done annually*

Cash flow analysis should be done monthly or quarterly to determine the financial status of your organization. An annual cash flow analysis would not provide the financial information managers need.

### *Financials that are Opaque*

Transparency is important both to the outside world (i.e., attorneys general) as well as to the inside world (board members and employees). Providing transparency enables an organization to make wise and prudent decisions. 'Bottoms up' budgeting (input from all staff levels) empowers and holds managers accountable to provide the service prescribed in the adopted budget.

### *Inflexible*

Many organizations, especially larger ones, are not flexible in their operations, use of finances, or the services they deliver. In order to be a leader in the nonprofit sector an organization should be flexible. Organizations must look at alternatives or new ways to provide services which may lead to expanded clientele or revenue sources. A large portion of unrestricted cash can provide a great deal of flexibility.

### *Little to no overhead*

Organizations that claim they have no indirect or overhead costs may not be reflecting their entire financial picture. According to Robert Egger, Founder of the nonprofit agency D.C. Central Kitchen, "just because an organization has next to nothing in administrative overhead doesn't mean it's an effective nonprofit." There are always some indirect costs, however determining a percentage that works for all organizations may not be appropriate. In determining overhead, include the Executive Director's time, along with all associated costs with each program.

### *Low operating reserves*

Low operating reserves could mean that an organization is nearing financial disaster. Little or no operating reserves restrict every facet of operation. Decisions based solely on whether there are finances available can hamper wise choices that may prove to bring success. Organizations should set a realistic goal of a 90 day cash reserve that can handle the ups and downs of the cash in/cash out fluctuations or market changes. Providing for a cash reserve will provide comfort for the entire organization.

### *More Expenses than Revenues*

Surprisingly, organizations focus more on the mission than the cost of providing that mission. No doubt, it won't take much time before the financial problems appear. According to Peter Brincherhoff, president of Corporate Alternatives, Inc., Forbes 2004, organizations should plan and work towards providing a revenue surplus seven out of ten years. This will give financial "maneuvering room" to provide high quality services.

### *Never Leverage*

An organization should take advantage of leveraged funds in times when opportunities present themselves. Borrowing prudently is essential, with the knowledge that the loan or note will be paid back in the future. Never leveraging could mean opportunities lost.

### *No long term plan*

Not having a long-term plan can be short-sighted. Organizations should establish at least a five year budget outlook and capital program that forwards its goals and mission. Having a 5 year plan enables managers and board members to view the overall progress of an organization. The 5 year plan should be reviewed and updated annually.

### *Preparing financial projections, but never reading them*

Putting a budget together and leaving it on the shelf to gather dust will not do an organization justice. Make use of the budget on a regular basis and have your managers and staff utilize it as well.

### *The Auditor's notes don't mean much*

Ignoring an auditor's suggestions or notes attached to the audit may lead to unwanted consequences. Understand current financial practices and work towards achieving them. If the auditor's suggestions are difficult to understand or difficult to put into practice, seek outside assistance.

These are some of the many mistakes that can appear on an organization's business plan. Understanding how they can affect operations and the bottom line are important. Finances should not be considered accessory to the operations – they should be a part of, and included in everyday practices.

Brinckerhoff, Peter. *The Keys to Financial Empowerment for Your Organization*. Nonprofit World 1995., Vol. 13, Number 4. p20 – 23. Accessed through on-line website 11/09/06.

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Egger, Robert. *Charity Isn't Cheap*. Forbes 2004 Vo. 173, p.36. Accessed through on-line website 11/09/06.