Beyond the Bottom Line: Understanding & Promoting Nonprofit Financial Sustainability

Helen Bader Institute for Nonprofit Management, University of Wisconsin-Milwaukee
& partners Donors Forum of Wisconsin& Milwaukee Center for Independence

December 4, 2008

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- Learning Objectives:
  1. What is financial health?
  2. How can financial health be quantified?
  3. What can be done to improve it?

- Curriculum:
  The workshop will relate financial health to financial capacity (an ability to do things and withstand unexpected shocks) and sustainability (maintaining financial capacity). Some actions that are easy in the long run may be difficult in the short run and impossible right away. Therefore, the time dimension of financial capacity will receive special attention. Participants will be introduced to at least one way to measure financial capacity and sustainability in each of three time frames. Form 990 data will be used to achieve standardization, so the emphasis can be on how to improve financial capacity and sustainability rather than on the theory of measurement. Two case studies will illustrate the lessons.

- Resources:
  1. Instructor's Lecture Notes: Monitoring Nonprofit Financial Performance
  2. Case Study of Christian Family Services*
  3. Case Study of South Cinder Health Center*
  4. Case Study of National Museum of Craftsmanship*
     * Spring 2005 issue of *Nonprofit Quarterly*, used with permission.

  For the benefit of participants needing a crash course in the language of nonprofit finance, there is an appendix at the end of this package (The Basics of Nonprofit Financial Statements and Accrual Accounting).

MONITORING NONPROFIT FINANCIAL HEALTH

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Financial health has two dimensions: capacity and sustainability. Financial *capacity* is measured by the resources that allow an organization "to adapt to internal pressures for adjustment or to external pressures for change in policy, as well as to initiate changes in strategy with respect to the external environment."[1] Financial *sustainability* is the ability of an organization to maintain its capacity.

Changing direction or reacting to new threats and opportunities often involves acquiring new assets (a new building, perhaps) and shedding obsolete ones (such as software). But reconfiguring a portfolio of assets takes time. An organization may have plenty of capacity in the long run but in the short run (say, 1 to 5 years) donor restrictions and limited financing options are constraining. Here-and-now, liquid assets are the only resources available.

This paper shows how to measure a nonprofit organization's financial capacity in different time frames and how to measure its ability to sustain capacity in each case. There are several ways to measure – or metrics for – each of these concepts. Some metrics require adjustment for special circumstances, such as large real estate holdings or large investment portfolios. The only data needed for computing the particular metrics I have chosen are reported on IRS Form 990.[2]

Bear in mind, recommended values for the ratios described herein are rules-of-thumb. An unfavorable ratio calls for further investigation, not summary judgment. Appraisal of an organization's financial condition should be based on the pattern observed in several ratios, not just one. Trends over time are particularly useful for gaining insight.

Long Run Financial Health

Long Run Capacity

Many nonprofits have no long-range (5 to 10 years) plans. Inattention to the distant future is excusable for static nonprofits without growth ambitions but a growing organization should have a plan for anticipating and overcoming capital constraints. The Equity Ratio is a simple computation that will alert an organization to trouble down the road and it may also shed light on why it is struggling in the short run.

The numerator of the following formula is the sum of unrestricted, temporarily restricted and permanently restricted net assets (summarized in line 73B; the 'B' suffix indicates the end-of-year figure).[3]

- **Equity Ratio** = Total Net Assets / Total Assets.[4]

  = line 73B / line 59B

This ratio is 1.0 for organizations with no debts of any kind, including unpaid bills. At the other extreme, an Equity Ratio of zero means that an organization is operating entirely with borrowed assets. Because debt service is a fixed cost that an organization is obligated to pay, regardless of its economic circumstances, excessive debt service is a threat to long run survival. Konrad and Novak (2000, 113 – see note 19) recommend an Equity Ratio > 0.50.

This ratio includes restricted net assets as well as unrestricted. In the short run restrictions are very important but in the long run, temporary restrictions on grants and gifts will be satisfied. Unless restricted by a gift agreement, capital gains on restricted net assets are unrestricted. Most operating public charities have strong equity ratios.

Equity Ratio Medians
(N in parenthesis)

Small (28K)	**Medium** (29K)	**Large** (29K)	**X-Large** (25K)
0.63	0.76	0.73	0.68

Size classes are based on total assets. There are approximately 112K nonprofits in the sample.[5] (K means 1,000.) Groups were defined to equalize the number in each category. Total assets of small organizations are $201K or less; total assets of medium-size organization are greater than $201K up to $815K; of large organizations they are greater than $815K up to $3.26K and of X-large organizations, they are over $3.26K. The following table shows the proportion in each size class with inferior equity ratios.

Percent of Organizations with Equity Ratios < 0.5
(N in parenthesis)

Small (28K)	**Medium** (29K)	**Large** (29K)	**X-Large** (25K)
45%	35%	38%	35%

<u>Sustaining Long Run Capacity</u>.

Since long run financial capacity is given by the Equity Ratio, it is natural to measure sustainability by the change in the numerator divided by the same denominator.[6] A common metric used to analyze both for-profit businesses and nonprofit organizations that captures this idea is Return on Assets (ROA):[7]

- **ROA** = Change in Total Net Assets / Average of Total Assets

  = 2 · (line 73B – line 73A) / (line 59B + line 59A)

Another name for the numerator is total surplus (total deficit, if it is negative). Surpluses increase an organization's net assets,[8] and hence its financial capacity. Conversely, deficits reduce financial capacity. Surpluses are necessary to sustain an organization. Surpluses provide capital for building renovation, replacement of equipment, and upgrading technology. A string of large or frequent deficits can wipe out an organization's net assets altogether.

There is no accepted standard for nonprofit ROA. However, if it is not at least equal to the long run rate of inflation, an organization will move backward. Thus ROA should be at least 3.5%. As the following table suggests, most nonprofits do not do this well. Since nonprofits face many constraints on raising prices (if they charge at all), a poor ROA performance indicates an inadequate fundraising effort.

Median Return on Assets (ROA)
(N in parenthesis)

Small (28K)	**Medium** (29K)	**Large** (29K)	**X-Large** (25K)
0.6%	1.9%	1.4%	2.3%

The proportion in each size class with ROAs less than the average long run rate of inflation (3.5%) is shown below.

Percent of Organizations with ROA < 3.5%
(N in parenthesis)

Small (28K)	**Medium** (29K)	**Large** (29K)	**X-Large** (25K)
55%	55%	58%	59%

Surpluses can suddenly turn into deficits and vice versa. Capital campaigns can cause a sharp surge in ROA.[9] To reduce volatility I recommend calculating average ROA over a 3-year period, if data are available.[10]

- **3-year trailing ROA** = 3-year average ROA = 2 · (line 73B in year *Y* – line 73A in year *Y-2*) / (line 59B in year *Y* + line 59A in year *Y-2*)

If ROA in the most recent year is less than the trailing 3-year ROA, an organization may also have a sustainability problem, even if both numbers are positive. Some exceptions:

when an organization is wrapping up a capital campaign or spending down a multi-year grant.

Short Run Financial Health (Simple Case)

Nonprofits with little in the way of physical assets and no endowment can use a very simple ratio to measure short run financial capacity.

Skip to the next section IF
• Land, building, and equipment (LBE) plus investments > 10% of Total Assets, or if
• Investment revenue > 10% of total revenue,[11] or if
• Permanently restricted net assets > 0.

Short Run Capacity

"Months of Spending" measures an organization's financial capacity to respond to a sudden drop in revenue in the short run. *Unrestricted Net Assets* are functionally equivalent to an operating reserve which can be tapped in an emergency. Cutting expenses is the only quick and sure way to balance a budget. Long run financial health requires finding new sources of revenue, but this takes time. If an organization chooses to maintain spending levels while searching for replacement revenue, it must succeed within the following number of months before circumstances will force it to cut expenses.

- **Months of Spending** = 12 · Unrestricted Net Assets / Total Expenses[12]

  = 12 · line 67B / line 17

Konrad and Novak (2000, 113 – see note 19) endorse a standard for an operating reserve equal to 3 months of expenses.[13] A negative number means the organization has no short run financial capacity.

Median Months of Spending
(N in parenthesis)

Small (18K)	**Medium** (12K)	**Large** (7K)	**X-Large** (4K)
2.4	5.1	5.7	7.4

The above table shows the medians for organizations with minimal holdings of land, building, equipment and securities as defined in the box at the beginning of this section. All but the smallest nonprofits have more than 3 months of spending "in reserve." The table below shows the proportion of nonprofits in each size class with less than 3 months of spending available.

