

LIQUIDITY MANAGEMENT

2.1 INTRODUCTION 29

- (a) Importance of Liquidity 31
- (b) Are Nonprofits Overly Risk-Averse? 31

2.2 NONCOMMERCIAL NONPROFIT ORGANIZATIONS 34

- (a) Guidance from Finance Theory 35
- (b) Evaluation of Finance Theory 35
- (c) Complexity of Nonprofit Cash Flows 35

2.3 EVIDENCE ON LIQUIDITY MANAGEMENT IN THE NONPROFIT SECTOR 37

- (a) Liquidity Management in the Healthcare Sector 37
- (b) Liquidity Management in Colleges and Universities 38
- (c) Liquidity Management in Faith-Based Donative Organizations 38

2.4 FACETS OF LIQUIDITY MANAGEMENT 40

- (a) Layers of Liquidity 41
- (b) Solvency 41
- (c) Liquidity 41
- (d) Financial Flexibility 42

2.5 IMPORTANCE OF LIQUIDITY MANAGEMENT 42

- (a) Institutional Factors 42
- (b) Managerial Philosophy Factors 45
- (c) Liquidity Implications of Institutional and Managerial Philosophy Factors 46
- (d) Watchdog Agency Standards on Solvency and Liquidity 47
- (e) Assessment of Watchdog Standards 50

2.6 WHAT IS THE APPROPRIATE LEVEL OF LIQUIDITY? 51

- (a) Establishing the Liquidity Position Based on Financial Vulnerability 52
- (b) Diagnostic Tools to Assist in Setting the Appropriate Liquidity Target 52

2.7 CONCLUSION 54

2.1 INTRODUCTION

We need to set the financial context for nonprofit financial management and for the special importance of liquidity management in the nonprofit sector. In this chapter we make the case for liquidity – ability to pay bills, meet emergency shortfalls, fund growth, and maintain flexibility – as critical to your organization’s financial health and financial sustainability. We lay out the reasons behind our continuous emphasis on liquidity by profiling the legal, environmental, and institutional constraints on nonprofit financial managers. We then move into a critical analysis of the financial ratings available from charity watchdog agencies, which we find overly constraining with regard to liquidity management. You may wish to review the distinction between narrow liquidity and broad liquidity in Chapter 1 before proceeding, as there is a basic understanding of this distinction that we assume in our development of the theory and practice of setting liquidity policy.

Nonprofits that do not have enough accessible financial resources may divert their attention from mission accomplishment to coping with financial pressures.¹ We often hear of donation-dependent nonprofits thrust into a cash crunch or cash crisis due to the loss

of a key donor or part of their donor base. However, contract-based nonprofits are at least as vulnerable if not more so: Managers may underestimate the costs of carrying out the contract; unexpected increases in cost elements such as rent, energy, benefits, or insurance may occur; or several years of inflation may turn what was once an adequate contract revenue amount into an insufficient sum. Consider this observation from Stephen Rathgeb Smith:

In short, the cash flow problem is not an idiosyncratic occurrence or primarily due to mismanagement; instead it is built into the very structure of the contracting regime. Cash flow problems are to be expected. Nonprofit managers are in the position of coping with chronic cash flow concerns. Managers respond with a variety of strategies. They may delay their payments to their vendors, ask their bankers for easier terms on their loans, request that staff take unpaid leave or vacation time, temporarily lay off employees or freeze hiring, even in cases of staff of staff members leaving. In particularly serious cases, agency executives may forego some of their salary or decide to suspend payment of the agency's payroll taxes.²

The latter tactic would end the agency in legal problems, if detected. In an update to his work on government contracting, Rathgeb Smith suggests that due to additional competition for organizations with government contracts, as well as the fact that many of these contracts do not fully fund the work that needs to be done in order to meet increasing performance-based funding, further pressure is placed on cash flow and liquidity.³ Smith suggests that nonprofits try to deal with the chronic cash flow concerns by one or more of the following funding strategies:

- Obtain a line of credit or win an increased line from their bank
- Gather donations from individuals or grants from corporate foundations
- Tap into the principal of their endowments

Most nonprofits find that these three funding strategies fail them however.⁴ Only nonprofits with collateral – something like inventories or receivables from sales or fees that can be sold to recoup dollars not repaid – or a longstanding reputation are viewed favorably by bank lending officers. Significantly increasing private gifts is difficult at best, and many foundations prefer to fund capital expenditures or projects, not operating expenses. Relatively few agencies can tap the local United Way funding stream, and that only after a lengthy application and review process. Mid-sized and small nonprofits rarely have endowments, and even if they do, only a small percentage of that endowment can be used for operations in a given year (and borrowing directly from an endowment or using endowment as collateral is fraught with complexity: when creating the endowment, you will want to get donors to agree to allow for the use of principal in an emergency; to tap the established endowment fund you will need to ask the donor to change the terms of the endowment retroactively, necessitating petitioning a court and perhaps getting the approval of a state's attorney general's office if the donor is deceased).⁵ For all of these reasons, new monies are difficult to come by; knowing this, government administrators may prefer to contract only with large nonprofits.

We see cash flow problems as endemic to the nonprofit sector, particularly for organizations outside the healthcare or educational fields. From a managerial perspective, we believe that liquidity management is one of the most important yet least studied areas in the management of nonprofits. Liquidity is the key component to financial sustainability. *Liquidity* in our view may be broadly defined as being able to meet present and future draws on cash without impairing the mission or programs of the organization, incurring

significant expense, or diminishing the financial health of the organization. This broad view of liquidity includes financial flexibility⁶ (able to withstand cash flow declines and able to take advantage of near-term opportunities such as price declines or the ability of the organization to augment its future cash flows).⁷ A more popular, but deficient view, is to look at the *solvency* of the organization – the extent to which its assets exceed its liabilities. We view liquidity broadly, encompassing both the definitions of liquidity here as well as solvency. *Our concern? Many managers and board members, as well as charity watchdog agencies, have either ignored liquidity management or have limited their analysis of nonprofit finances to solvency.* We demonstrate the weakness of the solvency view in this chapter and offer guidance on how your organization can set its desired liquidity level. By so doing, it has gone a long way toward ensuring its financial sustainability.

