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POINT OF VIEW

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RISK MANAGEMENT FOR NONPROFITS

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The 2015 bankruptcy of FEGS, the largest social service nonprofit in New York, shook the confidence of the city's nonprofits. Coming in the wake of the turmoil at Cooper Union and the collapse of the New York City Opera, many trustees are asking new questions about the organizations they govern. What risks do we face?[1] How risky are we in relation to our peers? Are we doing the right things to understand and mitigate our risks? How should we balance financial risk against programmatic reward? What should we do to reduce the potential hardships from financial distress?

Unfortunately, very few nonprofits have processes in place to address these issues of financial risk management. However, our research suggests that this can and must change.

- New York City nonprofits are fragile: 10% are insolvent (18% in health and human services); as many as 40% have virtually no cash reserves (i.e., margin for error); and over 40% have lost money over the last three years. We believe that less than 30% are financially strong. Yet many trustees do not understand the financial condition of their organization or how it compares to its peers.
- Distressed nonprofits have very limited ways to recover, so trustees must do all they can to reduce the risk that their organization becomes distressed in the first place. And they must take prompt, decisive action if it does.
- Practices such as scenario planning, benchmarking and self-rating, and setting explicit financial stability targets, can improve risk management. A few organizations already do these things. Most do not.

We believe that the nonprofit sector can make dramatic improvements in risk management over the next few years – and bring more stability to vital programs. Institutions ranging from nonprofit umbrella groups to regulators, such as the Charities Bureau of the Office of the New York State Attorney General, also support better risk management.[2] This report outlines concrete steps that organizations can take to manage risk better. These recommendations come from a study by SeaChange Capital Partners and Oliver Wyman on how to adapt private sector risk practices to nonprofits. It was motivated by recent failures and a concern that nonprofits face an increasing number of risks, including rising interest rates, the move to value-based payments in healthcare, and increased real estate costs. Organizations that don't adopt better risk management may find themselves in an increasingly precarious situation.

1 By "risk" we mean unexpected events and factors that may have a material impact on an organization's finances, operations, reputation, viability, and ability to pursue its mission.

2 The Human Services Council's Commission on Nonprofit Closures' recent report recommending a strong emphasis on risk management may be found at: http://www.humanservicescouncil.org/Commission/HSCCommissionReport.pdf.

THE CONTEXT: STRUCTURAL CHALLENGES

Trustees often fail to appreciate the difficult conditions under which nonprofits operate. These conditions can be far more difficult than any they have seen before.

- **Tackling the hardest problems:** Nonprofits address economically intractable and politically unappealing problems. This is true even though charities arose long before government social programs and have helped shape the public agenda.
- **Cost-minus funding:** Most nonprofit funding, especially in health and human services, comes in the form of government contracts or restricted grants that virtually guarantee a deficit. Government contracts also create working capital needs because funding arrives after expenses are paid. These funds are also subject to unpredictable delays in payment.[3]
- **One-way bets:** Nonprofits face contingent liabilities that can swamp them financially. These include claw-backs for disallowed expenses, after-the-fact audits, and unilateral retroactive rate reductions.
- **Zero-sum philanthropy:** The total supply of philanthropy is largely fixed.[4] Large organizations working in difficult issue areas will always be overwhelmingly reliant on government funding.
- **Cost disease:** Nonprofits provide face-to-face, labor-intensive services that do not get more productive from technology. The real cost of these services has risen substantially over time and is likely to do so in the future.[5]
- **Recruiting and retention:** Nonprofits face structural challenges in recruiting and retaining high-quality staff in finance, accounting, technology, and back-office functions. Factors driving this situation include the small size of many organizations, the challenge in providing career development, and competition from higher-paying for-profits.
- **Gales of creative destruction:** Nonprofits operate in a dynamic environment. Challenges include demographics, funding fashions, political priorities, and real estate costs. The weak financial position of many nonprofits can make it difficult to respond.

It is no surprise that many nonprofits are always living close to the edge.

3 Advocates for the nonprofit sector are working to educate government about the risks these contracts impose on nonprofits and to advocate for changes. While trustees should hope that these efforts are successful, they cannot shirk their governance responsibility for risk management on the basis that "it's the government's fault."

4 Philanthropy as a percentage of GDP has moved within a very tight band for at least the last 45 years (see https://philanthropy.com/article/The-Stubborn-2-Giving-Rate/154691), and philanthropy per nonprofit has actually fallen, as the number of nonprofits has grown faster than GDP and the population. Nevertheless, many nonprofits underinvest in development or have boards that do not recognize the vital role they must play in raising unrestricted funds.

5 See http://www.amazon.com/The-Cost-Disease-Computers-Cheaper/dp/0300179286 for a fuller explanation of this phenomenon. Nevertheless, many nonprofits could be more effective and efficient through better use of technology.

THE PATH FORWARD: MORE ROBUST AND SYSTEMATIC RISK MANAGEMENT

Enterprise Risk Management in for-profit companies[6] and our interviews with nonprofit leaders suggest a set of best practices for nonprofit risk management. They are in use at several leading nonprofits, and each one can make a real difference to any organization that adopts it.

1. **Governance and Accountability for Risk Management:** Oversight for risk management is part of the board's legal duties of care, loyalty, and obedience. It should be an explicit responsibility of the audit and/or finance committee,[7] with an appropriate dedication of time to the task. One leading organization reports that roughly 10% of total board discussion now revolves around risk. The committee responsible for risk must have direct communication with the finance function and with staff who have time to ask "What if?" It should report to and elicit input from the board as a whole. It should ensure that the board sets the right tone by communicating a commitment to risk management throughout the organization. This should be part of its strategy, culture, and pursuit of the mission.[8] Organizations should develop an explicit risk tolerance statement. This is similar to mission and vision statements. It needs to indicate the limits for risk-taking and the willingness to trade short-term program impact for longer-term sustainability. A thoughtful risk tolerance statement will reduce the likelihood that an organization is either cavalier about risk or paralyzed by excessive risk aversion.
2. **Scenario Planning:** Organizations should keep a running list of the major risks they face. For each, they should indicate its likelihood and the expected loss (probably in terms of unrestricted net assets) if it occurs. Then they should consider actions to reduce the likelihood of it occurring and mitigate the damage if it does. The list may include a wide range of possible risks depending on the organization. Examples include lease renewal, cost overruns on a capital project, the non-renewal of an important funder, investment performance, and succession.
3. **Recovery and Program Continuity Planning:** Organizations should have plans for how to maintain service in the event of a financial disaster. Large organizations should also consider developing "living wills" to expedite program transfer. These living wills should be discussed in advance during stable times with government agencies and partners so everyone is prepared to act in a crisis.