Percent of Organizations with < 3 Months of Spending Available
(N in parenthesis)

Small (18K)	Medium (12K)	Large (7K)	X-Large (4K)
58%	37%	35%	33%

<u>Sustaining Short Run Capacity</u>

A natural metric for sustainability of short run capacity is *Change* in Unrestricted Net Assets / Total Expenses.[14] One can think of this metric as the unrestricted surplus per dollar spent. Retailers call this ratio "markup" but this sounds odd when applied to nonprofits, so I call this ratio Expense Margin.[15]

- **Expense Margin** = Change in Unrestricted Net Assets / Total Expenses

  = (line 67B – line 67A) / line 17

If an organization receives a multi-year temporarily restricted grant, the numerator of this formula includes the grant money in the year it is spent as net assets are released from restrictions. Experts do not favor any particular number.[16] But, the pattern of expense margin by size of organization (below) suggests that a range of 2 to 3 percent is a reasonable objective.

Median Expense Margin
(N in parenthesis)

Small (18K)	Medium (12K)	Large (7K)	X-Large (4K)
0.6%	2.2%	2.3%	3.1%

The proportion of nonprofits in each size class that have Expense Margins less than 2.5 percent is shown below.

Percent of Organizations with Expense Margins < 2.5%
(N in parenthesis)

Small (18K)	Medium (12K)	Large (7K)	X-Large (4K)
61%	55%	55%	53%

Like ROA, Expense Margin may fluctuate substantially from year-to-year, so again it is a good idea to calculate a 3-year average, if the data are available. The 3-year trailing Expense Margin is

- **3-year trailing Expense Margin** = (line 67B in year *Y* – line 67A in year *Y-2*) / (line 17 in year *Y* + line 17 in year *Y-1* + line 17 in year *Y-2* – line 42 in year *Y* – line 42 in year *Y-1* – line 42 in year *Y-2*)

Short Run Financial Health (Landed & Endowed Nonprofits)

Nonprofits with endowment need to use a more complicated ratio to measure short run financial capacity. This section is for nonprofits having land, building, and equipment (LBE) plus investments > 10% of Total Assets, or investment revenue > 10% of total revenue, or permanently restricted net assets > 0.

Short Run Capacity of Landed & Endowed Nonprofits

LBE contributes to financial capacity in the long run, but not in the short run. It may require several years to reach a decision to sell land or buildings and more time before an acceptable offer is forthcoming.

Some fortunate organizations have a large portfolio of investments (called endowment, if restricted, and quasi-endowment, if unrestricted) that generates regular financial support for operations. If the amount of revenue proves inadequate to balance a budget, they might be tempted to liquidate a portion of their portfolio to pay the bills. But, this compromises future earnings and, if they succumb to temptation, they would be eating their seed corn.

Form 990 does not report endowment and quasi-endowment. The approximation below assumes that screened out organizations have no endowment, and that endowments contain all reported investments but no cash or savings.

- **Months of Spending adjusted** for LBE and Investments[17]

= 12	= Months in a year
· [line 67B	· [Unrestricted Net Assets
– (line 55cB + line 57cB – line 64aB – line 64bB)	– Equity in LBE
– (line 54aB + line 54bB)	– Investment in securities
– (line 56B + line 58B)]	– Other investment & assets]
all divided by (line 17 – line 42)	/ (Expenses – Depreciation)

The standard for Months of Spending adjusted for LBE and/or investments is the same as the unadjusted standard of 3 months.

Median Months of Spending, Adjusted
(N in parenthesis)

Small (10K)	Medium (17K)	Large (22K)	X-Large (25K)
0.7	1.8	1.7	1.0

Organizations with large real estate holdings and/or investments do not have as many months of spending as other, organizations in their size class. But, the assumptions of this calculation have the effect of commingling operating reserves with true endowment and quasi-endowment. The true numbers are probably higher.

Percent of Organizations with Less than 3 Months of Spending Available, Adjusted
(N in parenthesis)

Small (10K)	Medium (17K)	Large (22K)	X-Large (25K)
65%	55%	55%	65%

<u>Sustaining Short Run Capacity</u>

Universities, major cultural organizations, research institutes, and other well-endowed nonprofits are hard to analyze with either Form 990 or audited data because cash and investments in their endowments are not separated from cash and investments used for working capital, operating reserves, maintenance of physical facilities, sinking funds, etc. The following equation, which represents an approximation, is broken into fragments, separately labeled for clarity:

- **Expense Margin adjusted** for Investments[18]

= [line 18	= [Excess for year
+ line 42	+ Depreciation
– (line 4 + line 5 + line 7 + line 8d)	– Investment income & gains
+ 0.05 · (line 54aA + line 54bA + 55cA + line 56A)	+ Pro forma payout
– (line 68B – line 68A + line 69B – line 69A)]	– Change in restricted NA]
all divided by (line 17 – line 42)	/ (Total Expenses – Dep.)

Income used to calculate line 18 does not include unrealized capital gains but it dies include restricted funds, so it is necessary to subtract the restricted portion (Change in restricted NA above). Although it does not include net assets released from restrictions, subtracting the change in restricted net assets introduces these resources into the numerator and removes any new restricted funds.

Median Expense Margin, Adjusted

(N in parenthesis)

Small (10K)	Medium (17K)	Large (22K)	X-Large (25K)
0.5%	3.2%	5.1%	12.7%

The larger adjusted margins (especially for the largest public charities) probably reflect the effects of capital campaigns that raise substantial amounts of unrestricted net assets.

Percent of Organizations with Median Expense Margin (Adjusted) < 2.5%

(N in parenthesis)

Small (10K)	Medium (17K)	Large (22K)	X-Large (25K)
58%	48%	45%	31%

It is a good idea to average this figure over 3 years, but the complete formula is cumbersome because of a large number of terms so it will not be given here. Fortunately, spreadsheet programs make the calculation very manageable. Just substitute a 3-year sum for each term above. For example, the denominator is line 17 in year Y + line 17 in year $Y\text{-}1$ + line 17 in year $Y\text{-}2$ – line 42 in year Y – line 42 in year $Y\text{-}1$ – line 42 in year $Y\text{-}2$.

Current Financial Health

<u>Current Capacity (Liquidity)</u>

The standard metric of current capacity, or liquidity, for both for-profit businesses and nonprofit organizations is the Current Ratio = Current Assets/Current Liabilities. Current Assets are cash plus assets that can easily be converted into cash within one year.[19] Current Liabilities are obligations that an organization must pay within one year. If its Current Ratio is too low, an organization has trouble paying its bills on time. Most authorities recommend a Current Ratio > 2.0.[20]

However, this standard is more appropriate to for-profit businesses (which use it extensively) than to nonprofits because nonprofit receivables are often less liquid: (1) Many recipients of services are not able to pay, and an organization may underestimate the amount of its doubtful accounts, (2) Grants and pledges may not convert to cash soon enough to pay an organization's bills, (3) State and local governments are notoriously slow to pay their vendors, especially when they are experiencing budget problems of their own, and (4) Nonprofits that build housing for low-income families are likely to have massive inventories that are difficult to liquidate. *If an organization is beset with at least two of* *these problems*, I suggest using the Cash Ratio instead. The denominator is the same, but the numerator includes only cash and savings.

- **Cash Ratio** = (cash + savings – temporarily restricted net assets) / (accounts payable + grants payable + deferred revenue)

  = (line 45B + line 46B – line 68B) / (line 60B + line 61B + line 62B)

The Cash Ratio eliminates receivables. Consequently it needs to be only large enough to cover immediate cash needs, i.e. payables. Therefore it should be greater than 1.0. If it is greater than 5.0 the organization is likely to be foregoing investment opportunities for earning higher returns. Actual medians are generally satisfactory. The small number for the largest organizations may reflect sophisticated just-in-time cash management. This table was calculated after eliminating nonprofits with zero payables.

Median Cash Ratio

(N in parenthesis)

Small (22K)	**Medium** (26K)	**Large** (27K)	**X-Large** (24K)
2.0	2.2	1.2	0.5

Therefore a more interesting number is the percent of organizations in each size class that has a cash ratio less than the recommended 1.0.

Percent of Organizations with Cash Ratio < 1

(N in parenthesis)

Small (22K)	**Medium** (26K)	**Large** (27K)	**X-Large** (24K)
39%	37%	48%	60%

However, many nonprofits have zero current liabilities. The above table was calculated after screening out all public charities with zero current liabilities. In practice, *if the denominator is zero*, substitute the monthly average of total cash expenses thusly:

- **Cash Expense Ratio** = 12 · (cash + savings – temporarily restricted net assets) / (total expenses – depreciation)

  = 12 · (line 45B + line 46B – line 68B) / (line 17 – line 42)

A reasonable amount of cash on hand is one month's expenses. Most operating public charities have adequate liquidity. They also avoid having too much liquidity.

Median Cash Expense Ratio in Months of Expenses
(N in parenthesis)

Small (30K)	Medium (29K)	Large (29K)	X-Large (29K)
1.5	2.1	1.4	0.8

Therefore a more interesting number is the percent of organizations in each size class that has a cash expense ratio less than the recommended one month.

