

ISSUES & INSIGHTS

Impressing Your “Suitors” With Financial Information

Attracting funding organizations and large individual contributors to donate money to your nonprofit is a little like finding a spouse — you want to create the best impression during the courtship in the hope that the other person will find you to be a “good catch” and make a commitment.

The financial information on your nonprofit has the potential to create a great first impression. Here are some things to keep in mind.

Sizing You Up

Before deciding where to put its dollars, a major funder likely will request two pieces of information to make its assessment of your organization. One is a copy of your most recent audit or financial statements prepared by your accountant, and the other is a copy of your most recently filed Form 990.

Your challenge is to make sure that information in these documents presents your organization accurately and in the most favorable light. Armed with this information, your potential funder will be able to see how your nonprofit stacks up against similar organizations. Funders often take information from a nonprofit’s financial statement and Form 990 and plug it into three ratios: a program spending ratio, a fundraising efficiency ratio and a management expense ratio.

How You Spend Money

Your *program spending ratio* is one of the most common benchmarking measurements that will interest possible funders. The ratio is calculated as follows:



$$\frac{\text{Program expenses}}{\text{Total expenses}}$$

The resulting percentage is the portion of your not-for-profit’s expenditures spent on program services. The higher the percentage, the more efficient your organization is with funder dollars.

In its *BBB Wise Giving Alliance Standards for Charity Accountability*, the Better Business Bureau (BBB) holds that a nonprofit should have a program spending ratio of 65% or higher. Several nonprofit watchdog organizations, including Charity Navigator and the American Institute of Philanthropy, routinely rate and publish this percentage for some of the larger and more prominent nonprofits.

A funder will benchmark your nonprofit against these percentages to determine

if your organization — or someone else’s — will likely spend its dollars most efficiently. Because of this, it’s important to accurately categorize your expenses by *function*. This maximizes the amount allocated to program costs as opposed to management and general or fundraising expenses.

How You “Bring Home the Bacon”

Your nonprofit’s *fundraising efficiency ratio* is another metric that frequently interests potential funders. It’s calculated as follows:

$$\frac{\text{Total fundraising expense}}{\text{Contribution and grant revenue}}$$

“Contribution and grant revenue” refers to those revenues received as a direct result of your nonprofit’s fundraising activities. This resulting percentage is a signpost of how much it costs to raise

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Show Them The Outcome

Funders have long valued expense ratios and other metrics that quantify your financial health. But potential funders are often just as interested in the impact your nonprofit makes in the community. Be sure you reliably measure the *outcomes* of your program dollars and report the results to the funder.

Let's say that the Westport Doodads Company awarded the Westport Job Retraining Center (WJRC) \$100,000 to fund job retraining programs. If WJRC wants to receive funding for a second year, it likely will need to report to Westport Doodads how that money was used — and, importantly, what results were achieved.

Westport Doodads, for example, would be most interested in knowing that 76 people upgraded their computer skills through a six-week training course (funded with dollars from the company) at the center. Of those 76, 57 were called in for interviews by employers seeking people for positions requiring computer skills. Of those 57, 28 people were called back for second interviews and 16 were offered a position.

Consider including outcomes information on Form 990, which has a lot of room for narrative. That way, readers of the form will have more information about you than simply numbers

each contribution dollar. Generally, the lower this percentage, the more dollars available to support program services.

The BBB states that this percentage should be no more than 35%, which would mean it costs no more than 35 cents to raise each contribution or grant dollar.

How You Manage the “Household”

Another good measure of a nonprofit's efficiency is the portion of expenditures spent to support administrative functions, or the *management expense ratio*. It's calculated as follows:

$$\frac{\text{Total management and general expenses}}{\text{Total expenses}}$$

Most funders want to see their donations support program services and thus will look for organizations with a low percentage of management and general to total expenses, usually in the range of 25% or less. A nonprofit with a high percentage will generally be deemed inefficient in running its organization, unless it's able to communicate the reasons for the unusually high percentage.

Other Yardsticks

Most funders will consider other financial factors, as well. Some may perform a trend analysis, placing the three most recent years of financial information side by side to see the increasing or decreasing trends in revenue and expenses.

A decreasing trend in financial support could indicate that the nonprofit will be unable to sustain itself in the future. Or, if program expenses are growing at a

faster rate than fundraising expense, the nonprofit could be experiencing some inefficiencies or mismanagement.

Many funders also will examine your accumulation of unrestricted net assets. A successful not-for-profit avoids accumulating an excess of unrestricted funds that otherwise could be directed toward program services. According to BBB guidelines, a nonprofit's unrestricted net assets available for use should be no more than three times the size of its past year's expenses or three times the size of its current year's budget, whichever is more.

If unrestricted net assets appear excessive, a funder may decide the nonprofit doesn't need the contribution. To avoid the appearance of accumulating excess funds, an organization may choose to designate, either on the face of the Statement of Financial Position or in a descriptive footnote, certain amounts for specific purposes such as debt service or building repairs.

The Image you Present

In short, it's in the best interest of your organization to understand what the numerical information on financial statements and Form 990 can represent to funding organizations, individual contributors and others in the public domain. The image you're presenting to possible “suitors” can draw them in or send them running.

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