6 For background see http://www.oliverwyman.com/what-we-do/financial-services/finance-risk.html and http://www.mmc.com/global-risk-center/overview.html.

7 Some specialized risks – for example data/cybersecurity – might be located in other committees. Unlike financial institutions, even the largest nonprofits do not face the range of risks that would merit a dedicated "risk committee."

8 For a discussion on the importance of "tone" and of risk management in the for-profit setting see http://www.wlrk.com/webdocs/wlrknew/AttorneyPubs/WLRK.24301.15.pdf.

4. **Environmental Scan:** On an annual basis, organizations should brief trustees about longer-term trends in the operating environment. They should consider the potential benefits of exploring various forms of organizational redesign in response, such as collaborations, mergers, acquisitions, joint ventures, partnerships, outsourcing, managed dissolutions, and divestments.
5. **Benchmarking and Self-rating:** Organizations should compare their financial performance to peers on an annual basis using IRS 990 data.[9] They should also ask umbrella groups to collect more detailed and timely information from the peer group. Another option is to use a self-rating tool to combine financial measures into an overall indicator of organizational health.
6. **Financial Stability Targets:** Organizations should have targets for operating results based on minimum and long-term needs. An example might be not having two consecutive years of deficits. They should also have targets for cash, unrestricted net assets, operating reserves, and access to credit. Trustees should develop contingency plans for when minimum targets are not met. Since earning the requisite capitalization is so difficult, organizations must think creatively about how to build the necessary reserves. Ideas might include one-time capital campaigns and pledged funds from trustees for use in a crisis. Organizations should put in place monitoring and governance processes to ensure that reserves are not inadvertently used to fund operating deficits.
7. **Reporting and Disclosure:** Larger organizations should summarize their financial and programmatic results in a short plain-English report similar to the management discussion and analysis section of the SEC's Form 10-K. This report should also cover their opportunities and risks in the context of internal and external conditions. Creating this type of report would give a sense of urgency to the underlying processes. It could also help reassure stakeholders such as trustees, banks, and regulators that organizations are doing all they can to ensure long-run sustainability.
8. **Board Composition, Qualifications, and Engagement:** Risk management requires a functioning partnership between capable management and a critical mass of experienced, educated, and engaged trustees. Organizations serious about risk management must redouble their effort to recruit trustees with a wide range of experience.[10] They need to empower high-functioning committees. They also need to ensure ongoing education for both new and existing trustees. Trustees cannot participate in intelligent risk management unless they understand important contracts and the associated processes for approval and registration. They also must know the distinction between direct/indirect and allowed/disallowed costs. Many organizations, particularly large complex ones, would benefit from having an experienced nonprofit executive on their board with firsthand experience of the programs and the associated funding streams.

Few nonprofit organizations will be able to implement all of these practices, but all will benefit from spending more time anticipating and preparing for risks.

9 Tools like the Non-Profit Finance Fund's NFF Financial SCAN can help with this (see http://nonprofitfinancefund.org/financial-scan).

10 An engaged and experienced board can be difficult to build and maintain when fundraising is its primary duty. Organizations must accept that they will always have some members who just "write checks." Organizations like BoardSource and others have tools to help boards with self-assessment.

THE SCALE OF THE CHALLENGE: HOW "RISKY" IS THE NONPROFIT SECTOR?

Our analysis of the financial results of New York City nonprofits illustrates just how fragile many nonprofits are. It should provide useful context for trustees to understand their organization's absolute and relative risk profile.

If New York City's nonprofit sector were a single organization it would have revenues of $14.5 billion and a deficit (over the five years between 2009 and 2013) of -1.8% before investment income and asset sales.[11] After investment income and asset sales, those margins rise to 3.4%.[12] The aggregate figures suggest that things have been getting slightly better for the nonprofit sector taken as a whole.

There are three important measures of a nonprofits risk-bearing capacity that trustees should keep in mind: **cash** to cover immediate needs; **unrestricted net assets** as the best measure of a nonprofit's "equity" that is available to bear losses or make investments; and **operating reserves** (the portion of the equity that is available in the short term).[13]
In aggregate, the sector has cash, equity, and operating reserves equal to 2.9, 10.1, and 3.6 months of expenses, respectively (based on 2013 figures). These cash and operating reserve ratios are well below the six-month level that nonprofit experts suggest is appropriate for many organizations.

The aggregate statistics conceal the very different circumstances facing individual organizations (and even entire sub-sectors) as becomes clear when the data are disaggregated.

- **More than 10% of the nonprofits are technically insolvent** (i.e., their liabilities exceed their assets), including 18% in health and human services (in terms of service volume, these non-profits account for 8% and 11%, respectively.) Many of these organizations are limping from payroll to payroll with less than a month of cash, effectively borrowing from vendors (by delaying payment) and/or dipping into restricted funds. These organizations have no capital for investment and little ability to consider a thoughtful restructuring given the lack of resources to fund the associated one-time costs.

11 Based on a representative sample of approximately 1,335 nonprofits filing IRS Form 990s for which GuideStar has electronic data. This incudes all organizations with revenue of $1.0 million of more in each reporting year from 2009-2013, as well as a small fraction of smaller ones. We have excluded hospitals, medical research, organizations working abroad, higher education, private schools, and churches. See the appendix for more information.

12 The results of ResCare, a private equity-owned for-profit social service provider with high-powered incentives competing in a traditionally "non-profit" arena suggest that profit margins would only be a few points higher for large social service nonprofits if they were run to maximize profits. (See: http://seachangecap.org/wp-content/uploads/2016/02/ResCare-Form-10-K-2013.pdf).