Percent of Organizations with Cash Expense Ratio < One Month of Expenses
(N in parenthesis)

Small (30K)	Medium (29K)	Large (29K)	X-Large (29K)
42%	38%	45%	55%

<u>Sustaining Liquidity</u>

The standard metric of current capacity (liquidity) being the current ratio suggests two ways to measure sustainability of liquidity. The first way, Accounts Receivable Turnover (or A/R Turnover), focuses on current assets in the numerator.

- **A/R Turnover** = Accounts Receivable / (Government Grants + Program Service Revenue)

  = line 47cB / (line 1d + line 2)

According to Konrad and Novak (2000, 11 – see note 19) this number should be 10% or less. A sudden increase in receivables indicates a loss of management control.

Median Accounts Receivable Turnover
(N in parenthesis)

Small (21K)	Medium (23K)	Large (24K)	X-Large (21K)
0.0%	1.5%	2.7%	5.8%

The median organization in each size class has a very satisfactory turnover rate in their receivables. However, a more interesting number is the percent of organizations in each size class that has an accounts turnover rate exceeding 10%.

Percent of Organizations with Estimated Accounts Receivable Turnover > 10%
(N in parenthesis)

Small (21K)	Medium (23K)	Large (24K)	X-Large (21K)
41%	22%	28%	35%

Another way to measure sustainability of liquidity is to focus on current liabilities in the denominator of the current ratio. Underperforming organizations have a hard time paying their bills. This is observed in a rising ratio between accounts payables and average monthly non-payroll cash expenses. A sudden increase in payables indicates a loss of management control.

- **Payables Turnover** = Accounts Payable / Non-Payroll Cash Expenses

  = line 60B / (line 44 – line 42 – sum of line 25a through 29)

Payables Turnover should not exceed 1.0. In other words, the average length of time an organization holds a bill or other payable should not exceed one month. The data base used in this paper does not have expense detail, so the following formula approximates it by assuming average monthly non-payroll cash expenses are half of total expenses.

- **Payables Turnover (Estimate)** = 2 · line 60B / (line 17 – line 42)

Median Accounts Payable Turnover (Estimated)
(N in parenthesis)

Small (22K)	Medium (23K)	Large (24K)	X-Large (25K)
0%	2.7%	5.0%	10.9%

The median organization in each size class has a satisfactory turnover rate in their payables. Even the turnover in the largest size class is not especially troublesome. This is to be expected because most organizations are not in dire straits. A more interesting figure is the proportion in each size class that do worse than the standard (i.e., > 10%).

Percent of Organizations with Estimated Accounts Payables Turnover > 10%
(N in parenthesis)

Small (22K)	Medium (23K)	Large (24K)	X-Large (25K)
25%	35%	39%	51%

Endnotes

[1] This is how Bourgeois (1981) defines organizational "slack." Organizational slack in for-profit businesses has been the object of research for decades. I rechristened it "financial capacity" in adapting it to the nonprofit sector. [Bourgeois, L. J. (1981). On the measurement of organizational slack. *Academy of Management Review* 6(1): 29-39.]

[2] This source has three advantages over audited financial statements: (1) Audited statements are based on Generally Accepted Accounting Principles (GAAP) but some nonprofits do not use GAAP. (2) Unlike financial statements, Form 990 data use standardized categories similar to a tax return. Line numbers in the formulas refer to the 2007 edition of Form 990. (3) Form 990 data are readily available on the Internet for 250,000 operating public charities, which allows benchmarking against peer organizations. However, when benchmarking, be careful not to mix organizations that use cash accounting with those that use accrual. (This information is found in box F.)

[3] Line 73 also includes fund balances for organizations that do not use SFAS 117. If audited financial statements are the source of data for this calculation, an analyst may encounter "designated" net assets. These are unrestricted net assets that a board is earmarking for some future purpose, so treat all designated net assets as unrestricted.

[4] The forward slash represents division. The numerator is left of the slash; the denominator is on the right. This is equivalent to 1 – Total Liabilities / Total Assets. If one is making comparisons with peer organizations, be aware that many nonprofits do not fill in line 73. A more robust alternative is the difference between total assets and total liabilities [line 59B – line 66B] – [line 59A – line 66A].

[5] Several screens were applied to assure comparability. All entities analyzed are 501(c)(3) operating public charities that use the long form of IRS Form 990 and use accrual accounting. They were screened to be sure total assets and total expenses are positive. Also screened out were two groups, each constituting 1% of the population: nonprofits reporting the largest deficits (over $1.75 million) and the largest surpluses (over $3.5 million) on line 18 of IRS Form 990.

[6] Therefore the equity ratio = the prior year's equity ratio + ROA.

[7] An average of two numbers is their sum divided by 2. A number is divided by a fraction is equivalent to multiplying it by the reciprocal of the fraction, which is how 2 winds up in the numerator.

[8] On Form 990 surpluses (or deficits) on line 17 do not include unrealized capital gains or losses. However subtracting beginning-of-year net assets (line 73A) from end-of-year net assets (line 73B) captures them.

[9] Unfortunately nonprofit accounting does not distinguish between contributions that support current operations and contributions that are made to a capital campaign. Long run it does not make much difference. Capital campaigns contribute to long run sustainability.

[10] For example, if *Y* is the year 2006, then year *Y-2* is the year 2004. The beginning-of-year for 2004 is the same as the end-of-year for year 2003. Thus, the above difference spans a 3-year period.

[11] Sum of lines 4, 5, 7 > 10% of line 12. This threshold is arbitrary, but below this level, it does not make much difference which formula is used to calculate Months of Spending.

[12] The dot indicates multiplication.

[13] They say working capital instead of operating reserve. According to folklore, foundations and other funding sources approve of an organization having up to 3 months of spending in reserve but I have been unable to find a citation to this effect.

[14] Total Expenses are unrestricted by definition. Thus the numerator, which includes net assets released from restrictions, and denominator are both unrestricted quantities. Months of Spending = the prior year's Months of Spending + the Expense Ratio.

[15] Traditionally Margin = Surplus / Total Revenue. I prefer dividing by Expense because it is simpler than calculating the amount of unrestricted revenue from 990 data, and (most important) it shares a common denominator with the metric for short run financial capacity. I call it Expense Margin to make clear that I am dividing by Expenses. Some authorities call it Return on Costs (ROC).

[16] Neither do they favor any particular profit margin, which is based on total revenue.

[17] This formula excludes depreciation from expenses because depreciation does not consume financial resources.

[18] Short run financial capacity has adjustments for LBE, but the short run sustainability equation does not because acquisition of LBE s not an expense under accrual accounting rules.

[19] Accounts payable (60B) and grants payable (61B) refer to bills and grants that are coming due. A/Ps are usually due within 30 days. Deferred revenue (line 62B) is cash received in advance of actually earning it, which must be returned if the organization defaults on providing the agreed services.

[20] See, for example Zietlow, John; Jo Ann Hankin, and Alan G. Seidner (2007) *Financial Management for Nonprofit Organizations*. Hoboken, NJ: Wiley, page 215. Also, Konrad, Peter and Alys Novak (2000) *Financial Management for Nonprofits: Keys to Success*. Denver: Regis University, page 113.

Appendix: Basics of Nonprofit Financial Statements

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Generally Accepted Accounting Principals require accrual basis accounting which records transactions in the period in which an economic event takes place, not when cash flows in or out; they also require audited statements include: financial position, activities, and cash flows.

Statement of Financial Position (Balance Sheet)

1. Balance sheet shows Assets, Liabilities and Net Assets at a given moment.
2. Assets are things an organization owns at a given moment.
    - Includes obligations to be paid: accounts receivables, grants receivable, pledges receivable
    - Includes payments by it in advance of a legal obligation (prepaid expenses)
    - Donors may impose
        - Restrictions limiting the use of donated assets by purpose or time period
        - Conditions that must be overcome before assets are transferred
    - Valuation:
        - Investments in marketable securities are valued at market prices
        - Other assets valued at original cost minus accumulated depreciation, which is wear and tear on physical assets since date of acquisition (land does not depreciate)
    - Current assets are cash and assets that are likely to be converted into cash within one year
3. Liabilities are whatever an organization owes at a given moment; they are debts.
    - Includes obligations to pay: accounts payable, grants payable, mortgages, bonds and notes
    - Includes payments to it in advance of a legal obligation (deferred revenue)
    - Current liabilities are due and payable within one year
4. Net Assets = Assets – Liabilities
5. Net Assets must be classified by type of restriction:
    - Permanently Restricted (PRNA): Net Assets that must be used per donor instructions, which do not expire with time or upon fulfillment of specific requirements in the gift
    - Temporarily Restricted (TRNA): Donor instructions expire with the passage of time or upon fulfillment of specific requirements in the gift
    - Unrestricted (UNA): Net Assets that the organization may do with as it wishes.
        - Unless explicitly labeled as restricted, net assets are unrestricted
        - Includes funds designated by a board for specific purposes