(a) IMPORTANCE OF LIQUIDITY. Liquidity policy and practice has been largely overlooked in nonprofit management periodicals and textbooks. Notable exceptions are discussed later in this chapter – those by Wacht and Ramirez. Also, Grønbyerg notes that growing donative human service organizations require access to liquid reserves to cope with cash flow problems.⁸ Recently, three practitioner’s guides to making cash flow projections, an important facet of liquidity management, have become available.⁹ In most instances when cash or marketable securities are discussed, the problem of inadequate liquidity is briefly mentioned but the possibility or desirability of excess liquidity is not addressed. The coverage gap is surprising for two reasons. First, nonprofit managers, employees, and board members commonly lament the perennial cash crunch or ongoing cash crisis faced by their organizations (see Hall).¹⁰ Second, this area of financial management is one that shares very much in common with business. The views of Aaron Phillips, former director of research of the Association for Financial Professionals, are worth quoting at length:

The one unifying consideration all organizations share, whether publicly held, privately held, government, or not-for-profit, is the concern over liquidity management. It is a safe assumption that a for-profit entity will not remain in business long if it either lacks liquidity or does not effectively manage its liquidity. Empirical research has documented that corporate financial liquidity measures are important for assessing and/or pricing credit, determining bond ratings, forecasting bankruptcy, etc. Similarly, a not-for-profit organization cannot continue to meet its mission objectives, or at the very least risks jeopardizing its relationship with its stakeholders, if it lacks prudent liquidity management. In short, liquidity management is a major concern for every organization.¹¹

Agency theory motivates us to better understand organizational liquidity. The argument is that managers (agents) build excess liquidity, or slack, because they are overly concerned about risk. In businesses, managerial risk aversion exceeds stockholder risk aversion, because stockholders are well diversified. The same argument *may* extend to donative nonprofits. To the extent that there are multiple organizations engaging in similar services (and with the same or very similar values and philosophies), the probability of organization failure and dissolution is of less concern to donors than to the organization’s managers. Donors may simply reallocate donations to surviving organizations when one of the existing organizations fails. Recognize that this does not negate the fact that adequate liquidity, being the core component of financial health, is vitally important.

(b) ARE NONPROFITS OVERLY RISK-AVERSE? The difficulty in assessing whether nonprofit managers are too risk-averse comes when trying to jointly assess (1) the probability

of organizational failure relative to the amount of liquidity held, and (2) the relative risk aversion of donors versus boards and managers of donative organizations. Without saying as much, charity watchdog organizations have made this joint assessment. These public watchdog organizations, in their desire to provide tangible, quantitative benchmarks of the effectiveness and efficiency of nonprofits, have adopted the solvency view of liquidity in their evaluative guidelines. Of the three major organizations – BBB Wise Giving Alliance, the American Institute of Philanthropy (CharityWatch), and Charity Navigator – two have explicitly adopted a prescribed *maximum* level of reserves (unrestricted net assets) that organizations may hold. Charity Navigator recently changed its rating system, but the revisions do not reflect any change in how it rates liquidity.¹² A fourth information provider, GuideStar, also makes three financial measures—months of expenses held in cash, months of expenses held in cash and short-term investments, and months of expenses held in estimated unrestricted liquid net assets—available to interested parties, while withholding judgment on “how much is too much.” The Financial SCAN Report provided by GuideStar, in conjunction with the Nonprofit Finance Fund, is very insightful and provides numerous tables and graphs that the manager as well as the funder will find invaluable.¹³

When a watchdog agency prescribes a maximum, what it is saying is that beyond this level, the organization is holding excess resources that should instead be used for current program or service provision. The reason we must tackle and understand these prescriptions is that they have financial policy implications that have not been identified. These policy guidelines may be appropriate for commercial nonprofits but will severely limit the management style of smaller, contract-based, or donative religious organizations. Watchdog agencies rightly hold nonprofits to standards that avoid excess reserves, but say nothing about the chronic issues related to inadequate liquidity. They in effect establish a ceiling but not a floor on this chronic problem. These standards may reduce the number of nonprofits which hoard cash but not from nonprofits that are constantly struggling to stay afloat in the face of great uncertainty. Management efficiency is diminished due to constant concerns about liquidity. It is necessary to understand what the policy implications of these agency standards are. The implications fall into two major categories: (1) capital structure – many organizations prefer to self-fund future acquisitions, capital projects, and major program expansions, which implies a large buildup in cash reserves; and (2) liquidity management. Not only do many nonprofits avoid or minimize short-term borrowing (two-thirds of religious nonprofits avoid short-term borrowing – see Section 2.5 – but short-term borrowing is the primary source of backup liquidity for businesses, according to Kallberg and Parkinson)¹⁴ – but they may hold their assets in a very illiquid form, such as pledges receivable. For example, often, the “wealth” of many nonprofits, particularly of religious institutions, is in their buildings and fixtures. The work of churches takes place largely in these facilities and the cost of maintaining these structures places an additional drain on liquidity.

Next, we need to know whether these standards rest on a sound financial management foundation. One might use one of three approaches to document and test the liquidity management approaches used by donative religious nonprofits and the degree of impact of the watchdog agency liquidity prescriptions.

1. A survey approach to data collection may be used. Survey evidence collected from 288 donative religious organizations provides information on the espoused liquidity management objectives, how liquidity is measured, and the policy toward and utilization of debt financing.