13 Calculated as net unrestricted assets less fixed assets. FMA and others call variations on this liquid unrestricted net assets (LUNA). See www.FMAonline.net.

- **Roughly, 40% of the organizations have virtually no margin for error,** with cash and operating reserves of less than two months. (In terms of service volume, these organizations account for 36% in aggregate and 50% in health and human services.) Yet these figures actually *overstate* the real cushion for weaker organizations, since much of the available cash is restricted to certain purposes. At best, 20-40% of organizations appear to be financially strong, defined as having more than six months of unrestricted net assets.
- **The median nonprofit has earned an operating margin of -0.1% over the past three years (i.e., before investment income and asset sales.)** The median margin rises to 1% after consideration of these items, though 40-50% of the organizations have still lost money over the last three years.
- **Most nonprofits are small but the large ones provide the vast majority of services:** 50% are less than $2.4 million; 24% are between $2 and $5 million; and 80% are less than $10 million. Only 10% are $20 million or above.[14] There are fewer than 50 organizations of more than $50 million in the city.[15] However, the smallest 50% of the organizations contributed only 5.6% of total service provision while the largest 5% provided almost 50%.
- **Nonprofits differ greatly in their reliance on philanthropy, but the majority of service provision comes from groups largely funded by the government.** The median level of philanthropy is 32%. But roughly one-third of nonprofits receive more than 90% of their funding from the government. Nearly 80% of the largest human service organizations are 90%+ government-funded. When looked at by service volume, 53% of service is provided by groups with less than 20% private philanthropy (and 74% in health and human services).

We are not suggesting that nonprofit organizations should earn consistently large surpluses. After all, the organizations exist to pursue programs, not to build up internal resources. However, the profound under-capitalization and small scale of most organizations impedes necessary investments and makes prudent risk management all the more important. Yet, greater scale is not a panacea. For example, a large, well-run nonprofit organization with economies of scale *might* be able to earn a surplus of 1% on revenue in a typical year if it relies principally on government contracts. However, even after five years the resulting retained surplus would amount to less than three weeks of expenses. This is not enough to support appropriate investments in technology or infrastructure or to provide a cushion against unforeseen risks. Larger nonprofits typically have a lower proportion of revenue coming from private philanthropy. They are therefore more reliant on government contracts. Beyond a certain tipping point, even the most efficient organizations will not necessarily have sufficient private funds to offset the deficit from their government funding.

14 This is based on Guidestar data, which already excludes many organizations under $1.0 million, but this is not material to the distribution of service provision.

15 Again, excluding hospitals, higher education, nursing homes, FQHCs, etc.

THE TRACK RECORD: HOW NONPROFITS HAVE DEALT WITH RISK

The sector's overall fragility means that many nonprofits will experience financial distress. SeaChange and Oliver Wyman interviewed executive directors, board leaders, and funders of nonprofits that had struggled. Some went bankrupt. Others were rescued at the 11th hour by other organizations. Others "saw the writing on the wall" early enough to enter into an orderly merger or dissolution. Across the discussions, several themes emerged, as did some "worst practices."

1. The organizations were fragile to begin with. Before the crisis hit they had limited resources and several years of deficits that had eroded whatever resources had once been in place.
2. The organizations had a longstanding challenge in recruiting and retaining a strong chief financial officer.
3. The crisis was precipitated by an event: the departure of the executive director; the non-renewal of an important funder; a change in government priorities or in the nature of government funding; a very meaningful (25-50%+) increase in scale; a real estate project that was large compared to the operating budget; or the emergence of a contingent liability (e.g., a Medicaid audit).
4. The organizations failed to do explicit scenario planning despite facing inherently uncertain situations. They did not pay enough attention to contingencies and milestones. Organizations were surprised by crises that could have been foreseen.
5. Trustees were not made fully aware of important long-term trends in financial performance or the operating environment. Important trends were masked by an exclusive focus on annual budgets, and year-to-date and year-over-year "rearview mirror" comparisons.
6. Trustees did not get timely, actionable information at the appropriate level of detail (i.e., by contract, program, or project) before or during the early stages of the crisis.
7. Trustees took too long to realize that there was a problem and then delayed taking action **even after they had decided it was necessary.** Executive directors and trustees suffered from magical thinking, particularly with respect to fundraising.

While there is a risk of 20/20 hindsight, we believe that many of these struggling nonprofits would have fared better, with less disruption to clients, had they put in place some or all of our recommended practices.

THE WILL TO ACT

Risk management does not guarantee survival. Consolidation, mergers and acquisitions, divestments, and orderly wind-downs are part of a vibrant nonprofit sector. However, it *is* tragic when distress causes an organization to lose the capacity to make wise choices. This can result in exposing vulnerable people to the risk of disrupted services. It can also mean that hardworking staff lose paychecks or pensions and that trustees are exposed to personal liability for unpaid payroll taxes, etc. And in bankruptcy, everybody loses as scarce philanthropic assets are squandered on transaction costs. Similarly tragic are "zombie" nonprofits that are too weak to provide effective or efficient services and use whatever resources they can muster for organizational survival.[16]

Unfortunately, distressed or zombie nonprofits have few options for recovery. Unlike for-profits, they cannot attract funders with reduced price, seniority, or other advantageous terms. Nor are there any specialized nonprofit turnaround funders to evaluate and assume financial risks. In fact, most private funders run at the first sign of trouble, creating a nonprofit version of a run on the bank. Their best hope, if trouble comes, is to hobble along. This can mean hollowing out the program, freezing salaries, reducing headcount, borrowing from vendors, using restricted cash for impermissible purposes, and begging existing supporters (including trustees) for support.

Trustees must strive to maximize the good that their organization does while managing its risks. Balancing these can be challenging because of the passion they feel for the organization and its mission. Nonprofits lack the indicators of organizational health that reach the directors of for-profit businesses, such as stock prices or credit spreads. They also lack outside parties like activist investors, rating agencies, stock market analysts, and short-sellers to encourage them to step back and take an objective view of the situation.[17] In this context, nonprofit trustees in leadership positions must ensure that well thought-through risk management processes are in place. In a challenging operating environment, the status quo is no longer acceptable.