Statement of Activities

1. Statement of Activities shows Revenue & Public Support, Expenses, and Changes in Net Assets over a specific time period.
2. Revenue is the result of an exchange transactions occurring over a specific time period
    - Recognized (recorded and reportable) when measurable and earned
    - Cash receipts in advance of being earned are deferred revenue (they are liabilities)
3. Public support (gifts) is a non-exchange transfer occurring over a specific time period
    - Donors receive no consideration (any consideration reduces value of gift by equal amount)
    - Recognized upon the earlier of receipt or promise to give (a pledge)
    - Pledges are recognized even if donor restricts promised gift to use in a future year, even if it will not be paid until then
        - Pledges must be backed by documentation that a promise was made and received
        - Gifts for future years are reported as temporarily restricted net assets
        - When restrictions on assets are satisfied, the assets are reclassified as unrestricted
        - Pledges are recognized at fair value
        - Fulfilled pledges are not revenue (that would be double counting)
    - In-kind contributions are reported at fair value
    - Value of volunteer services can be recognized only if:
        - Services create or enhance non-financial assets, or
        - Services require specialized skills, are provided by persons possessing those skills, and would typically be purchased if volunteers were not available
4. Revenue and public support increase net assets; expenses decrease net assets
    - These transactions do not change net assets: borrowing/repayment of principal (there is an offsetting change in liability); selling/buying stock (there is an offsetting change in cash)
5. Revenue and Public Support, like net assets, are classified as unrestricted, temporarily restricted and permanently restricted; all expenses are unrestricted
    - Restricted contributions whose restrictions are met in the same reporting period as they are made may be reported as restricted or unrestricted support (must disclose and be consistent year-to-year)
6. Excess or surplus (loss or deficit) must be reported by class of restricted net assets
7. Revenues, expenses must be reported gross (investment income may be reported on net basis)
8. Capital gains/losses are unrestricted unless otherwise stipulated by law or the donor

Statement of Cash Flows

1. Statement of Cash Flows reconciles changes in net assets to changes in cash
2. May be divided into three categories:
   - Cash provided by/used in operations
   - Cash provided by/used in investing
   - Cash provided by/used in financing
3. Transactions that do not change net assets (hence are neither revenue nor expense) show up on this statement.

THE STORY OF
Christian Family Services

When the decision to close the orphanage was revealed to the staff and the public, people were frightened, wondering what it would mean for their programs and their jobs.

When the Shepherd's Orphanage opened its doors just before the Civil War, the founders could not have known that it would eventually form the core of an institution that would serve this southern town on the edge of the Mississippi for more than 150 years. The orphanage was the first program of what would evolve into Christian Family Services, formally incorporated in the early 1970s when it grew to include a range of services to parents and families. Even as it grew, though, it kept its "soul"—pursuing a mission that is explicitly grounded in scripture to support the poorest and most vulnerable in the community.

CFS is not an independent organization: it is controlled by a large church hierarchy. In the early 70s, the sponsoring church decided to expand its community services beyond the orphanage. It used its various buildings to start new programs—among these an immigrant and refugee resettlement program, followed by programs for homeless people, victims of domestic violence, and people suffering from alcohol and chemical dependency. All of these operated relatively independently until the 80s when they were brought under the umbrella of Christian Family Services. Church officials hired an executive director to oversee all of the programs, and took steps to begin consolidating services and back office operations. As with many such attempts at combining existing programs, their progress in forming as a whole was slow.

For CFS's entire 150-year history, the orphanage had been a constant—the flagship of CFS. However, in 2000, the decision was made to close it. As much as the decision itself rocked the organization's sense of identity, the way the decision was made—it came down from the church, bypassing the board—damaged any sense of security felt by those working in the still frail conglomeration of programs.

CFS had become a large, complex organization with many people working at various levels. When the decision to close the orphanage was revealed to the staff and the public, people were frightened, wondering what it would mean for their programs and their jobs. They felt a sense of failure, seeing the inability to assure the viability of the orphanage as a major challenge to

PHOTOGRAPHS (4): CITY OF VANCOUVER, PUBLIC ART PROGRAM

the mission and vision of the organization. The closing crystallized a deep-seated distrust that had been developing internally.

The fallout from the closing of the orphanage as well as other managerial and leadership concerns eventually led to the departure of the executive director. This individual had not been well known for including either community or staff in considering the agency's future, and possibly was a convenient whipping boy for an overall bad process that threatened the relationships between the church and community—and between the organization and its employees. In any case, the lesson was taken at least at face value and new leadership was installed with a stated commitment to community and staff inclusion. This new direction is comprised of two well-seasoned leaders, one with a long history in community work and the other with a long history and influence with the church hierarchy. Staff is not completely mollified; they remain somewhat disengaged and seem to be taking a wait-and-see attitude.

Indeed, they have many other things to attend to. During this crisis the agency also experienced a decrease in funding, requiring every program to tighten its belt. CFS has been determined to maintain services at their current level despite the funding cuts, but it is struggling.

More than half of its $4 million annual budget comes from local, state, or federal grants. United Way, church contributions, fees for service, and private donations together make up the remaining half of the funding mix. The agency's reliance on governmental grants worked well for a time, but recent policy changes along with increased competition and red tape have resulted in less money for more effort. Those working on the ground in the organization say that they are existing hand-to-mouth, with insufficient economic strength to do what they know is needed. Grant funding is directed to projects, but is insufficient to cover the full expense associated with those projects, and staff are too overworked to devote much time to seeking supplemental funding. Many grants come with a matching requirement, but the organization is not always able to raise the required match, and thus is not able to utilize the full amount of the associated grants.

The CFS fundraising strategy is a reflection of earlier days when each program operated independently. There is no centralized fundraising strategy or staff, leaving fundraising responsibilities on the shoulders of program directors. Program directors say that they could help with and participate in fundraising activities if there was a game plan—if someone was in place to create and manage the overall development strategy. They are even aware of opportunities for raising more money, but they do not have the time to investigate or pursue those opportunities.

Good financial management systems are always important, but with CFS's current funding situation, making the most of every dollar is essential. Talking about financial management in this organization, however, is like opening a pressure valve. Staff talks about the challenges of trying to raise matching funds and how disappointed they feel when they are unable to raise a required match. Cash flow challenges also cause the organization to pay bills late on a regular basis. Staff acknowledged that they did not understand their budgets or how to use budgeting and financial management systems to get ahead of the game. They also expressed a desire to expand their understanding of the budgeting process, and even learn what should be included in a budget. They know that they need to identify gaps and be clearer about what financial resources are required, as well as devote more time to monitoring spending.

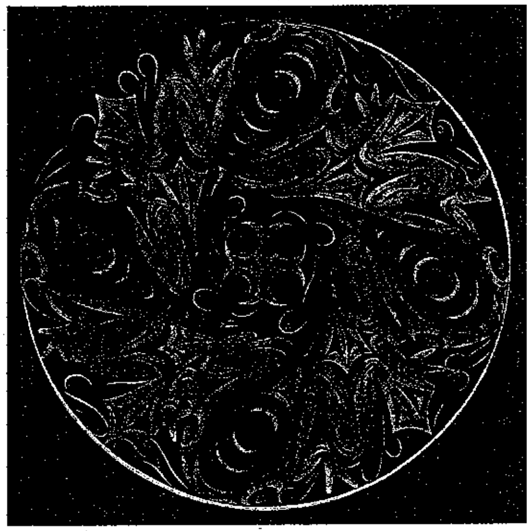
What would CFS look like if it were operating under optimal circumstances? The primary difference, say the staff, would be that people

During this crisis the agency also experienced a decrease in funding, requiring every program to tighten its belt. CFS has been determined to maintain services at their current level despite the funding cuts, but it is struggling.

CFS is a faith-based organization that has drifted from its mission over time. The organization needs to define its true source of authority, so that the group can reaffirm its mission.

would not feel like they were working with inadequate resources and substandard facilities. They would not have ceilings that are falling down, staff would be able to go to training sessions, buildings would be safe and clean, parking lots would be paved, windows would open, and there would be adequate lighting. The staff would feel good about themselves and where they work. It would be a place where people felt they could really do their best.

Evidence of low morale shows up in a variety of ways: quality of service delivery seems to be slipping, the level of complaints about work conditions is increasing, and participation in the organization's United Way campaign has been lackluster. Someone commented that the staff now seems to be focusing more on internal rules and regulations than on the clients—a major departure for an organization that prides itself on being mission directed and presenting the face of Christ to all who enter.



When asked to characterize CFS's current board of directors, one of the participating board members said "nonexistent"—an opinion shared by other staff and board members. The board had been active in the past, but had gradually "shut down" in recent years due to the information-controlling tendencies of the previous executive director, combined with clear evidence that authority rested with the sponsoring church hierarchy anyway. An advisory group convened by the church created further confusion, blurring the lines of responsibility among all involved. It was previously thought that the board's job was, at least, to advise the church on decisions. The board never had final decision-making authority—that authority rested with the responsible member of the hierarchy in the sponsoring church, who also appointed members from a slate of recommendations submitted by a nominating committee. CFS's new leadership has negotiated with the church and secured an assurance that, in the future, the board's opinion will be respected. This is predicated on the agency's ability to make the current board—comprised of seven white males—more diverse, adding youth and clients as well as "deep pockets" who could help with fundraising.