2. A nonprofit financial database may be used to study the incidence of “problem organizations,” defined as those having more than the prescribed amount of reserves. The best study of actual nonprofit liquidity management practices to date is conducted by Andres Ramirez (2011). Ramirez harnessed the methodology used by the finest corporate finance research and applied it to nonprofits. He studied cash as well as cash as a percent of yearly expenses. His primary findings of interest include:
 - Nonprofits in his sample held the equivalent of three months of annual expenses in cash and another nine months of expenses in savings (short-term investments).
 - Ramirez’s study documents that nonprofits also hold cash for the same reasons as businesses. Businesses hold cash for logical managerial reasons, or in some cases for reasons related to the governance of the organization: (1) transaction motive (it is the least-expensive way to finance daily operations), (2) precautionary motive (as a buffer against unpredictable declines in revenue and support), (3) speculative motive (to take advantage of future investment opportunities, which may also be unanticipated), and (4) governance-related reasons (the board and management superintend liquidity correctly and for good reasons or hold too little or too much liquidity to gain personally or stand in the way of donors’ and other funders’ best interests from being carried out). Smaller nonprofits, those with riskier (less predictable) revenues and support, and those with higher surpluses (surpluses divided by expenses; these surpluses, presumably, accumulate these in the form of cash over time), tend to hold more cash, similar to practices in the business sector.
 - When drilling down into organizations that appear to hold “excess cash,” Ramirez discovered that they will then invest more in land, buildings, and equipment than similar organizations holding less cash. This use of cash to fund asset growth underscores the need to prefund growth by building up liquidity. We call these amounts “strategic reserves.”
 - When organizations have higher level of liquid investments (public securities, including stocks and bonds), those that are easily and quickly sold for their fair market value, they tend to hold less cash, which suggests that managers are aware of and manage substitutes for cash wisely.
 - Organizations spending relatively more on program expenses tend to hold higher levels of cash. Our interpretation of this is twofold: (1) that these organizations might be using the extra cash as an insurance policy or buffer against revenue declines, and/or (2) they might recognize there are relatively fewer non-program amounts that they have discretion over to spend down in the event of unexpected revenue declines or expense spikes (consistent with the Tuckman and Chang interpretation of the administrative cost ratio).
 - More diversified revenue and support streams are positively associated with higher cash holdings. Ramirez questions whether this might be due to a reduced importance for donations and grants (so, less outside monitoring, perhaps leading organizations to hold too much cash) or to the greater required resources and counterintuitively greater volatility of overall nonprofit revenues and support. Our thought here is that managers and boards may couple both revenue diversification and higher liquidity to hedge against uncertainty in future revenues and support as well as expenses.

- Boards with more members hold more cash, whereas officer compensation is negatively correlated with cash (more cash held is associated with lower compensation).
- When there is funding coming from donor-advised funds and from board member loans, this is associated with lower levels of cash.
- Donors do not penalize organizations that hold high levels of cash. They evidently do not see governance/agency problems that might result in too-high liquidity levels. Quoting Ramirez: “Because of the uniqueness of nonprofit organizations, high cash reserves could be seen as prudent management—a precautionary cushion, agility for transactional purposes, and flexibility for speculative purposes—instead of an indication of agency problems.” He concludes his study: “It appears that cash holdings in the nonprofit sector, like their for-profit counterparts, can be largely explained by precautionary and speculative measures ... The evidence presented in this study is consistent with a harmless view of cash. Nonprofits with higher excess cash are those who grow assets more. Cash is very valuable for organization, and donors seem to agree.”¹⁵ So do we.

We have every reason to believe these results are credible and replicable, but would like to see the study redone using audited financial statements rather than the 2000–2006 Statistics of Income (SOI) Form 990 data that was used in this study.

3. One could use simulation modeling or scenario analysis to show how the maximum liquidity limits the financial management options for small donative nonprofits that:
 - a. Do not use debt financing
 - b. Do not typically generate positive operating cash flows (first category on statement of cash flows)
 - c. Are unable to launch capital campaigns
 - d. Have no endowments

To the best of our knowledge, no one has yet employed the third approach to study liquidity or to help set the desired liquidity level for an actual organization.

Before we go any further with our liquidity analysis, we must explain what we mean by donative organizations, give helpful counsel from corporate finance experts, and survey some early landmark studies of liquidity management in healthcare and educational organizations. We illustrate practice and inform policy by providing evidence regarding the financial management practices of a group of donation-dependent nonprofits. We then broaden the focus to commercial organizations, such as private schools and colleges and healthcare organizations. We show how the popular watchdog agency standards may be misguided and detrimental to your organization’s financial health and conclude by providing a checklist of factors that will assist you in setting your liquidity policy.

2.2 NONCOMMERCIAL NONPROFIT ORGANIZATIONS

Nonprofit organizations often rely on sources other than product or service sales for much of their revenue and support. For public charities reporting to the IRS, about 48 percent of total revenue comes from service fees and goods sales revenue (not including government contracts).¹⁶ This figure is largely affected by hospitals and colleges and universities. Many nonprofits rely heavily on donors (20 percent of total revenue overall, 44 percent for arts,

culture, and humanities organizations),¹⁷ or granting agencies for much of their operating revenue. Some types of nonprofit organizations, including religious organizations, gather over 90 percent of their revenues from donations. Some call these *donative organizations* because of their primary income source, while others view these as organizations having a *high collectiveness index*, where “collectiveness” refers to gifts and grants as a percentage of total resources.

(a) GUIDANCE FROM FINANCE THEORY. While corporate finance theory is well developed for businesses, it is still in the earliest stage of development for nonprofits. In fact, the only broad-range financial theory of nonprofit organizations was developed over 30 years ago by Richard Wacht. Wacht prescribes for all nonprofit entities the financial goal of “cost minimization, subject to the absolute constraint of maintaining organizational liquidity and solvency over time.”¹⁸