16 Since creditors cannot put a nonprofit into involuntary bankruptcy and many nonprofits are too small for creditors to bother with, the zombie state can continue for a protracted period.

17 Despite all the reporting that FEGS was forced to do for government agencies and funders, nobody saw its bankruptcy coming. In fact, we have never been able to ascertain what the government actually does with its most comprehensive financial report, the CFR. We suspect they do nothing with it as it is virtually incomprehensible.

APPENDIX

Exhibit 1: Contains aggregated financial information, including revenues, expenses, and balance sheet information, for selected New York City-area nonprofit organizations for the five years, 2009-2013. The "Ratios" table at the bottom of the exhibit expresses selected balance sheet data (receivables, payables, cash, etc.) for the industry as a whole as a function of the industry's monthly expenses. The "2.9" figure for the cash ratio in 2013, for example, indicates that in 2013, the members of the industry in aggregate held an amount of cash on their balance sheets equal to 2.9 months of their average expenses over the course of the year.

The underlying financial data included in this exhibit, as well as the following appendix exhibits, were provided by GuideStar, the world's largest provider of information on nonprofit organizations. The data covers a representative sample of approximately 1,335 nonprofits filing IRS Form 990s for which GuideStar has electronic data. This includes all organizations with revenue of $1.0 million of more in each reporting year from 2009-2013, as well as a small fraction of smaller ones. We have excluded hospitals, medical research, organizations working abroad, higher education, private schools, and churches. For comparability, we have also excluded organizations that did not report in at least four of the five years (in US$ 000s).

INCOME STATEMENT	2009		2010		2011		2012		2013	
Revenue, gains and other support										
Program revenues and fees for service	$ 5,223,278	42%	$5,128,111	39%	$5,402,443	39%	$5,538,738	40%	$5,570,411	38%
Contributions and foundations	$7,184,109	58%	$7,426,015	57%	$7,598,450	55%	$7,598,670	54%	$7,944,816	55%
Investments, rental, special events and other	$277,035	2%	$270,560	2%	$282,082	2%	$283,274	2%	$279,845	2%
Net gain (loss) from asset sales	($265,486)	(2%)	$214,608	2%	$590,255	4%	$551,110	4%	$684,988	5%
Total Revenues, Gains and Other Support	**$12,418,936**	**100%**	**$13,039,293**	**100%**	**$13,873,231**	**100%**	**$13,971,793**	**100%**	**$14,480,059**	**100%**
Expenses										
Program services	$10,874,010	85%	$10,897,413	85%	$11,222,968	85%	$11,368,302	85%	$11,501,606	84%
Management and general	$1,444,021	11%	$1,411,218	11%	$1,470,241	11%	$1,521,296	11%	$1,567,507	12%
Fundraising	$497,004	4%	$493,230	4%	$513,746	4%	$532,348	4%	$551,764	4%
Total supporting services	$1,941,025	15%	$1,904,448	15%	$1,983,987	15%	$2,053,644	15%	$2,119,271	16%
Total expenses	**$12,815,035**	**100%**	**$12,801,861**	**100%**	**$13,206,955**	**100%**	**$13,421,947**	**100%**	**$13,620,877**	**100%**
Net Income	**($396,099)**	**(3%)**	**$237,433**	**2%**	**$666,277**	**5%**	**$549,846**	**4%**	**$859,183**	**6%**
Other adjustments to net assets	**($1,509,869)**		**$841,774**		**$947,442**		**($781,706)**		**$1,079,639**	
Net Assets, beginning of year	$19,982,390		$18,141,074		$19,237,436		$20,907,277		$20,138,577	
Net assets, end of year	**$18,076,422**		**$19,220,281**		**$20,851,155**		**$20,675,417**		**$22,077,399**	
Program Economics										
Program expenses	$10,874,010	100%	$10,897,413	100%	$11,222,968	100%	$11,368,302	100%	$11,501,606	100%
Less: Program revenues and fees for service	($5,260,301)	48%	($5,182,084)	48%	($5,447,692)	49%	($5,595,041)	49%	($5,618,450)	49%

Program-level philanthropy need	$5,613,709	52%	$5,715,329	52%	$5,775,275	51%	$5,773,262	51%	$5,883,156	51%
Add: Management and general expenses	$1,444,021	13%	$1,411,218	13%	$1,470,241	13%	$1,521,296	13%	$1,567,507	14%
Pre-philanthropy deficit	($7,057,730)	65%	($7,126,547)	65%	($7,245,516)	65%	($7,294,558)	64%	($7,450,662)	65%
Add: Net philanthropy	$6,694,534	62%	$6,939,727	64%	$7,085,934	63%	$7,063,471	62%	$7,378,443	64%
Operating surplus/(deficit)	($363,195)	(3%)	($186,820)	(2%)	($159,582)	(1%)	($231,087)	(2%)	($72,219)	(1%)
Add: Gain/(loss) on investments and asset sales	($32,903)	(0%)	$424,253	4%	$825,858	7%	$780,933	7%	$931,402	8%
Net Income	**($396,099)**	**(4%)**	**$237,433**	**2%**	**$666,277**	**6%**	**$549,846**	**5%**	**$859,183**	**7%**