CHRISTIAN FAMILY SERVICES

REVENUES & EXPENSES

990 year	FY	Direct Support	Indirect Support	Government Grants	Program Service Rev.	Special Events	Dividends & Interest	Total Revenue	Total Expenses	Excess or Deficit
1997	1998	669,241	1,261,192	3,468,597	2,631,763	384,443	138,191	8,576,402	8,481,140	95,262
1998	1999	851,717	1,626,661	3,896,654	2,768,440	408,630	117,008	9,697,837	8,912,193	785,644
1999	2000	347,077	1,249,910	3,857,114	3,100,426	131,546	111,641	8,808,694	9,302,239	(493,545)
2000	2001	207,735	1,284,809	4,093,484	2,666,327	153,724	128,403	8,530,643	9,033,239	(502,596)
2001	2002	596,974	1,197,808	3,877,935	2,335,397	190,945	78,003	8,277,032	9,393,927	(1,116,895)
2002	2003	513,012	724,038	3,309,171	1,968,407	166,146	45,216	6,746,321	6,688,647	57,674
2003	2004	534,251	582,252	3,289,074	1,371,644	45,302	44,115	5,883,913	6,670,321	(786,408)

BALANCE SHEET (EOY ASSETS)

990 year	FY	Cash	Savings	Accounts Receivable	Pledges Receivable	Grants Receivable	Investments	LBE less Acc.Dep.*	Total Assets
1997	1998	0	357,105	581,526	0	735,291	2,149,238	6,660,384	10,506,263
1998	1999	0	1,587	988,887	0	683,644	2,350,467	6,907,475	10,961,397
1999	2000	0	0	1,062,097	0	630,158	2,331,341	6,692,698	10,756,041
2000	2001	0	0	1,155,611	97,036	738,862	2,181,949	6,366,972	10,556,450
2001	2002	148,920	0	1,181,506	70,026	561,244	1,775,819	5,568,231	9,305,746
2002	2003	537,361	0	1,152,949	0	575,639	1,633,037	5,241,184	9,141,110
2003	2004	69,282	0	825,355	0	460,573	1,665,661	5,140,123	8,164,716

BALANCE SHEET (EOY LIABILITIES & NET ASSETS)

990 year	FY	Accounts Payable	Mortgages & Notes	Total Liabilities	Unrestricted Net Assets	Temporarily Restricted Net Assets	Total Net Assets
1997	1998	574,530	2,311,566	3,407,788	5,884,402	1,214,073	7,098,475
1998	1999	484,647	2,331,038	3,076,460	6,816,260	1,068,677	7,884,937
1999	2000	444,660	2,662,511	3,406,084	6,370,159	979,798	7,349,957
2000	2001	957,125	2,581,787	3,709,089	5,891,325	956,036	6,847,361
2001	2002	972,861	2,390,976	3,476,371	4,904,065	925,310	5,829,375
2002	2003	273,390	2,787,508	3,254,062	5,048,376	838,672	5,887,048
2003	2004	460,558	2,603,518	3,064,076	4,499,643	600,997	5,100,640

**LBE less Acc. Dep. is "land, building and equipment less accumulated depreciation."*

The Story of
South Cinder Health Center

"We acted like what we were— an important institution in this community. We showed them our spine."

South Cinder Health Center (SCHC) started as a community mental health center in 1979 and is a refreshing example of an organization that has maintained a clear sense of its original spirit and purpose through the sometimes intense challenges of growth and development. This clarity does not happen by accident. Leadership of the agency, which the executive director says is spread throughout every level, should be commended for its attentiveness and care.

Although termed a community mental health center, SCHC was primarily a pass-through source of mental health dollars when it began—passing money along to other community-based organizations. Eventually, it began developing its own direct service programs and expanded quickly—without sufficient capital to support the effort. By 1984–85, SCHC had had two executive directors and had developed a debt of $400,000 to a local hospital. Obvious questions surfaced at that point about its ability to survive.

A third executive director helped to guide the organization through the crisis with a combination of strategies, including the closing of a major program and staff layoffs. The entire staff was engaged for two years in a common effort to "hold the line" on costs. The solidarity developed in this process extended beyond the survival of the organization to encompass the quality and meaning of the work, and the best interests of its often underserved and marginalized constituents.

Another indicator of the South Cinder's personality was the chutzpah it displayed in standing up to the hospital to which it was in debt. One participant said, "We acted like what we were—an important institution in this community. We showed them our spine."

The array of programs run by SCHC shows them to be an important connector for those in the community with mental health–related issues and even, in some cases, for those whose life circumstances threaten their physical and mental well-being. The diversification of its services and ability to provide mobile services were both mentioned by participants as key to meeting the needs of its consumers. The 1986 adoption of the Havens, a domestic violence program as well as that of the Starlight Services, in 1997, are examples of SCHC's inclusive understanding of its mission and its willingness to take some level of risk to fulfill it.

The adoptions of these two formerly freestanding organizations has reportedly greatly enhanced the quality and quantity of services. Back office services are provided by the parent organization, leaving Startlight Services and the Havens to focus on programs. The Havens specifically mentioned being able to expand and provide clinical services such as art therapy for children as a direct result of being a part of SCHC. These two programs, however, are also the two most financially vulnerable of all of the services provided. There appears to be a high degree of consensus throughout the organization about the

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The ability to be progressive and creative at all levels is aided by the agency's belief that "work teaches the worker." This has encouraged staff and volunteers to take responsibility for their own work, leaving the agency the opportunity for foresighted planning.

critical need for the services provided by these programs, and everyone seems very attentive to their need for greater sustainability.

This attentiveness is evidenced in a number of ways. For instance, when the organization grew in complexity, the board took the initiative to reorganize the corporate structure to provide protections and a certain amount of autonomy for some activities. Participants described this as enabling the organization to approach the mission "in a more sophisticated way"—not only for the clients, but also for the staff.

There is, on the other side of this coin, a widespread organizational commitment to creative and responsive programming. Participants in this assessment described the organization as "innovative, flexible, and creative, and they freely cited examples throughout the interview of both external and internal collaboration. Internally, this has resulted in staff being unusually well informed about each other's work. It has also led to agency-wide engagement in referral, advocacy, and fundraising activities.

The ability to be progressive and creative at all levels is aided by the agency's belief that "work teaches the worker." This has encouraged staff and volunteers to take responsibility for their own work, leaving the agency the opportunity for foresighted planning. Planning is continuous, but central planning is accomplished through a "strategic council" made up of program directors and other staff. A participant described SCHC as "always being five steps ahead." The staff and board both reported that the organization is proactive and strategic, rather than waiting for things to happen.

They described themselves as being good team workers who are very focused on making sure that the people who contact them get the right services, whether or not they fit into one of SCHC's formal programs. As one participant stated, "people understand the 'why' of what they do."

Constituents are integrated into the staff and act as volunteers, running their own programs including a "warm line" (i.e., phone service designed to solve relatively minor problems or to prevent those problems from becoming serious). The community appears appreciative of all of this good energy and comes out in force (300–350 attendees) to the organization's annual meeting.

At the time of this study, South Cinder Health Center, along with many other local service providers, had recently taken an across-the-board budget cut on state contracts. This followed cutbacks that specifically affected the domestic violence and substance abuse work, as well as 10 years of flat funding (not adjusted for inflation) for all their contracts. As one participant expressed, "funding levels are going down while demand for services is going up." To address revenue concerns at this important level, the organization is active with the legislature—motivating staff, board members, consumers, and other volunteers, and literally sending "vanloads of people" to testify and lobby. In addition, a consumer advocacy group associated with the organization is "deeply" active among the state associations that have crafted legislative strategies. Despite this, larger economic and political forces resulted in the afore mentioned cutbacks, and SCHC anticipated that more would follow over the next few years.

SCHC is active in foundation grant seeking, but recognizes that this money must be used strategically with an eye to the fact that these investments are generally small and short term. Local foundations evidently are well disposed to the organization. Participants noted that "quality services" garnered the respect of both the funders and constituents. In addition to talking about respect for clients and constituents, staff also mentioned reporting to funders in a timely way as a very basic way of evidencing respect.

SCHC is also in a good position for attracting individual donors. It now runs several annual fundraising campaigns that bring in more than $100,000, and has instituted a larger donor campaign through its "leaves of hope" program, aimed at increasing the organization's endowment. At the time of this study, staff were beginning to use a computerized donor base to track donors systematically, with the intention of upgrading them. Members of the board also actively solicit donors. There was general agreement that the individual donor work could be expanded.