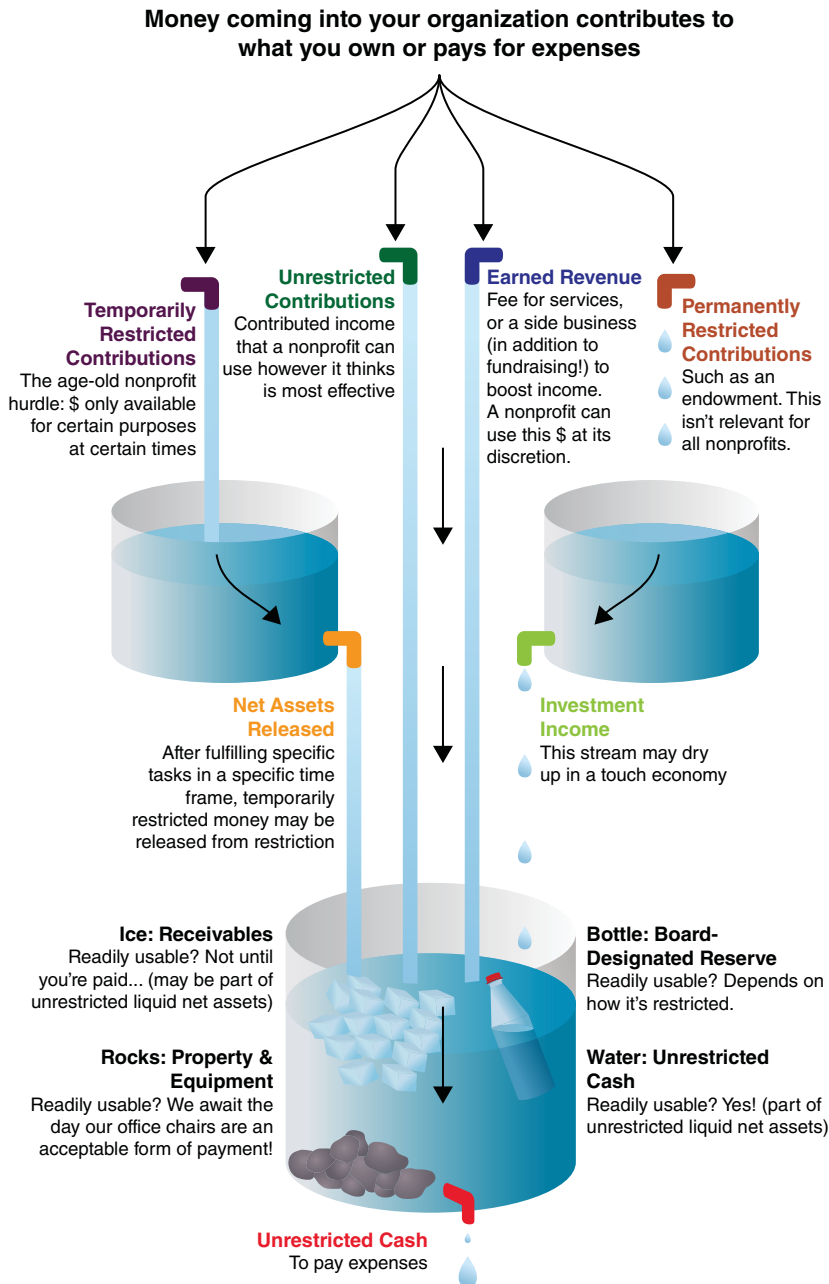
Wacht advocates a cash flow balancing approach to nonprofit financial management. He states at one point that “the financial manager must ensure that actual cash inflows and outflows are balanced and operations are proceeding according to plans.”¹⁹

(b) EVALUATION OF FINANCE THEORY. We commend Wacht as the true pioneer in the field of nonprofit financial management theory development. He recognized the importance of liquidity along with cost control. Furthermore, he is the only one to ever devise a full-blown model of how mission and finance may work together in a nonprofit organization.

Wacht is somewhat vague on the specific implementation of the financial goal. He does note that new project implementation or existing program expansion can prevent the organization from meeting its financial goals of liquidity and solvency, and may plunge the organization into a financial crisis. Implied in his framework is the ability of an organization to develop and correctly utilize a fairly detailed financial model. Without such a model, there would be no way for the financial manager to back or reject proposed capital projects or program expansion initiatives. In our view, liquidity management should be more proactive than reactive, and organizations should start liquidity planning right from the start-up of the organization. All nonprofits should incorporate the riskiness of their cash flows into their assessment of “How much liquidity is enough?” Recently, Grant Thornton, which has a strong practice in nonprofit accounting and auditing, postulated an approach to developing “risk reserves.” This approach is sound for several reasons. First, it engages managers from across the organization in evaluating strategic risks and then applies financial modeling to arrive at projections that are probabilistic. This method provides a data-driven metric that is foundational, logical, and a good way to set policy. It also increases financial literacy through engagement and education for managers who usually function strictly on the operating budget level.²⁰

Wacht overlooks the cash position and short-term securities components of an organization’s liquid reserve by arguing that financial uncertainties must be dealt with by having “sufficient flexibility built into the budgets and financing arrangements to avoid jeopardizing the solvency of the organization.”²¹ Put simply, only by managing down the cost structure (and increasing the amount of operating cash flow) or taking out a loan can the organization deal with a possible revenue shortfall or expense spike. Again, we believe that proactive liquidity management may forestall these more drastic measures if an appropriate target liquidity is set and maintained.

(c) COMPLEXITY OF NONPROFIT CASH FLOWS. The Nonprofit Finance Fund created a “bucket diagram” that illustrates the liquidity issue in nonprofit organizations (Exhibit 2.1).



Source: The Nonprofit Finance Fund. **USED BY PERMISSION.**

EXHIBIT 2.1 WHY NET ASSETS WILL NOT PAY THE BILLS

According to The Nonprofit Finance Fund, this graphic represents how total net assets do not reflect ready cash available to cover expenses.

A major difference between a for-profit enterprise and a nonprofit organization is the fact that nonprofits have restrictions placed on their funding. Not all cash is available for use to fund the organization's operations. This places a serious constraint on the finance manager who must take this into account when forecasting cash flows.²² All other things equal, managers much prefer to have funding come from the middle "inlet pipes" of unrestricted contributions and earned income. Managers who take a false sense of security in a large dollar amount of net assets are bewildered when they cannot pay bills or expand operations due to icy and rocky conditions (money tied up in receivables and property and equipment). We advocate use of this diagram in a session that you might schedule as part of a board retreat or with your management team to give a visual understanding of the financial dimensions of your nonprofit.

2.3 EVIDENCE ON LIQUIDITY MANAGEMENT IN THE NONPROFIT SECTOR

Three groups surveyed nonprofit liquidity-related management practices in nonprofit organizations previously. The surveys focus on healthcare, education, and faith-based donative organizations. These surveys, though dated, are the best gauges we have of actual policies and practices.

(a) LIQUIDITY MANAGEMENT IN THE HEALTHCARE SECTOR. The first survey, by Hahn and Aggarwal, focuses on healthcare organizations. It dealt primarily with the receivables management of hospitals.²³ That survey detected areas of possible improvement in receivables monitoring and collections that would increase organizational liquidity. Some of the key findings are:

- Working capital management (primarily current assets and current liabilities) is primarily handled by the controller (24 percent) or finance or fiscal director (18 percent).
- Most responding managers spend between 5 and 10 percent of their time on working capital management, with about one-quarter of the managers spending 11 to 15 percent of their time on such topics – a surprising response compared to similar business manager survey results, which show much larger percentages.
- Only 36 percent had a cash planning horizon under one year, with 45 percent using a year or more as their horizon.
- Cash budgets are revised yearly by 14 percent, semiannually by 7 percent, quarterly by 20 percent, monthly by 36 percent, biweekly by 2 percent, weekly by 13 percent, and daily by 3 percent of the respondents.
- Checks are processed by 93 percent of the respondents in a day or less.
- About 77 percent of the hospitals regularly invested surplus cash in the money market, meaning almost one-quarter do not.
- While 24 percent of respondents stated that they could achieve an average days of receivables of 30 to 45 days, only 7 percent of the firms actually achieve that collection experience.