BALANCE SHEET (SELECTED)	2009	2010	2011	2012	2013
Assets (selected)					
Cash and savings	$3,146,439	$3,125,066	$3,270,493	$3,242,828	$3,321,957
Pledges, grants, loans and other receivables, net	$2,781,491	$2,733,467	$2,766,136	$2,612,081	$2,710,515
Accounts receivable (net)	$1,294,345	$1,232,475	$1,326,965	$1,334,013	$1,502,303
Securities and investment programs	$12,278,043	$13,048,281	$13,944,437	$13,912,682	$14,469,713
Intangible and other (incl. inventory)	$1,828,188	$2,279,656	$2,092,642	$2,268,351	$2,203,398
Fixed assets	$6,614,600	$7,243,752	$7,895,163	$8,045,310	$7,933,579
Total assets	**$27,947,204**	**$29,664,130**	**$31,295,861**	**$31,419,309**	**$32,141,716**
Liabilities (selected)					
Accounts payable	$2,734,847	$2,624,765	$2,737,697	$2,733,938	$2,751,513
Tax-exempt bond liabilities	$1,477,375	$1,829,027	$2,034,056	$2,073,507	$2,065,011
Secured mortagages and notes payable	$2,953,587	$2,903,511	$2,445,458	$2,221,272	$1,838,371
Other liabilities	$2,660,708	$3,070,052	$3,228,466	$3,731,593	$3,412,960
Total liabilities	**$9,806,734**	**$10,427,155**	**$10,445,512**	**$10,899,604**	**$10,068,607**
Net assets (selected)					
Unrestricted	$9,494,266	$10,570,169	$10,813,341	$10,689,738	$11,447,120
Temporarily restricted	$4,270,411	$4,189,961	$5,551,709	$5,410,933	$5,990,727
Permanently restricted (i.e, endowment)	$4,132,103	$4,180,165	$4,294,735	$4,404,275	$4,459,528
Total net assets	$17,896,780	$18,940,295	$20,659,784	$20,504,946	$21,897,374
Total liabilities and net assets	**$27,703,514**	**$29,367,450**	**$31,105,296**	**$31,404,549**	**$31,965,981**

RATIOS (MONTHS)					
Receivables	3.9	3.6	3.5	3.4	3.5
Payables	2.6	2.5	2.5	2.4	2.4
Cash	2.9	2.9	3.0	2.9	2.9
Unrestricted net assets	8.9	9.9	9.8	9.6	10.1
Operating reserves	2.0	2.4	3.1	3.4	3.6

Exhibit 2: Indicates the percentage of nonprofits that are insolvent, meaning that their liabilities exceed their assets, by year, sector, and size bucket. The final table in the Exhibit drills down on the results for the industry sector with the highest insolvency rate, Health and Human Services. The final table indicates that the elevated insolvency rates observed in the HHS sector are not confined to the smallest nonprofits, but in fact exist at four of the five size buckets defined for the purposes of this study.

NYC Nonprofit Insolvency Indicators.*

INSOLVENCY: LIABILITIES ARE GREATER THAN ASSETS						
Percentage of nonprofits that are insolvent by major industry group and year	**2009**	**2010**	**2011**	**2012**	**2013**	**Average**
1. Community capacity	8%	7%	7%	7%	8%	7%
2. Health and human services	16%	18%	18%	18%	18%	18%
3. Arts, culture and humanities	6%	7%	7%	8%	9%	7%
4. Education, science, technology and social sciences	5%	8%	6%	7%	8%	7%
5. Environment and animal-related	2%	6%	6%	2%	2%	4%
6. Youth development	5%	5%	7%	9%	10%	7%
7. Other	6%	6%	6%	6%	0%	5%
Total	**10%**	**11%**	**11%**	**11%**	**11%**	**11%**
Percentage of nonprofits that are insolvent by size and year	2009	2010	2011	2012	2013	Average
1. Grassroots	6%	8%	8%	8%	8%	8%
2. Small safety net	11%	11%	12%	13%	13%	12%
3. Mid safety net	14%	14%	16%	15%	14%	14%
4. Large safety net	11%	13%	12%	12%	14%	12%
5. Economic engines	6%	7%	4%	4%	5%	5%
Total	**10%**	**11%**	**11%**	**11%**	**11%**	**11%**
Percentage of nonprofits that are insolvent by major industry group, size and year	2009	2010	2011	2012	2013	Average
Heatlh and human services	**16%**	**18%**	**18%**	**18%**	**18%**	**18%**
1. Grassroots	10%	15%	15%	13%	14%	13%
2. Small safety net	22%	23%	23%	25%	24%	23%
3. Mid safety net	13%	15%	18%	17%	16%	16%
4. Large safety net	14%	15%	15%	16%	19%	16%
5. Economic engines	10%	10%	5%	5%	5%	7%

* Nonprofit size categories are as follows: Grassroots, <$1 million; Small Safety Net, between $1-$5 million; Mid Safety Net, between $5-$10 million; Large Safety Net, between $10-$50 million; Economic Engines, >$50 million.

Exhibit 3: Shows the months of different forms of financial reserves that nonprofit organizations (both generally and in the HHS sector specifically) hold, by decile. For example, the top table indicates that the bottom 10% of all nonprofits hold cash reserves equal to 0.3 months of expenses (or a little more than a week), while the top 10% (or 90th percentile) hold cash reserves equal to 12.5 months of expenses (or slightly over a year).

NYC nonprofit Liquidity/Debt ratios (2013).

MONTHS OF RESERVES BY TYPE									
Aggregate Distribution (2013)	**10%**	**20%**	**30%**	**40%**	**50%**	**60%**	**70%**	**80%**	**90%**
1. Cash	0.3	0.8	1.4	1.9	2.6	3.7	5.0	7.3	12.5
2. Unrestricted net assets*	-1.0	0.0	1.1	2.7	4.2	6.5	10.3	16.3	38.8
3. Operating	-3.7	-0.3	0.3	1.4	2.8	4.4	6.7	11.1	24.8
4. Investments	0.2	0.5	0.9	1.6	2.5	3.7	6.0	10.0	21.2
5. Cash and investments	1.0	1.9	3.2	4.8	7.3	10.7	16.3	28.4	62.7
Health and human services distribution (2013)	**10%**	**20%**	**30%**	**40%**	**50%**	**60%**	**70%**	**80%**	**90%**
1. Cash	0.2	0.5	0.9	1.5	2.0	2.7	3.9	6.4	10.5
2. Unrestricted net assets*	-4.4	-0.2	0.3	1.5	3.0	4.7	7.6	12.2	28.0
3. Operating	-10.1	-1.9	0.0	0.6	1.8	3.2	5.0	8.5	22.6
4. Investments	0.2	0.3	0.6	1.1	1.5	2.4	3.9	7.0	13.2
5. Cash and investments	0.8	1.4	2.2	3.2	4.7	6.8	10.9	18.9	49.3

* Unrestricted net assets is an equity proxy.

