NONPROFIT

Are Charities Teetering on the Financial Brink?

03.08.18 | Linda J. Rosenthal, JD

"*The sky is falling!*" – Chicken Little

Thursday (1/31/18): According to a new report, the "nonprofit sector as a whole is fragile and profoundly undercapitalized." Chicken Little is spotted running for cover.
Friday (2/1/18): "*The Nonprofit Financial Sky is Not Falling."*

Report on Financial Condition of Nonprofits

In late January 2018, GuideStar, the influential 501(c)(3) that collects and publishes data of the nonprofit sector, released a study: *The Financial Health of the United States Nonprofit Sector: Facts and Observations* ("*The Financial Health*").
The GuideStar publication first notes that nonprofits are a key part of the American economy accounting for more than 5% of GDP and 10% of the workforce. It then includes reports on, and data analyses of, the financial condition of some 219,000 nonprofits for fiscal years 2010 through 2014. The information comes from GuideStar's archive of digitized IRS Form 990s, leaving out data from nonprofits, like churches, that are excluded from the 990 filing requirement, as well as from groups with less than $200,000 in revenue or less than $500,000 in assets.
Collaborating on the study were Oliver Wyman, a leading management consulting firm, and SeaChange Capital Partners, an investment bank that specializes in nonprofits.
Jumping right on this story on Thursday, January 31, 2018, were *The Nonprofit Times* (*Study: Most Charities Teetering On Financial Peril* and (in a password-access-limited article) *The Chronicle of Philanthropy* (*Half of US Nonprofits are on Financial Brink.*

Serious Financial Peril?

According to *The Nonprofit Times*' article on *The Financial Health ,* fifty percent of the nonprofits in the GuideStar report have "cash reserves of less than a month and almost a third lost money over three years. More than one in 12 are technically insolvent" and "the first line of the [*The Financial Health*] report itself is '[h]alf of US nonprofits at risk financially.'"

The Nonprofit Times summarizes *The Financial Health's* key findings on the nation's nonprofits:

- 7-8% are technically insolvent, with liabilities exceeding assets
- 30% face potential liquidity issues, with minimal cash reserves and/or short-term assets less than short-term liabilities
- 30% have lost money over the last three years
- Approximately 50% have less than one month of operating reserves

Quoting John MacIntosh, a partner at SeaChange who is an author of the GuideStar report: "[t]he scale of the problem is vast. Just restoring current insolvent nonprofits to solvency would require an injection of $40 to $50 billion."

The Nonprofit Times article continues with brief summaries of data from *The Financial Health* about various categories of nonprofits including:

- "The ⅔ of nonprofits that have operating budgets under $1 million
- The 2% of nonprofits that have budgets over $50 million, and account for 80% of total spending of the sector (including hospitals, health and human services and educational institutions that comprise over 50% of that 2%, and 80% of $2.4 trillion in expenses, and that receive most funding from government contracts and fee-based services)
- Religious groups, and environment and animal-related nonprofits that are predominantly funded by philanthropy and have less debt and larger reserves"

Then there is a decidedly odd paragraph:

> *This simple analysis should remind trustees, funders and policy makers that it makes little sense to assess the financial health of any given nonprofit relative to the sector as a whole; it is too broad a landscape, encompassing too many different funding models,' according to the report. Analysis is more appropriate when done by size and subsector as large hospitals and educational institutions can dominate any sector-wide analysis.*

Simple analysis?

Next, *The Nonprofit Times* tells us that "[a]fter setting the stage with its findings, the 30-page report goes on to suggest what trustees, funders, regulators, and policy-makers can do to address financial health" [including compiling] a "'risk management statement' [and trading] 'short-term programmatic impact for long-term sustainability.'" But – apparently – "… even the best risk management strategy does not guarantee survival. Consolidation, mergers and acquisitions, divestments, and orderly wind-downs are part of a healthy, evolving nonprofit sector."

The reader is left with the vague feeling that it may be prudent to search for Chicken Little and hide out with him, albeit with a general uneasiness about exactly why.

Pervasive Financial Peril?: Maybe Not

Happily, the day after the Nonprofit Times headline blared the scary message that most charities are teetering on financial catastrophe, there was a rebuttal in The Nonprofit Quarterly. A nonprofit expert on the faculty of Hamline University, Jeannie Fox urged Chicken Little to chill and continue on with his lovely walk in the woods.

In *Let's Rewrite Today's Headline: The Nonprofit Financial Sky is Not Falling*, Professor Fox homed in right out of the gate on one of the scourges of the 24/7 news cycle: headlines – (often, we note, written by editors who don't write the actual articles) – that exaggerate and mischaracterize facts and conclusions in the news article itself or in the underlying source material.

> *'Half of US nonprofits at risk financially,' reads the introduction to a new, quite useful report. But one media headline reads "Half of US Nonprofits are on Financial Brink," while another frets, "Most Charities Teetering on the Brink of Financial Peril." The unfortunate practice of writing sensationalist headlines is once again visiting our sector, as this new report looks at the financial risk factors for nonprofits. The thing is, the sky is not falling…*

As to *The Financial Health*, she has some positive comments as well as criticisms.

The key data "sounds fairly accurate to us," she writes, "but are these alarming facts, or a tough status quo that dedicated boards and leaders have addressed over many decades in pursuit of our missions?"

Professor Fox points out that the business sector is not all that different; it has an "alarming" failure rate (about 50%) too. Tech startups fail at the rate of 90%.

She observes, also, that "Oliver Wyman's own numbers demonstrate that the majority of nonprofit organizations overwhelmingly operate in the black and are, indeed, thriving." She suggests a rewrite of the bottom-line data conclusions in a more positive, glass-half-full, light:

- "92–93% of organizations have assets exceeding liabilities
- 70% face no liquidity issues
- 70% have not lost any money over the last three years

- Around 50% have operating reserves in excess of one month's activity"

She also takes aim at certain "odd" recommendations. First is the advice "to put government-funded services back into government and not the private nonprofit sector"; this is "peculiar," she notes, coming from Oliver Wyman, a "pro-business consulting firm."

A second recommendation is that "those same services be transferred to for-profit entities" because "[i]f even the best governed, most efficient nonprofits cannot provide certain services on a sustainable basis given the nature of government contracts and the realities of nonprofit financing, then the government must, as a policy matter, consider using for-profit providers." We can almost hear Professor Fox sighing as she writes: "There is so much wrong with that recommendation, we don't know where to start."

Her conclusion: "All that said, … we do believe that there is great information in this report."

Conclusion

That's certainly a relief; there is helpful recent data and trends to evaluate. But this current discussion ignores the elephant in the room: the dramatic changes in federal fiscal and operational policy beginning in January 2017 that may skew any historical analysis of the viability of the nonprofit sector.

There are serious challenges and uncertainties ahead. Just over 12 months into the new Administration, it's clear that many nonprofits are facing existential threats to their continued existence, notwithstanding their records of sound governance and prudent fiscal planning.