- Average days of receivables is listed as the primary measure of receivables monitoring.
- Fully 96 percent of the hospitals took advantage of trade credit and cash discounts offered.
- Inventory management was the weakest part of working capital management.

(b) LIQUIDITY MANAGEMENT IN COLLEGES AND UNIVERSITIES. Another survey, conducted by the National Association of College & University Business Officers (NACUBO) and summarized in Marsee, investigated cash and investment management in colleges and universities.²⁴ The information that follows is representative of that study's findings.

Of the 453 survey responses, 208 colleges and universities (46 percent) indicated that their depository institution was the primary financial institution used when making investments such as certificates of deposit or repurchase agreements.

The responses also indicated that the typical cash manager:

- Handles both the cash management and investment decisions (70 percent), usually as the chief financial administrator
- Is operating under the guidelines of an institutional investment policy (65 percent)
- Feels relatively free of local politics when making investment decisions (82 percent)
- Works primarily with in-state banks (83 percent)

Neither the Hahn/Aggarwal nor the NACUBO study addressed the role of or the objective for liquidity management.

(c) LIQUIDITY MANAGEMENT IN FAITH-BASED DONATIVE ORGANIZATIONS. We believe the greatest insight regarding the uniqueness of nonprofit organizations should come from the subgroup(s) that is (are) most purely nonprofit. In this section we briefly recap the methods used in our Lilly research study (see Appendix 1A for background and more detail on that study). Donative nonprofits – those relying on donors for much or all of their operating revenues – were selected for study on this basis. Four types of faith-based organizations served as the sampled group of nonprofit organizations: (a) denominational headquarters; (b) denominational foreign mission headquarters (where operated separately); (c) independent mission agencies; and (d) domestic rescue missions.

The study, funded by the Lilly Endowment, was conducted in two phases in the early 1990s. Survey evidence we collected from 288 donative religious organizations provides visibility into the espoused liquidity management objectives, how liquidity is measured, and the policy toward and utilization of debt financing. The topics covered include those mentioned earlier along with other short-term financial management topics, such as inventory management and bank relations. Field studies also were conducted at eight selected organizations. Two organizations were selected from each of the four subtypes, with ensuing individual on-site visits for approximately two and a half days. During the field studies, archival data were collected (budgets, variance reports, board minutes, financial policies, audited financial statements, and forecasts) and in-depth personal interviews were conducted. The interviews were with the chief financial officer (CFO), chief executive officer (CEO), and usually also with the board member most involved with financial decisions. Bear in mind that the “key informant” responses are from the vantage point of individuals holding these three roles, with the most extensive questioning done with the CFO.

(i) Study Findings. This section presents several of the main findings regarding liquidity management. Many of the findings are provided later in the section on the importance of liquidity management, in that they bear on the factors determining the vitality of liquidity.

Organizations manage by planning (including policy setting), executing, and controlling. The finance function focuses mostly on the planning and controlling activities. We profile the survey responses in planning first, then executing (one measure), and controlling. Then we turn to our field study findings, including a basic model of the apparent operational financial objective.

(ii) Short-Term Policies and Planning. Only one in four organizations (24.3 percent) has an explicit overall policy for the liquidity management (worded in the questionnaire as “the management of its current assets and liabilities – working capital”). Most of those organizations that do have such a policy (56 percent) indicate that it is risk-avoiding (“current asset and liability levels selected to keep risk to a minimum”), with the second most common response (28 percent) being situational (“current asset and liability levels selected depending on the financial position of the agency”). Interestingly, only 10 percent of those organizations having a policy consider that policy to be risk-accepting (“current asset and liability levels selected to increase interest income, while accepting the possibility that short-term borrowing may be needed”). Sixty percent of the organizations have an investment policy, which all organizations should have. Field studies revealed that almost none of the policies separately addressed short-term investments.

Surveyed organizations scored better on operating budget practices than on cash forecasting practices. Eighty-nine percent of the organizations have (and presumably use) an operating budget, leaving 11 percent with a handicapped short-term planning system. Forty-four percent of the surveyed organizations develop a cash forecast – an exercise that is absolutely vital for liquidity management. Based on a survey by Campbell, Johnson, and Savoie, Fortune 1000 treasurers consider short-term cash flow projections to be one of the most valuable tools for liquidity management.²⁵ Beginning to project cash inflows, cash outflows, and the resulting cash position, is the first place to start in improving short-term financial management for over one-half of our surveyed organizations.

Organizations with more solvency typically have a greater degree of their assets in the form of short-term, or current assets. Current assets are those that are either already in the form of cash or will be converted to cash within a year. A mere 13 percent of responding organizations have a target current assets-to-total assets (CA/TA) ratio value. This ratio, recommended for practitioner use by Herzlinger and Nitterhouse and others,²⁶ is a solvency measure that gets at *relative liquidity* (closeness to cash) of the organization’s asset investment. In his 1989 ratio compilation study, Chris Robinson found a wide range of actual values for this “asset ratio” for faith-based organizations: Churches had a median ratio value of 0.06, while foreign mission agencies invested about one-half of their assets in current assets.²⁷ (The latter do so because they serve as “conduits,” as profiled in our framework, presented later.)

Using a slightly different ratio, from data compiled in 2006 by Dan Busby and his staff at the Evangelical Council for Financial Accountability (ECFA), we find that the cash-to-revenue ratio for the 1,200 faith-based organizations then holding membership in ECFA is 0.21.²⁸ This implies that a typical organization could survive for about 2.5 months, on average, if revenues were interrupted ($2.5 = 0.21 \times 12$ months). Assuming revenues (or total revenues and support) equals expenses for this group overall, this demonstrates that these organizations hold less in cash reserves than the commonly advocated target of 3–6 months of expenses. Bear in mind that the latter guideline is strictly for operating

reserves, and does not include additional amounts that should be held for prefunding capital assets or new programs.

(iii) Executing Liquidity Management. One measure of liquidity management execution is provided by a question regarding whether the organizations practice daily active cash management. Daily active cash management involves setting the day-ending cash position early in the day (before noon), then making funds movement and short-term investing and borrowing decisions in light of that cash position. About one-half of the organizations state that they do this, which would be considered quite good given their size (\$800,000 median annual revenue).