Exhibit 4: Shows average three year profitability margin, defined as net income/total revenue, by decile by sector and size bucket. The results indicate that roughly 30% to 40% of nonprofits have been unprofitable over the period. The bottom table demonstrates that, if the proceeds of asset sales and investment income are excluded and margin is measured purely on the basis of normal operating revenues, roughly 50% of nonprofits are unprofitable, across all sectors and size buckets.

NYC nonprofit marginal analysis (2013).

3 YEARS AVERAGE MARGIN (NET INCOME/TOTAL REVENUE)									
Distribution (2013)	**10%**	**20%**	**30%**	**40%**	**50%**	**60%**	**70%**	**80%**	**90%**
1. Community capacity	-29.7%	-11.6%	-5.2%	-1.2%	0.5%	2.2%	4.5%	8.3%	13.2%
2. Health and human services	-19.6%	-7.3%	-3.3%	-0.5%	0.4%	1.7%	4.3%	8.2%	18.6%
3. Arts, culture and humanities	-24.6%	-10.0%	-3.9%	-1.5%	1.5%	3.7%	7.6%	13.9%	25.7%
4. Education, science, technology and social sciences	-28.2%	-7.5%	-3.0%	0.7%	3.7%	6.9%	11.6%	16.4%	32.5%
5. Environment and animal-related	-20.5%	-11.1%	-4.9%	-0.4%	2.7%	5.7%	9.2%	13.2%	25.4%
6. Youth developement	-18.3%	-10.4%	-5.9%	-2.5%	2.4%	6.4%	8.9%	18.6%	28.1%
7. Other	-37.7%	-14.8%	-1.3%	5.0%	5.8%	8.3%	9.3%	12.8%	16.2%
	-23.9%	**-9.4%**	**-3.9%**	**-0.8%**	**1.0%**	**3.2%**	**6.3%**	**11.5%**	**21.7%**

1. Grassroots	-58.4%	-20.0%	-9.1%	-3.4%	1.4%	5.6%	8.8%	17.1%	40.0%
2. Small safety net	-20.4%	-10.0%	-4.7%	-1.3%	0.7%	3.2%	6.4%	11.4%	19.7%
3. Mid safety net	-17.4%	-6.6%	-2.7%	-0.9%	0.4%	3.0%	5.1%	8.6%	16.1%
4. Large safety net	-10.3%	-4.1%	-1.8%	0.2%	1.3%	2.2%	4.1%	8.4%	15.1%
5. Economic engines	-1.3%	0.1%	0.5%	1.1%	2.0%	2.5%	5.0%	8.4%	15.9%
	-23.9%	**-9.4%**	**-3.9%**	**-0.8%**	**1.0%**	**3.2%**	**6.3%**	**11.5%**	**21.7%**

3 YEARS AVERAGE MARGIN (TOTAL EXPENSES BEFORE ASSET SALES AND INVESTMENT INCOME/TOTAL REVENUE)									
Distribution (2013)	**10%**	**20%**	**30%**	**40%**	**50%**	**60%**	**70%**	**80%**	**90%**
1. Community capacity	-25.8%	-12.0%	-5.1%	-1.9%	0.4%	1.6%	4.0%	9.1%	13.1%
2. Health and human services	-28.4%	-10.5%	-4.8%	-1.8%	-1.0%	0.9%	2.6%	5.8%	16.3%
3. Arts, culture and humanities	-34.8%	-18.0%	-8.2%	-4.0%	-1.3%	1.5%	4.8%	11.6%	24.3%
4. Education, science, technology and social sciences	-35.1%	-12.6%	-4.6%	-1.0%	0.9%	3.5%	7.1%	14.2%	22.9%
5. Environment and animal-related	-53.4%	-13.5%	-6.2%	-1.6%	0.2%	2.9%	5.5%	12.9%	22.0%
6. Youth developement	-28.8%	-11.3%	-6.6%	-3.8%	-0.8%	1.2%	7.2%	13.4%	27.5%
7. Other	-38.2%	-13.3%	-4.3%	4.2%	4.9%	6.9%	8.1%	9.9%	16.4%
	-33.3%	**-13.2%**	**-5.9%**	**-2.5%**	**-0.1%**	**1.5%**	**4.0%**	**9.4%**	**18.9%**
1. Grassroots	-68.9%	-27.7%	-10.9%	-3.6%	0.6%	3.6%	9.1%	15.5%	38.4%
2. Small safety net	-27.9%	-12.0%	-6.1%	-2.7%	-0.3%	1.6%	4.2%	9.2%	17.7%
3. Mid safety net	-26.1%	-9.5%	-5.0%	-1.8%	-0.3%	0.6%	3.6%	5.9%	12.4%
4. Large safety net	-24.6%	-7.3%	-3.9%	-1.5%	0.0%	1.1%	2.1%	4.9%	13.8%
5. Economic engines	-20.4%	-12.0%	-5.6%	-3.4%	-1.4%	0.1%	0.7%	1.7%	4.3%
	-33.3%	**-13.2%**	**-5.9%**	**-2.5%**	**-0.1%**	**1.5%**	**4.0%**	**9.4%**	**18.9%**

Exhibit 5: Shows the distribution of nonprofits by size (as measured by expenditures, by sector by decile.) For example, the median nonprofit had expeditures of $2.4 millions.

Distribution of nonprofit expenditure by size and sector (2013 functional expenses, in US$ 000s).