The group also runs "Macie's," a very successful thrift store that brought in $160,000 during the year previous to this study, which went to support the under-resourced Havens program. Macie's was expected to net $180,000 the following year, and SCHC was considering the development of a satellite store.

At the time of the study, there were 108 staff (including a few per diem) at South Cinder

It downsized when it was appropriate and knew how to consolidate its administrative functions, leading to more resources and services directed to the most vulnerable programs.

Health Center, which has all of its basics in place. Its personnel policies are continually updated and available on computer, and are also handed to people upon hiring. Supervision is done regularly—although some programs and departments are more frequent than others, all supervision is reportedly performed at least monthly. Participants noted that supervisory expectations were not documented, but were "understood." Management evaluates staff annually and all at once for budgetary purposes. The executive director looks at all of the evaluations to inform her own understanding of the potential for growth. Staff also evaluate supervisors, with the comments being collated and given to the supervisors by the human resources department.

Benefits were reported to be excellent, with three weeks of vacation upon hire, comprehensive medical and dental coverage, tuition reimbursement, pension, and many other hallmarks of a strong benefits program. Staff expressed concern about the heavy increases in health insurance premiums, however—and their potential for eating up any possibility for salary increases.

Participants in this assessment felt the need for greater staff diversity to better reflect the demographics and meet the needs of constituents, particularly where bilingual and multilingual staff are concerned. While acknowledging the progress made to date, they agreed that there remained work to be done in this area and formed a committee to address diversity issues.

SCHC already makes good use of volunteers throughout the agency, but its practices are uneven. Large numbers of people are involved with this organization—a central resource for volunteer management in the agency may significantly augment both program capacity and resource generation. SCHC has a complex governance structure that appears to be working fairly well. At the time of the assessment, the most widespread group involved in governance was the 270 corporators. Corporators are required to come to the annual meeting. They are reviewed every year by the board of directors and constitute the pool from which the board is drawn. At the time of this study, there were 44 people involved on the four formal boards that oversaw the three interconnected subsidiary structures. The main board (South Cinder Health Center, Inc.) had 24 members and overlaps with each of the others: South Cinder Foundation, Inc., Healthwork, Inc., and South Cinder Mental Health, Inc. The overlapping, which is mandated, causes some difficulties in attendance since it makes multiple demands on the same individuals but, still, there is generally not a problem reaching a quorum.

Staff members voice a lot of respect for the board. They are grateful for the board's attention to matters having to do with the organization's long-term fiscal stability and laud the board both for its healthy and respectful partnership with the executive director and for its activism. In fact, the partnership extends even further—the board has a yearly retreat with the strategy council to do whole-agency planning. Other committees of the board also integrate board and staff members, as do hands-on activities including fundraising and whole-agency events like the annual meeting.

There are no consumers on the board, but there are family members of consumers. Participants expressed concern that if the board were to include consumers that careful preparation would need to be done to ensure all board members were on equal footing.

SCHC has its own MIS director, who appears very capable and tuned in to the needs of the agency. Many of the organization's best-laid plans in this area, however, have been waylaid by practical concerns both about hardware and software. At the time of this study, the organization needed 20 additional computers—not all staff had a computer, which made intra-organizational communication difficult. It was recognized that software to facilitate the complex infrastructure of the agency would be a big expense, but would make an enormous difference in the speed and congruity with which staff could move work along. For instance, the agency estimated that it would need $25,000 to upgrade the billing software—a priority in an organization as sophisticated as this one. SCHC had a budget of $6.5 million at the time of the study. Four staff members were dedicated exclusively to the accounting function of this agency—the CFO, an accounting supervisor, a bookkeeper, and an administrative assistant. The billing is separate, with an additional senior staff member and administrative assistant specifically assigned to billing (although at the time of this study much of the billing that could be done by computer was done by hand). The process of developing and managing program budgets is shared throughout the agency. Program directors are very involved in budgeting and, in turn, involve program staff. In general, participants said, program staff are "attuned to their budgets," which makes them very aware of where funding gaps may exist. Budget cuts have heightened staff's interest in their budgets and the budget for the whole agency. The CEO only reviews financial requests that are non-budgeted items.

Each program within SCHC did its own quality assurance at the time of this study (such as meeting DMH or DMR expectations or tracking outcome measurements). However, with the exception of Starlight Services, quality assurance was not tied into an overall evaluation or quality assurance for the organization as a whole, nor did it necessarily drive program development.

Participants noted that there had been dialogue about conducting satisfaction surveys across SCHC's programs, as well as integrating a quality assurance system for the organization as a whole. Participants identified insufficient MIS capacity as the major barrier to this endeavor.

SCHC is highly unusual in that it functions comprehensively as a "learning organization," even though it does not call itself that. The organization has strong leadership with decentralized decision-making authority throughout. The staff, board, volunteers, and consumers all appear to be united and enthusiastic about their work toward a common vision.

Although it came away from its early crises with a commitment to solidarity, and has become a learning organization, it could evolve into a collection of programs with no core—mental health over here, domestic violence and substance abuse treatment over there, with a warm line and thrift store in between.

SOUTH CINDER HEALTH CENTER											
REVENUES & EXPENSES											
990 year	FY	Direct Support	Indirect Support	Government Grants	Program Service Rev.	Special Events (net)	Memberships	Inventory Sales (net)	Total Revenue	Total Expenses	Excess or Deficit
1997	1998	29,610	21,004	229,061	1,045,115	0	0	209,157	1,630,343	1,383,886	246,457
1998	1999	25,638	21,747	145,709	1,198,186	0	0	257,109	1,654,417	1,607,053	47,364
1999	2000	36,966	1900	158,510	1,122,096	0	0	304,250	1,680,445	1,707,223	(26,778)
2000	2001	23,565	500	200,294	1,232,480	0	0	334,868	1,871,469	1,855,854	15,615
2001	2002	15,960	500	241,027	1,208,014	0	0	359,922	1,893,075	1,869,994	23,081
2002	2003	41,534	0	225,101	1,369,287	0	0	367,972	2,093,796	2,072,353	21,443
2003	2004	24,346	17,026	7,458	1,413,395	0	0	362,722	1,911,839	1,912,146	(307)
BALANCE SHEET (EOY ASSETS)											
990 year	FY	Cash	Savings	Accounts Receivable	Pledges Receivable	Grants Receivable	Investments	LBE less Acc.Dep.*	Total Assets		
1997	1998	29,134	42,209	10,190	0	0	0	2,167,434	2,435,900		
1998	1999	13,205	53,490	5,325	0	0	0	2,295,716	2,404,619		
1999	2000	4,245	65,249	4,214	0	33,859	0	2,198,489	2,345,695		
2000	2001	27,759	76,651	1,535	0	115,947	0	2,147,867	2,413,420		
2001	2002	18,189	85,063	7,539	0	2,505	0	2,101,983	2,279,539		
2002	2003	31,688	110,826	4,377	0	79,747	0	2,041,387	2,297,203		
2003	2004	55,676	54,241	1,101	0	0	0	1,984,869	2,130,235		
BALANCE SHEET (EOY LIABILITIES & NET ASSETS)											
990 year	FY	Accounts Payable	Deferred Revenue	Mortgages & Notes	Total Liabilities	Unrestricted Net Assets	Temporarily Restricted Net Assets	Total Net Assets			
1997	1998	170,127	42,113	781,613	1,129,090	1,281,800	25,010	1,306,810			
1998	1999	207,238	42,113	742,037	1,053,548	1,345,071	6,000	1,351,071			
1999	2000	258,405	50,817	589,152	898,374	1,439,621	7,700	1,447,321			
2000	2001	273,653	62,557	528,382	948,543	1,459,077	5,800	1,464,877			
2001	2002	260,644	49,004	476,726	786,374	1,485,044	8,121	1,493,165			
2002	2003	259,940	15,961	425,677	780,856	1,502,014	14,333	1,516,347			
2003	2004	237,759	0	369,739	614,195	1,499,215	16,825	1,516,040			
**LBE less Acc. Dep. is "land, building and equipment less accumulated depreciation."*											

Woods Bowman 3-13-06

THE STORY OF The National Museum of Craftsmanship

The museum . . . is tackling the common issues that emerge in an organization when the person who has been instrumental in shaping an institution is no longer at the helm.

THE NATIONAL MUSEUM OF CRAFTSMANSHIP is both unique and typical. Its uniqueness is what makes it especially memorable—its beautiful location along the bay in a welcoming old building; the unusual combination of being grounded in the local arts scene while serving a national and international constituency; its wonderful workshops and soon-to-be library; and its dedicated staff, supporters, and attendant four-legged friends.

The museum is typical in that it is confronting the characteristic challenges a nonprofit organization faces as it moves from one chapter in its story to the next. It is preparing for the 2007 departure of its founding executive director after 30 years under his visionary leadership.