(iv) Controlling. Organizations do well at calculating monthly budget variances (actual amount versus budget), with four in five organizations doing so, and another 8 percent making quarterly comparisons. Unfortunately, only two in five organizations compute and analyze financial ratios, and half of those organizations do so on a monthly basis. The asset ratio is monitored by almost one-half of the organizations, although as mentioned earlier, most of these do not manage it toward a specific target value. Possibly the best news is that 78 percent of the organizations say that they use information technology to monitor and/or forecast their cash positions.

(v) Primary Financial Objective: Lessons from the Field Studies. The second phase in the Lilly study involved field studies of eight selected organizations. In-depth interviews, study of archived documents such as board meeting minutes and financial reports, and statistical study of cash flows were executed for each of the eight organizations. A pattern of financial decision making appeared from these studies. From the perceived pattern, a new model of organizational financial decision making was developed. The model, which we call the “Appropriate Liquidity Target” model of financial decision making, describes how nonprofits make financial decisions. (See Appendix 1A for more on this model.)

Interestingly, charity watchdog agencies now include some facets of liquidity in their ratings of nonprofits. Before we see what the charity watchdog agencies prescribe for your organization’s solvency and liquidity, we need to establish just how critical liquidity management is for nonprofits. The next section is one of the most important in this book, because it provides the arguments for our central financial objective of managing the organization’s target cash position and cash flows.

2.4 FACETS OF LIQUIDITY MANAGEMENT

Liquidity management in the business sector is defined as “the allocation of liquid resources *over time* to meet resource needs for payment of obligations due and for various investments that management undertakes to maximize shareholder wealth.”²⁹ Changing the last phrase to read “to attain its mission” recasts the definition for nonprofit organizations. Gallinger and Healey allege that the failure of managers to provide adequate liquid resources to both meet near-term bills and finance growth initiatives has been the cause of as many business failures as have economic recessions. They indicate that the most fundamental objective of liquidity management is to ensure corporate solvency (pay bills as they become due) or ensure corporate survival. The key issues in liquidity management are to minimize “insolvency risk” by (1) determining how much to invest in each component of current assets and allocate funding needs to each component of current liabilities, and (2) managing these investments and allocations effectively and efficiently.

(a) **LAYERS OF LIQUIDITY.** We can view liquidity management in a way useful to managers by establishing “tiers of liquidity.”³⁰ Here the organization’s liquidity is viewed in tiers of decreasing liquidity, with six major layers of liquidity (see Exhibit 2.2).

For our discussion of nonprofit liquidity management, it is helpful to distinguish among solvency, liquidity, and financial flexibility. We shall combine all three in the idea of “broad liquidity,” or “liquidity, broadly defined.” Managers following best practices actively manage all facets of broad liquidity.

(b) **SOLVENCY.** An organization is *solvent* when its assets exceed its liabilities. The larger the degree to which assets exceed liabilities, the more solvent the organization is. In the non-profit context, this difference is labeled “positive net assets” (see Chapter 6 for definitions of these items). When evaluating solvency, we usually go one step further and compute *net working capital*, which equals current assets minus current liabilities. A related measure, the *current ratio*, compares current assets to current liabilities by dividing current assets by current liabilities. This data is available on the organization’s balance sheet, which we also detail in Chapter 6.

(c) **LIQUIDITY.** Further, an organization is *liquid* when it can pay its bills on time without undue cost. Clearly an organization is *illiquid* if it is consistently unable to take cash

Liquidity Tier	Comments
Tier 1: Cash flow, cash balances, and the short-term investment portfolio	Most liquid. Watch out for restricted cash and for previously designated unrestricted cash. Watch out for restricted short-term investments (may serve as collateral for a loan).
Tier 2: Short-term credit	This, more so than cash balances and ST investments, provides the majority of the liquidity reserve for businesses. To a degree, a line of credit from a financial institution can substitute for cash balances or short-term investments in Tier 1. May come from a board member or members. In extreme difficulties, some nonprofits have been permitted to borrow using an endowment fund as collateral.
Tier 3: Management of cash flows	Examples are to encourage donors (especially on pledges) or foundation grantors to give unrestricted funds for operations or to build a reserve or to accelerate their giving, as well as for the organization to delay payments, offer services at lower prices, offer easier credit terms, or alter inventory positions.
Tier 4: Renegotiation of debt contracts	Some lenders (such as board members) are more flexible than others.
Tier 5: Asset sales	The organization is beginning to liquidate valuable assets simply to provide cash to stay afloat. As things get to an extreme financial exigency scenario, (1) living endowment donors may release spending restrictions, and/or (2) the state attorney general may approve sale of some endowment assets.
Tier 6: Bankruptcy	The purpose of bankruptcy is to buy time to reorganize by protecting the organization from creditors. Bankruptcy may culminate in reorganization or liquidation.

Source: Adapted from diagram in Gallinger and Healey.

EXHIBIT 2.2 THE SIX LAYERS OF LIQUIDITY

discounts (e.g., 2 percent cash discount if one pays an invoice within 10 days), must delay making payments, or must constantly engage in interfund borrowing.

(d) FINANCIAL FLEXIBILITY. Finally, an organization possesses *financial flexibility* when its financial policies (use of debt, excess of revenues over expenses, and relationship of revenues to assets) are consistent with its projected increase in revenues. The Financial Accounting Standards Board (in Financial Accounting Standard 117) defines financial flexibility operationally, indicating that “Financial flexibility is the ability of an entity to take effective actions to alter amounts and timing of cash flows so it can respond to unexpected needs and opportunities. Information about the nature and amount of restrictions imposed by donors on the use of contributed assets, including their potential effects on specific assets and on liabilities or classes of net assets, is helpful in assessing the financial flexibility of a not-for-profit organization.”³¹ We would include in financial flexibility the willingness of board members to meet emergency needs to making above-normal donations or loans to the organizations. Correspondingly, finance staff need visibility into information on restrictions on the use of assets, compensating balances that must be maintained in checking accounts, the maturity structure of long-term assets and liabilities, and designated amounts within unrestricted cash and short-term investments.