DISTRIBUTION OF SPEND										
Distribution (2013)	**10%**	**20%**	**30%**	**40%**	**50%**	**60%**	**70%**	**80%**	**90%**	**95%**
1. Community capacity	$701	$1,036	$1,361	$1,819	$2,426	$3,410	$4,971	$8,476	$17,102	$38,410
2. Health and human services	$537	$1,034	$1,552	$2,034	$2,926	$4,408	$8,268	$12,980	$32,001	$55,967
3. Arts, culture and humanities	$511	$839	$1,166	$1,484	$2,018	$2,624	$3,849	$6,217	$15,462	$40,217
4. Education, science, technology and social sciences	$566	$892	$1,220	$1,650	$2,224	$2,945	$5,208	$7,969	$15,042	$22,751
5. Environment and animal-related	$484	$1,112	$1,421	$1,706	$3,456	$4,905	$5,979	$8,985	$31,510	$93,187
6. Youth developement	$550	$1,079	$1,416	$1,889	$2,398	$4,308	$6,255	$9,278	$13,512	$23,708
7. Other	$961	$1,092	$1,409	$1,971	$2,178	$3,404	$5,465	$8,963	$24,002	$38,996
Entire sector	**$566**	**$966**	**$1,330**	**$1,762**	**$2,414**	**$3,533**	**$5,467**	**$9,511**	**$21,499**	**$45,824**

Exhibit 6: Shows the distribution of type of spend, by sector and by nonprofit size decile. For example, the largest 5% of nonprofits represented 51.2% of the spending. The smallest 50% of nonprofits represented 5.6% of the spending.

Distribution of aggregate nonprofit expenditure by size and sector (2013 functional expenses, in US$ 000s).

AMOUNT OF SPEND					
Distribution (2013)	**≤10%**	**10%< x ≤20%**	**20%< x ≤30%**	**30%< x ≤40%**	**40%< x ≤50%**
1. Community capacity	$11,689	$19,382	$29,282	$35,780	$51,564
2. Health and human services	$10,102	$37,022	$57,887	$78,171	$114,750
3. Arts, culture and humanities	$9,220	$25,172	$35,639	$45,167	$62,708
4. Education, science, technology and social sciences	$3,429	$8,794	$12,326	$17,401	$23,635
5. Environment and animal-related	$1,112	$3,679	$6,350	$9,134	$11,986
6. Youth developement	$2,296	$7,265	$10,070	$13,689	$17,481
7. Other	$1,090	$2,084	$1,289	$3,402	$4,160
Entire sector	**$36,217**	**$102,131**	**$150,654**	**$201,824**	**$272,870**
Percentage of entire sector	**0.3%**	**0.7%**	**1.1%**	**1.5%**	**2.0%**

AMOUNT OF SPEND						
Distribution (2013)	**50%< x ≤60%**	**60%< x ≤70%**	**70%< x ≤80%**	**80%< x ≤90%**	**90%< x ≤95%**	**≥95%**
1. Community capacity	$66,254	$97,123	$153,344	$295,542	$293,745	$1,100,983
2. Health and human services	$166,784	$270,920	$463,517	$922,347	$980,423	$2,379,165
3. Arts, culture and humanities	$81,761	$113,242	$176,421	$362,795	$446,192	$2,198,167
4. Education, science, technology and social sciences	$30,834	$48,200	$76,239	$122,829	$113,191	$516,403
5. Environment and animal-related	$20,104	$32,763	$37,118	$61,052	$171,600	$391,042
6. Youth developement	$26,967	$42,388	$62,031	$90,244	$76,832	$251,441
7. Other	$3,176	$8,394	$7,966	$23,496	$38,578	$40,667
Entire sector	**$386,347**	**$580,354**	**$955,848**	**$1,853,053**	**$2,110,060**	**$6,973,420**
Percentage of entire sector	**2.8%**	**4.3%**	**7.0%**	**13.6%**	**15.5%**	**51.2%**

Exhibit 7: Shows the portion of nonprofits' revenues that are accounted for by philanthropy – by sector, size bucket, and decile. The results indicate that the while median nonprofit receives roughly 32% of its revenue from philanthropic sources, the median nonprofit in the health and human services sector receives only 9% of its revenue from philanthropy – highlighting this sector's greater reliance on non-philanthropic, primarily governmental, sources of funding.

Distribution of philanthropy as a percentage of gross total revenue by size and sector (2013).

Distribution (2013)	10%	20%	30%	40%	50%	60%	70%	80%	90%
1. Community capacity	0.0%	0.4%	7.5%	20.7%	37.3%	59.3%	77.2%	87.5%	97.5%
2. Health and human services	0.0%	0.0%	0.5%	2.8%	9.2%	19.2%	37.6%	64.0%	87.5%
3. Arts, culture and humanities	6.5%	15.3%	25.8%	37.6%	44.5%	53.1%	61.7%	73.9%	86.5%
4. Education, science, technology and social sciences	0.0%	1.3%	8.2%	17.5%	38.0%	53.1%	73.1%	89.3%	96.7%
5. Environment and animal-related	2.2%	14.8%	27.1%	45.0%	63.6%	77.3%	85.5%	93.6%	99.3%
6. Youth developement	0.0%	5.0.%	20.2%	34.4%	44.9%	59.2%	76.0%	85.7%	94.3%
7. Other	0.0%	3.5%	13.7%	20.0%	38.2%	68.7%	89.7%	93.4%	97.9%
	0.0%	**1.3%**	**7.4%**	**17.9%**	**32.1%**	**46.6%**	**62.4%**	**79.3%**	**93.7%**
1. Grassroots	0.0%	1.7%	11.8%	30.3%	48.1%	67.4%	81.3%	90.1%	98.9%
2. Small safety net	0.0%	1.4%	9.0%	21.8%	38.1%	51.9%	63.8%	78.0%	92.2%
3. Mid safety net	0.0%	1.7%	6.1%	13.6%	23.2%	38.5%	56.5%	78.0%	90.2%
4. Large safety net	0.0%	0.5%	4.8%	11.2%	18.4%	23.0%	33.4%	49.0%	76.5%
5. Economic engines	0.1%	1.5%	3.9%	6.0%	14.8%	20.1%	28.4%	51.7%	74.5%
	0.0%	**1.3%**	**7.4%**	**17.9%**	**32.1%**	**46.6%**	**62.4%**	**79.3%**	**93.7%**
Health and human services distribution (2013)	**10%**	**20%**	**30%**	**40%**	**50%**	**60%**	**70%**	**80%**	**90%**
1. Grassroots	0.0%	0.0%	0.1%	3.6%	16.3%	45.6%	71.2%	83.7%	99.5%
2. Small safety net	0.0%	0.0%	0.4%	2.4%	9.9%	21.8%	48.8%	68.4%	88.7%
3. Mid safety net	0.0%	0.1%	1.0%	2.8%	6.1%	13.5%	31.5%	58.2%	86.6%
4. Large safety net	0.0%	0.2%	0.6%	4.8%	10.5%	17.6%	22.3%	30.4%	57.5%
5. Economic engines	0.1%	0.7%	1.3%	2.7%	3.5%	4.6%	6.0%	12.4%	35.6%
	0.0%	**0.0%**	**0.5%**	**2.8%**	**9.2%**	**19.2%**	**37.6%**	**64.0%**	**87.5%**

Exhibit 8: Shows similar information to Exhibit 7, but represents philanthropic revenue as a percentage of total functional spend by size bucket and decile. For example, organizations with 10% or less of private philantrophy represented 37.4% of total spending.