A Rich History

The museum was founded in 1975 with a $10,000 grant from a local funder. The essence of its mission—to preserve, collect, and educate while extolling the virtues of various types of craftsmanship—has remained essentially unchanged over the past 30 years. In addition to showcasing fine examples of craftsmanship, the museum has expanded its mission to include a dual focus of educating both craftspeople and the public by offering classes and serving as a place where those with an interest in handmade works can congregate and teach one another.

The museum began with the current executive director and one intern. Today, it employs 13 full-time staff members and operates four galleries and a full production shop. A library is on the drawing board, slated to open in 2007. The library is seen as the final component needed for the museum to fully carry out its mission.

Artistic quality permeates this institution. Over the years, the museum has initiated a number of public events that have put it on the national and international map. These included "Share Your Craft" days, during which well-known artisans from all over the country would share their art and techniques with museum visitors. The museum has since hosted many volunteers, some of whom have been with the organization for nearly 20 years.

A large tenth anniversary celebration where two new galleries were formally opened to the public boosted the prestige of the museum in the mid-80s. However, the expansion led to a budget deficit. This deficit was relieved when a $20,000 grant "fell from the sky," providing a much-needed breather and a period of stability for the museum, which added to its credibility.

The museum began much like other nonprofits—with barely enough money to get started. The commitment and passion of the founder and his wife filled in the gaps. Over time, however, the museum developed the capacity to raise sufficient money to keep the doors open, expand services, and even have enough of a surplus to contribute to an endowment. The organization's funding mix has remained rather steady, with a third of its funding coming from

ILLUSTRATION © STEFANO VITALE

The absence of a written plan as an organizational roadmap is not seen as a major handicap. The plan that is most important to the museum staff is the plan that is in their heads—the vision for the museum.

the local arts council, a third from contributions, and a third from earned income.

Fundraising, however, is an area that is causing a good deal of concern. Staff is very conscious about balancing income and expenses, and sees income as remaining relatively stable while expenses are increasing—in many cases, in areas where they feel they have little or no control. There is concern about the capital campaign for the library taking money away from operations, the museum's dependency on several larger donors, and what will happen when the executive director leaves. The perception is that the museum is becoming less financially stable, and that if cash flow trends continue, the museum won't be in a healthy financial situation within five or six years.

The board has not been engaged in financial management or fundraising in a significant way. Generally, fundraising has fallen to the executive director, with his passion and vision for the museum as the main selling point. Sophisticated computerized databases and donor management approaches have not been part of the museum's strategy. The museum also does not have a plan for fundraising, and the staff says they do not have the expertise to develop one.

The board of directors is characterized by the staff as a group of good people who are inactive and somewhat out of touch with the real needs associated with running the museum. The board is comprised of people from the local community and elsewhere, with local people drawn to fill areas of expertise needed for running a nonprofit organization (accountants and lawyers) and non-local people selected because of their standing or expertise in the arts arena. The board meets four times a year. The agenda is prepared by the staff, and a packet of materials is distributed prior to the meeting. Few board members prepare for the meeting by reading the materials that they receive. Some, but not all, board members contribute to the museum. Board training has not been a priority.

One staff member said that the problem with the board is that they all love the executive director and do whatever he says. There is a general feeling that although the board is in place and functioning, it is overly complacent.

The organization relies heavily on its well regarded staff. The museum is a haven for people who are energized by a leader with a vision and who are good at finding their place within that vision and working independently. Staff members set and meet their own deadlines, follow through on their promises, and are good at solving their own problems, but also understand that their actions affect others—that they are part of a system. Honesty and integrity are highly valued. The museum experiences very little turnover and staff is very stable.

In an environment where independence and initiative are valued and rewarded, it is not surprising to find that there is no formal strategic plan. The museum's most recent plan is now out of date, but the absence of a written plan as an organizational roadmap is not seen as a major handicap. The plan that is most important to the museum staff is the plan that is in their heads—the vision for the museum. The museum has found that being opportunistic has worked for them, and has rarely if ever relied on more formal planning processes for direction.

This does not mean that the museum disregards the need for careful planning. A written plan has formed the basis for the museum's work on developing a library—the current "next thing"—with the plan spelling out the vision for the library and the steps needed to move the vision to reality. With the clarity of the current vision—a vision that has been shaped and eloquently articulated by the museum's executive director—a strategic plan has felt like more of a hindrance than a help.

The Future

Conversations with the museum's staff about the future and the major transitions that await the organization are not marked by anxiety. Perhaps the concern isn't there yet because the founder is still "managing the transition," and the reality of his leaving is only beginning to be imagined. If one were to tour the museum and talk with the staff about its combination of the unique and the typical, the sights, sounds, and smells of craftsmen and women creating works of art would come to mind. How much of the art of this museum is shared creation and passion for a strain of practice, and how much is individual inspiration and vision? This is a challenge the organization must soon face.

National Museum of Craftsmanship

REVENUES & EXPENSES										
		Direct	Indirect	Government	Program		Dividends	Total	Total	Excess or
990 year	FY	Support	Support	Grants	Services	Memberships	& Interest	Revenue	Expenses	Deficit
2004	2005	402,467	0	0	74,360	43,963	18,415	599,632	565,429	34,203
2003	2004	585,134	0	50,000	117,796	37,341	16,653	859,272	582,721	276,551
2002	2003	453,571	0	9,443	96,333	28,979	3,341	657,621	528,414	129,207
2001	2002	361,220	0	2,800	104,181	31,067	14,262	615,307	417,360	197,947
2000	2001	181,573	0	8,250	91,192	33,206	12,926	400,801	421,973	(21,172)
1999	2000	213,272	0	25,560	91,634	29,721	0	471,091	399,659	71,432
1998	1999	171,197	0	16,000	72,147	31,566	0	398,251	391,579	6,672
BALANCE SHEET (EOY ASSETS)										
				Accounts	Pledges	Grants		LBE less	Total	
990 year	FY	Cash	Savings	Receivable	Receivable	Receivable	Investments	Acc.Dep.	Assets	
2004	2005	55,616	34,238	0	0	146,802	0	143,510	2,200,587	
2003	2004	81,655	33,684	1,022	0	97,993	0	68,044	2,146,566	
2002	2003	56,356	43,694	6,275	38,935	0	0	80,331	1,826,002	
2001	2002	54,116	60,295	22,100	4,000	0	0	90,402	1,644,999	
2000	2001	52,398	69,152	4,945	5,000	2,000	0	94,326	1,467,680	
1999	2000	78,965	69,685	7,585	0	0	0	100,363	1,420,089	
1,998	1,999	58,889	26,436	0	0	83,000	0	111,512	1,292,884	
BALANCE SHEET (EOY LIABILITIES)										
		Accounts	Deferred	Tax-Exempt	Mortgages	Total				
990 year	FY	Payable	Revenue	Bonds	& Notes	Liabilities				
2004	2005	15,079	0	0	0	16,273				
2003	2004	2,954	0	0	0	3,257				
2002	2003	1,806	0	0	0	8,133				
2001	2002	14,790	0	0	0	22,386				
2000	2001	25,489	0	0	0	28,589				
1999	2000	13,281	0	0	0	15,981				
1998	1999	4,347	0	0	5,000	9,531				
BALANCE SHEET (NET ASSETS)										
990 year	FY	URNA	TRNA	PRNA	Total NA					
2004	2005	1,478,626	705,688	0	2,184,314					
2003	2004	1,472,233	671,076	0	2,143,309					
2002	2003	1,349,743	468,126	0	1,817,869					
2001	2002	1,272,897	349,716	0	1,622,613					
2000	2001	1,270,654	168,437	0	1,439,091					
1999	2000	1,287,876	116,232	0	1,404,108					
1998	1999	1,187,679	95,674	0	1,283,353					

Form **990**

Department of the Treasury
Internal Revenue Service

Return of Organization Exempt From Income Tax

Under section 501(c), 527, or 4947(a)(1) of the Internal Revenue Code (except black lung benefit trust or private foundation)

▶ The organization may have to use a copy of this return to satisfy state reporting requirements.

OMB No. 1545-0047

2007

Open to Public Inspection

A For the 2007 calendar year, or tax year beginning , 2007, and ending , 20

B Check if applicable:	Please use IRS label or print or type. See Specific Instructions.	C Name of organization		D Employer identification number
☐ Address change		Number and street (or P.O. box if mail is not delivered to street address)	Room/suite	E Telephone number ( )
☐ Name change				
☐ Initial return		City or town, state or country, and ZIP + 4		F Accounting method: ☐ Cash ☐ Accrual ☐ Other (specify) ▶
☐ Termination				
☐ Amended return				
☐ Application pending				

• **Section 501(c)(3) organizations and 4947(a)(1) nonexempt charitable trusts must attach a completed Schedule A (Form 990 or 990-EZ).**

H and I are not applicable to section 527 organizations.

H(a) Is this a group return for affiliates? ☐ Yes ☐ No

H(b) If "Yes," enter number of affiliates ▶

H(c) Are all affiliates included? ☐ Yes ☐ No (If "No," attach a list. See instructions.)