2.5 IMPORTANCE OF LIQUIDITY MANAGEMENT

The importance of liquidity management is partly self-evident. It makes sense to have enough funds to pay bills; the converse is to be in a cash crunch or, if the shortfall is ongoing, a cash crisis. A cash crisis eventually arises whenever an organization is not bringing in adequate revenues to offset its expenses. The significance of liquidity management to nonprofits seems clear from the ongoing discussion of how to cope with these cash shortfalls.³² Some believe that cash flow problems might simply be the result of mismanagement in selected, but visible, nonprofits. We disagree. Liquidity management is the single most important financial function in most nonprofits.³³ This is so because of two overlapping sets of factors: institutional factors and managerial philosophy ones.

(a) INSTITUTIONAL FACTORS.

(i) Primary Financial Objective. Businesses attempt to maximize shareholder wealth as their primary financial objective. This objective drives businesses to constantly increase cash flow, given the amount of risk they wish to take. Liquidity tends to take care of itself, except in the cases in which (1) growth is combined with low profit margins and long product development, inventory, or credit sales-collection periods, or (2) the organization is in decline. In nonprofit organizations, without the shareholder wealth objective, what is the appropriate financial objective, and what are the liquidity implications? Other sources have traditionally advocated as the primary objective striving for financial breakeven (revenues just covering expenses), which implies that the stock of liquid resources remains relatively constant, all other things being equal. Increasingly, calls are made for organizations to attempt to earn a small surplus (“positive net revenue,” or “positive change in unrestricted net assets”), which should provide a boost to the organization’s liquidity, at least for some seasons of the fiscal year. We agree that this is appropriate as a means to an end – the end being *maintaining a liquidity target* adequate to protect the organization and its mission against seasonal and cyclical cash shortfalls and to build a financial resource base for future program and facility expansion. We will come back to actual practices a bit later.

(ii) Limited and Volatile Revenue Stream. Colleges, hospitals, and other commercial nonprofits are much like businesses, but donative nonprofits have no price lever with which to earn revenue on their core services. Correspondingly, they cannot increase or decrease price – selecting the appropriate change based on how responsive customers' purchases are to price – in order to increase revenue when facing present or potential cash flow shortfalls. (Quantity-cost relationships are important here too in order to define the *net* revenue effects.) Furthermore, the natural and almost automatic coupling between cash outflows to pay for supplies and labor and the ensuing cash inflows from sales is absent in donative nonprofits. To make matters worse, while a slowdown in revenue from sales for a business triggers a quick downward adjustment in cash outflows for production, cash outflows will be difficult to adjust downward for a donative nonprofit, and the cash position may actually be further depleted if the organization ratchets up its fundraising investment to try to offset the recent decline in donations. Even then, human service organizations pursuing various levels or types of donation efforts often are not able to increase the predictability or size of donation revenues.³⁴ Donations may be volatile and change in unpredictable ways, in spite of intensive development efforts or the existence of natural constituencies (less so in cases of institutionalized relationships, such as United Way or religious federations). Further evidence of the unpredictable stream of donated funds is provided by Kingma, whose research indicates that increased financial risk arises from donation revenue streams. Liquidity thus has greater value for the donative nonprofit.³⁵ A more recent study by Carroll and Slater also finds that if a nonprofit relies primarily on donations, it will experience more volatility.³⁶ If an organization raises funds in advance of program and service delivery, it is engaging in a liquidity management strategy that explicitly recognizes the need for and value of a greater degree of liquidity. *For most organizations, this proactive liquidity management approach of prefunding future needs is the advisable approach.* This approach is often ignored as many nonprofits measure their financial success solely by the increase in revenue and support and not by managing their asset positions. We are aware of a private academy in Texas that prefunds almost an entire year of expenses by putting this year's tuition and fees in savings for next year. As it brings in tuition and fees this year, that amount goes into savings for the next academic year.

Organizations may partly offset the revenue limitations by turning to supplemental earned income ventures, but this implies four greater barriers than are commonly recognized: (1) These ventures deploy already-scarce resources (which would actually exacerbate a cash flow crunch or crisis), (2) they may and often do defuse the organization's mission focus, (3) quite often the managerial team and/or board does not possess competencies requisite for profitably managing the ventures, and (4) even when successful, there is a *long time lag* between launching the venture and achieving positive net revenue.³⁷ Numerous nonprofit organizations attempt these ventures, as noted in studies by La Barbera and by Froelich and Knoepfle, but La Barbera finds that, in the small nonrandom sample studied, raising funds was an objective in only a minority of the faith-based organizations.³⁸

(iii) Inability to Issue Stock to Raise Equity Capital. Donative nonprofit organizations face an additional funding constraint in that they cannot issue stock. An important permanent source of financing is therefore unavailable to them. Internal nonborrowed funding (equity) is available to these organizations to the extent they achieve operating surpluses, engage in capital campaigns, or build endowments. On an ongoing basis, the only means of accumulating equity capital is to earn a surplus (profit equivalent) on operations. Yet, some organizations consider financial breakeven to be their chief financial objective, which

implies that they are unwilling to earn significant surpluses. Many managers report that it is considered to be culturally inappropriate to plan for a surplus and that neither boards nor funders allow this as a standard practice. The institutional reality that no cash dividends are allowed or expected partly offsets this limit on capital. In this sense, nonprofits operate much like a start-up or other rapidly growing business that reinvests all of its profits in order to self-fund its growth as much as possible. Added assistance comes from the 501(c)(3)'s tax exemption, implying that all "before-tax" net revenue is available as "after-tax" addition to equity.

(iv) Time-Restricted and Use-Restricted Donations. Possibly the most significant impediment to matching cash inflows to cash outflows comes from the large proportion of time-restricted or use-restricted donations. Cash outflows for expenditures that are not easily or currently funded by donors pose a significant threat to the liquidity position of the donative nonprofit. Fullmer estimates that 75 percent of donations to nonprofits are restricted (primarily to a specific use), and in the Lilly study of donative nonprofits, we find a self-reported average of 72 percent of their current/operating fund donations come with donor restrictions.³⁹ This factor alone accounts for a more difficult management task when comparing liquidity management for donative versus other nonprofits, governmental agencies, or businesses. In fact, US accounting standards setters tacitly recognized the organizational impact of restricted gifts on liquidity, motivating the split-out of unrestricted and (donor) restricted net assets in nonprofit financial statements. Our survey of donative faith-based nonprofits indicates that borrowing from restricted funds is viewed as a necessary evil by those practicing it in many organizations: When asked "How frequently does your organization temporarily transfer funds from its current restricted or other restricted funds to meet a shortfall in your current unrestricted (general) fund?" 13 percent said on a monthly basis (!), 14 percent said on a quarterly basis, 10 percent said once a year, 19 percent said less than once a year, and 44 percent said never.⁴⁰ The problem is compounded for those organizations that are striving for financial breakeven as opposed to a positive net revenue (the former should have a smaller cash inflow, all other things equal) or that have small or nonexistent cash reserves (stock of cash), illustrating the overlap and often cumulative effect of these institutional and managerial philosophy factors.

