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Nonprofit Sector

Proctor: New tool helps assess nonprofit health

Premium content from Business First by Allen J. Proctor

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Evaluating the financial health of nonprofits always has been unnecessarily difficult.

Recent changes in accounting rules have added confusion and hindered easy interpretation of financial condition. Many of the conventional metrics in for-profit financial analysis do not apply to nonprofits. And too many nonprofits are so concerned with emphasizing their programmatic uniqueness that they turn financial dashboards into lengthy documents that subvert the dashboard's purpose of simplification.

The primary tool to evaluate and compare nonprofits has until now been the IRS Form 990 reports. Using this information has been difficult, requiring downloading individual annual reports, manually extracting the detail one needs, and then compiling into a historical series or comparison across nonprofits. This difficulty has discouraged effective use of this information.

To address this inefficiency, a new tool has been created through the collaboration of GuideStar and Nonprofit Finance Fund to create an automatic, standardized report on nonprofit financial health. GuideStar is a national nonprofit which makes all IRS Form 990 filings available on the Internet free of charge. Nonprofit Finance Fund is a well-regarded community development financial institution which has been a thought-leader in the area of nonprofit financial health.

Their new tool, Financial Scan, draws data directly from GuideStar's IRS Form 990 database and compiles the information into an easy-to-read, graphical format. A subscription for a nonprofit to run a single report on itself is only \$250. The creators hope that this report will become an industry standard for interpreting nonprofit financial data.

I agree with their claim: "It demystifies nonprofit finance, helping you understand how and what financial data to measure and comparing an organization's situation to up to five others. It can be used ... to plan for the future, communicate resource needs, and make better decisions."

I was impressed by the sample report available on the Internet. It presents a comprehensive picture of financial health. Multi-year charts make it easy to spot improvement or deterioration. Equally valuable, they have emphasized simplicity by choosing the metrics which they believe are the most valuable and understandable.

The report has a single-page dashboard followed by 13 pages of graphs and explanations and a final page providing data for up to five self-selected nonprofits for 15 items on the dashboard. Each page begins with a paragraph of policy guidance from Nonprofit Finance Fund. Brief technical notes alert the reader to potential misinterpretations of Form 990 classifications and definitions. And every chart comes with three important questions the reader should use the graphs to answer.

The report provides information on revenue and expenses, but its most useful contribution is its equal emphasis on profitability, balance sheet structure and liquidity. Nonprofit accounting and the Form 990 make it impossible to measure profitability in as straightforward a manner as for-profits can. However, using its extensive experience in evaluating nonprofits, Nonprofit Finance Fund has chosen a next-best definition based on the information available. It provides extensive technical notes on its choices and any limitations. Its guidance places profitability in the context of sustainability and service reliability during economic recessions.

The five pages of graphs, guidance, and key questions focused on balance sheet composition alone should be game-changers in nonprofit board deliberations. One page evaluates asset composition in the context of a nonprofit's ability to manage risk. Another page brilliantly combines depreciation and fixed asset information to allow a nonprofit to see over time an approximate image of emerging deferred maintenance. Subsequent pages evaluate the trends in asset/liability ratios, composition of liabilities, and composition of net assets.

Nonprofits traditionally have paid more attention to their operating budgets than to their balance sheets. This emphasis has not served nonprofits well and the expansive attention in this report to key balance sheet issues hopefully will expand the amount of board time spent on those issues.

The past four years have brought the need for liquidity to the forefront of many nonprofit discussions. The existence of donor restrictions on assets makes the evaluation of nonprofit liquidity particularly difficult using the Form 990 level of detail. To enhance informed discussion by nonprofits, the report provides three measures of liquidity along with extensive policy guidance, technical notes and additional questions to consider.

I have written extensively on the critical issues that can allow nonprofits to be reliable providers of community needs. This simple report is one of the most effective tools I have seen to lay out the full range of strategic issues that impact reliability. Every nonprofit board should consider using this tool.

To learn more, visit guidestar.org/rxg/products/nonprofit-data-solutions/financial-scan.aspx.

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