H(d) Is this a separate return filed by an organization covered by a group ruling? ☐ Yes ☐ No

I Group Exemption Number ▶

M Check ▶ ☐ if the organization is **not** required to attach Sch. B (Form 990, 990-EZ, or 990-PF).

G Website: ▶

J Organization type (check only one) ▶ ☐ 501(c) ( ) ◀ (insert no.) ☐ 4947(a)(1) or ☐ 527

K Check here ▶ ☐ if the organization is not a 509(a)(3) supporting organization **and** its gross receipts are normally **not** more than $25,000. A return is not required, but if the organization chooses to file a return, be sure to file a complete return.

L Gross receipts: Add lines 6b, 8b, 9b, and 10b to line 12 ▶

Part I Revenue, Expenses, and Changes in Net Assets or Fund Balances *(See the instructions.)*

Revenue	1	Contributions, gifts, grants, and similar amounts received:				
	a	Contributions to donor advised funds	1a			
	b	Direct public support (not included on line 1a)	1b			
	c	Indirect public support (not included on line 1a)	1c			
	d	Government contributions (grants) (not included on line 1a)	1d			
	e	**Total** (add lines 1a through 1d) (cash $ noncash $)			1e	
	2	Program service revenue including government fees and contracts (from Part VII, line 93)			2	
	3	Membership dues and assessments			3	
	4	Interest on savings and temporary cash investments			4	
	5	Dividends and interest from securities			5	
	6a	Gross rents	6a			
	b	Less: rental expenses	6b			
	c	Net rental income or (loss). Subtract line 6b from line 6a			6c	
	7	Other investment income (describe ▶)			7	
			(A) Securities	(B) Other		
	8a	Gross amount from sales of assets other than inventory	8a			
	b	Less: cost or other basis and sales expenses	8b			
	c	Gain or (loss) (attach schedule)	8c			
	d	Net gain or (loss). Combine line 8c, columns (A) and (B)			8d	
	9	Special events and activities (attach schedule). If any amount is from **gaming,** check here ▶ ☐				
	a	Gross revenue (not including $ of contributions reported on line 1b)	9a			
	b	Less: direct expenses other than fundraising expenses	9b			
	c	Net income or (loss) from special events. Subtract line 9b from line 9a			9c	
	10a	Gross sales of inventory, less returns and allowances	10a			
	b	Less: cost of goods sold	10b			
	c	Gross profit or (loss) from sales of inventory (attach schedule). Subtract line 10b from line 10a			10c	
	11	Other revenue (from Part VII, line 103)			11	
	12	**Total revenue.** Add lines 1e, 2, 3, 4, 5, 6c, 7, 8d, 9c, 10c, and 11			12	
Expenses	13	Program services (from line 44, column (B))			13	
	14	Management and general (from line 44, column (C))			14	
	15	Fundraising (from line 44, column (D))			15	
	16	Payments to affiliates (attach schedule)			16	
	17	**Total expenses.** Add lines 16 and 44, column (A)			17	
Net Assets	18	Excess or (deficit) for the year. Subtract line 17 from line 12			18	
	19	Net assets or fund balances at beginning of year (from line 73, column (A))			19	
	20	Other changes in net assets or fund balances (attach explanation)			20	
	21	Net assets or fund balances at end of year. Combine lines 18, 19, and 20			21	

Part II **Statement of Functional Expenses** All organizations must complete column (A). Columns (B), (C), and (D) are required for section 501(c)(3) and (4) organizations and section 4947(a)(1) nonexempt charitable trusts but optional for others. *(See the instructions.)*

Do not include amounts reported on line 6b, 8b, 9b, 10b, or 16 of Part I.		**(A) Total**	**(B)** Program services	**(C)** Management and general	**(D)** Fundraising
22a Grants paid from donor advised funds (attach schedule) (cash $ ______ noncash $ ______) If this amount includes foreign grants, check here ▶ ☐	**22a**				
22b Other grants and allocations (attach schedule) (cash $ ______ noncash $ ______) If this amount includes foreign grants, check here ▶ ☐	**22b**				
23 Specific assistance to individuals (attach schedule)	**23**				
24 Benefits paid to or for members (attach schedule)	**24**				
25a Compensation of current officers, directors, key employees, etc. listed in Part V-A	**25a**				
b Compensation of former officers, directors, key employees, etc. listed in Part V-B	**25b**				
c Compensation and other distributions, not included above, to disqualified persons (as defined under section 4958(f)(1)) and persons described in section 4958(c)(3)(B)	**25c**				
26 Salaries and wages of employees not included on lines 25a, b, and c	**26**				
27 Pension plan contributions not included on lines 25a, b, and c	**27**				
28 Employee benefits not included on lines 25a – 27	**28**				
29 Payroll taxes	**29**				
30 Professional fundraising fees	**30**				
31 Accounting fees	**31**				
32 Legal fees	**32**				
33 Supplies	**33**				
34 Telephone	**34**				
35 Postage and shipping	**35**				
36 Occupancy	**36**				
37 Equipment rental and maintenance	**37**				
38 Printing and publications	**38**				
39 Travel	**39**				
40 Conferences, conventions, and meetings	**40**				
41 Interest	**41**				
42 Depreciation, depletion, etc. (attach schedule)	**42**				
43 Other expenses not covered above (itemize):					
a	**43a**				
b	**43b**				
c	**43c**				
d	**43d**				
e	**43e**				
f	**43f**				
g	**43g**				
44 **Total functional expenses.** Add lines 22a through 43g. (Organizations completing columns (B)–(D), carry these totals to lines 13–15)	**44**				

Joint Costs. Check ▶ ☐ if you are following SOP 98-2.

Are any joint costs from a combined educational campaign and fundraising solicitation reported in **(B)** Program services? ▶ ☐ **Yes** ☐ **No**

If "Yes," enter **(i)** the aggregate amount of these joint costs $ ______; **(ii)** the amount allocated to Program services $ ______; **(iii)** the amount allocated to Management and general $ ______; and **(iv)** the amount allocated to Fundraising $ ______

Part IV **Balance Sheets** *(See the instructions.)*

	Note: *Where required, attached schedules and amounts within the description column should be for end-of-year amounts only.*			**(A)** Beginning of year		**(B)** End of year
Assets	**45** Cash—non-interest-bearing				45	
	46 Savings and temporary cash investments				46	
	47a Accounts receivable	47a				
	b Less: allowance for doubtful accounts	47b			47c	
	48a Pledges receivable	48a				
	b Less: allowance for doubtful accounts	48b			48c	
	49 Grants receivable				49	
	50a Receivables from current and former officers, directors, trustees, and key employees (attach schedule)				50a	
	b Receivables from other disqualified persons (as defined under section 4958(f)(1)) and persons described in section 4958(c)(3)(B) (attach schedule)				50b	
	51a Other notes and loans receivable (attach schedule)	51a				
	b Less: allowance for doubtful accounts	51b			51c	
	52 Inventories for sale or use				52	
	53 Prepaid expenses and deferred charges				53	
	54a Investments—publicly-traded securities ▶ ☐ Cost ☐ FMV				54a	
	b Investments—other securities (attach schedule) ▶ ☐ Cost ☐ FMV				54b	
	55a Investments—land, buildings, and equipment: basis	55a				
	b Less: accumulated depreciation (attach schedule)	55b			55c	
	56 Investments—other (attach schedule)				56	
	57a Land, buildings, and equipment: basis	57a				
	b Less: accumulated depreciation (attach schedule)	57b			57c	
	58 Other assets, including program-related investments (describe ▶)				58	
	59 **Total assets** (must equal line 74). Add lines 45 through 58				59	
Liabilities	**60** Accounts payable and accrued expenses				60	
	61 Grants payable				61	
	62 Deferred revenue				62	
	63 Loans from officers, directors, trustees, and key employees (attach schedule)				63	
	64a Tax-exempt bond liabilities (attach schedule)				64a	
	b Mortgages and other notes payable (attach schedule)				64b	
	65 Other liabilities (describe ▶)				65	
	66 **Total liabilities.** Add lines 60 through 65				66	
Net Assets or Fund Balances	**Organizations that follow SFAS 117, check here ▶** ☐ and complete lines 67 through 69 and lines 73 and 74.					
	67 Unrestricted				67	
	68 Temporarily restricted				68	
	69 Permanently restricted				69	
	Organizations that do not follow SFAS 117, check here ▶ ☐ and complete lines 70 through 74.					
	70 Capital stock, trust principal, or current funds				70	
	71 Paid-in or capital surplus, or land, building, and equipment fund				71	
	72 Retained earnings, endowment, accumulated income, or other funds				72	
	73 **Total net assets or fund balances.** Add lines 67 through 69 **or** lines 70 through 72. (Column (A) **must** equal line 19 and column (B) **must** equal line 21)				73	
	74 **Total liabilities and net assets/fund balances.** Add lines 66 and 73				74	