FOUR SIGNS YOUR NONPROFIT IS IN FINANCIAL DANGER

Signs of financial distress in a not-for-profit can be subtle. But board members have a responsibility to recognize them and do everything in their power to avert potential disaster. Pay particular attention to:

1. BUDGET BELLWETHERS Confirm that proposed budgets are in line with strategies already developed and approved. Once your board has signed off on the budget, monitor it for unexplained variances.

Some variances are to be expected, but staff must provide reasonable explanations — such as funding changes or macroeconomic factors — for significant discrepancies. Where necessary, direct management to mitigate negative variances by, for example, implementing cost-saving measures.

Also make sure management isn't overspending in one program and funding it by another, dipping into operational reserves, raiding an endowment or engaging in unplanned borrowing. Such moves might mark the beginning of a financially unsustainable cycle.

2. FINANCIAL STATEMENT FLAWS Untimely, inconsistent financial statements or statements that aren't prepared using U.S. Generally Accepted Accounting Principles (GAAP) can lead to poor decision-making and undermine your nonprofit's reputation. They also can make it difficult to obtain funding or financing if deemed necessary.

Insist on professionally prepared statements as well as annual audits. Members of your audit committee should communicate directly with auditors before and during the process, and all board members should have the opportunity to review and question the audit report.

Require management to provide your board with financial statements within 30 days of the close of a period. Late or inconsistent financials could signal understaffing, poor internal controls, an indifference to proper accounting practices or efforts to conceal.

3. DONOR DOUBTS If you start hearing from long-standing supporters that they're losing confidence in your organization's finances, investigate. Ask supporters what they're seeing or hearing that prompts their concerns. Also note when development staff hits up major donors outside of the usual fundraising cycle. These contacts could mean the organization is scrambling for cash.

4. EXCESSIVE EXECUTIVE POWER Even if you have complete faith in your nonprofit's executive director, don't cede too many responsibilities to him or her. Step in if this executive tries to:

- Choose a new auditor,
- Add board members,
- Ignore expense limits, or
- Make strategic decisions without board input and guidance.

PROCEED WITH CAUTION The mere existence of a financial warning sign doesn't necessarily merit a dramatic response from your nonprofit's board. Some problems are correctable by, for example, outsourcing accounting functions if the staff is overworked. But multiple or chronic issues could call for significant changes. Contact us for advice.