Distribution of philanthropy revenue as a percentage of total nonprofit spend by size and sector (2013).

Distribution (2013)	<10%	<20%	<30%	<40%	<50%	<60%	<70%	<80%	<90%
1. Community capacity	39.3%	53.3%	59.0%	70.9%	73.3%	74.5%	76.5%	82.8%	94.8%
2. Health and human services	65.1%	73.5%	81.9%	83.7%	87.4%	89.6%	91.0%	92.5%	95.8%
3. Arts, culture and humanities	6.0%	31.3%	51.5%	62.2%	80.1%	86.5%	89.9%	94.1%	97.9%
4. Education, science, technology and social sciences	29.1%	66.5%	72.1%	79.2%	81.9%	84.5%	87.5%	89.8%	90.7%
5. Environment and animal-related	3.6%	12.8%	15.0%	21.8%	22.5%	22.5%	59.4%	90.0%	91.8%
6. Youth developement	24.7%	38.8%	54.5%	73.5%	75.4%	81.1%	81.5%	87.2%	92.6%
7. Other	6.9%	15.3%	45.6%	48.0%	50.6%	50.6%	50.6%	50.6%	62.7%
Entire sector	**37.4%**	**53.4%**	**64.5%**	**71.6%**	**78.5%**	**81.6%**	**85.6%**	**90.4%**	**95.1%**
1. Grassroots	25.6%	31.2%	36.1%	40.2%	48.9%	52.6%	59.8%	67.8%	80.6%
2. Small safety net	29.1%	38.3%	45.9%	51.8%	59.4%	66.8%	73.2%	81.3%	88.4%
3. Mid safety net	33.1%	44.5%	50.2%	58.8%	67.0%	71.9%	74.1%	80.4%	89.4%
4. Large safety net	39.5%	52.3%	64.9%	74.8%	81.5%	85.8%	87.4%	88.9%	95.2%
5. Economic engines	39.2%	60.2%	72.4%	77.7%	84.2%	85.3%	90.5%	96.2%	98.2%
Entire sector	**37.4%**	**53.4%**	**64.5%**	**71.6%**	**78.5%**	**81.6%**	**85.6%**	**90.4%**	**95.1%**

Health and human services distribution (2013)	<10%	<20%	<30%	<40%	<50%	<60%	<70%	<80%	<90%
1. Grassroots	43.0%	50.7%	54.1%	54.1%	57.6%	62.6%	64.6%	75.8%	81.9%
2. Small safety net	47.2%	55.8%	65.8%	69.7%	71.6%	75.3%	79.2%	84.6%	90.2%
3. Mid safety net	52.0%	64.4%	66.2%	71.8%	77.6%	81.4%	82.6%	87.4%	98.5%
4. Large safety net	55.2%	67.2%	80.9%	83.5%	87.3%	91.5%	93.9%	95.4%	97.0%
5. Economic engines	79.4%	84.0%	89.4%	89.4%	93.0%	93.0%	93.0%	93.0%	95.6%
Entire HHS sector	**65.1%**	**73.5%**	**81.9%**	**83.7%**	**87.4%**	**89.6%**	**91.0%**	**92.5%**	**95.8%**

ABOUT THE AUTHORS

SeaChange Capital Partners is a merchant bank focused exclusively on the nonprofit sector and itself a nonprofit. SeaChange assesses nonprofit risk in all aspects of its business – mergers and collaborations, lending/investment, and advisory work – and has observed first-hand both the critical difference that risk management can make for nonprofits and the wide range of risk-related practice in the sector. SeaChange wishes to thank The Clark Foundation, The Heckscher Foundation for Children, and The New York Community Trust for their support and encouragement of this work. The views and opinions expressed in this report are those of the authors and do not necessarily reflect the views of these supporters.

Oliver Wyman is a global management consulting firm, and part of the Marsh & McLennan Companies (MMC), a global professional services network with brands and affiliates in more than 100 countries. Oliver Wyman's management consulting business has more than 4,000 consultants working out of offices in over 50 cities, spread across some 26 countries. Oliver Wyman Group also includes NERA Economic Consulting and the brand and identity consultancy Lippincott.

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This report draws on SeaChange's experience and Oliver Wyman's 30+ years of experience advising the largest global financial institutions and regulators with respect to risk management; a rigorous analysis of the most comprehensive data set on the financial performance of New York's nonprofits provided by GuideStar, the largest source of information on nonprofit organizations; in-depth interviews with more than 20 executive directors, board members, and funders involved with nonprofits in distress; and discussions with the Human Services Council and the Center for an Urban Future, both of which have undertaken related projects to understand and improve the state of New York's nonprofits.

We wish to thank everyone who participated in these interviews and discussions, as well as those people who provided feedback on earlier drafts of the report.

This work is motivated by our recognition that nonprofits play a critical social role – improving education, alleviating poverty, providing economic opportunity, supporting our healthcare system, sustaining the arts – and that their health is vital to New York. We hope to have contributed to the important discussion taking place, particularly in the wake of the bankruptcy of FEGS, about how to mitigate the likelihood of acute financial distress for nonprofits of any size or sector. All New Yorkers are indebted to those nonprofit trustees who take seriously their duties of care, obedience, and loyalty to govern their organizations well, striving to maximize the good they do while managing the risks they face. We hope that this report will prove useful to at least a few of them.

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