(v) Operating Characteristics of Donative Nonprofits. Financial processes of nonprofit organizations can be accurately characterized as a cash flow system. Many charities and churches receive cash in from gifts and grants, hold onto the cash for a while, and then disburse the cash to other organizations, needy members, clients, or other beneficiaries. Colleges and schools and food and medical care charities, which transform cash into services or products, also benefit greatly from liquidity management, as demonstrated in the cash flow system model (see Exhibit 2.3).

Organizations that primarily transfer funds from donor or grantor to clients or beneficiaries are called *conduits* in our profile. Examples include foundations, religious denomination and association headquarters operations, and international child welfare and other multinational agencies sending personnel abroad to deliver a service. Proficient cash management is absolutely essential to the success of conduits in that they are primarily cash-gathering and distributing machines. *Transformers*, in turn, convert cash into one or more products or services and distribute those outputs to clients and other beneficiaries. Transformers include churches, arts organizations, many healthcare organizations, educational institutions, and most human service organizations and other charities. Cash management proficiency is still important prior to the conversion process, but since the organization is also delivering a product or service to achieve its mission,

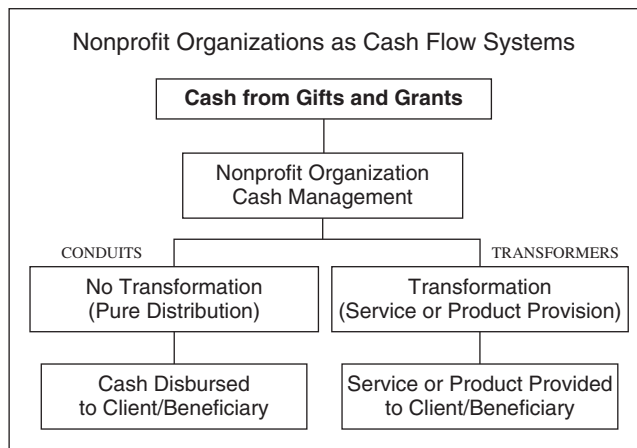


EXHIBIT 2.3 CASH FLOW MODEL OF DONATIVE NONPROFIT FINANCES

the quality and quantity of product/service delivery assume great importance. Overall working capital proficiency is the appropriate focus in transformers. Net working capital includes cash, receivables, inventories, payables, accrued expenses, and short-term loans. Whether conduit or transformer, management must focus on liquidity management, which encompasses cash management and the broader aspects of working capital management.

(b) MANAGERIAL PHILOSOPHY FACTORS.

(i) Major Reluctance to Earn Surpluses. When asked what their main financial goal is, a significant, if diminishing, percentage of donative faith-based organizations have selected financial breakeven.⁴¹ What is not as clear is whether this goal is operative. Intriguing evidence regarding actual surpluses is provided by Chang and Tuckman, who find that charities earned no surplus while other nonprofits were averaging a 10 percent surplus (as a percent of total revenues).⁴² By forgoing the accumulation of positive net revenues, charities are bypassing the major source of liquidity in businesses (especially those with high profit margins, such as Apple or Microsoft). Profits are also considered by some to be a nonprofit's most reliable source of cash.⁴³

(ii) Resistance to Engage in Short-Term Borrowing. Although Tuckman and Chang indicate that 71 percent of nonprofits included in the 1986 IRS 990 database engaged in some borrowing, we do not know how many of these organizations used short-term debt.⁴⁴ Many organizations that use mortgage loans for plant and equipment will resist short-term borrowing, in that it is considered risky to become dependent on borrowed funds to finance operations. Short-term debt, as noted by Kallberg and Parkinson's model, is the second tier of liquidity for an organization. The surveyed donative faith-based organizations are disinclined to use short-term loans:

- Two-thirds of the respondents never do short-term external borrowing.
- 21 percent do short-term borrowing, but not every year.
- 13 percent do short-term borrowing every year.

For the one-third of the organizations that do borrow, the *primary* use is:

- As a regular and constant part of total financing (11 percent)
- As a cyclical part of total financing (15 percent)
- As a seasonal part of total financing (29 percent)
- To meet irregular needs (45 percent)

About 4 in 10 (38 percent) of the borrowing organizations are never asked to provide security (collateral) for their short-term loans, while 34 percent are occasionally required to collateralize and 27 percent must always collateralize the borrowings. Although lenders much prefer to collect loan interest and principal repayment from cash flows realized by the borrower, the security stands as a backup to protect the lender in the event of default.

Finally, although most leasing is long-term in duration, 19 percent of the surveyed organizations arrange leases for financing purposes.

(iii) *Insufficient Liquidity Monitoring, Management, or Projection.* With one exception, the survey evidence shows that most donative faith-based organizations would benefit from greater adoption of available techniques for liquidity monitoring, management, and projection. As shown in the responses for the survey of donative faith-based organizations, less than one-half of the organizations were doing the minimal tasks necessary to properly monitor, manage, and project liquidity needs.

(c) LIQUIDITY IMPLICATIONS OF INSTITUTIONAL AND MANAGERIAL PHILOSOPHY FACTORS. There are two main implications for liquidity management and related financial policies from the foregoing analysis:

- *Implication #1:* The capital structure decision favors reinvested surpluses as the primary means of financing assets. These organizations are obviously quite risk-averse, based on the survey findings reported here, and will use only limited long-term debt to supplement equity. These organizations should be encouraged to operate at a surplus.
- *Implication #2:* Liquidity management is critical to the surviving and thriving of the donative nonprofit. This is true for short-term solvency, liquidity, and financial flexibility as well as for long-term financial sustainability, or what is sometimes termed “strategic liquidity.”⁴⁵ Strategic liquidity (often evidenced in the form of a “strategic reserve”) refers to the ability to seize new strategic opportunities, expand into new services or markets, build infrastructure, or make other large-dollar investments. It focuses on liquidity on a longer-term basis, recognizing the possibility of conceivable risks in the form of unexpected and potentially adverse operating conditions.

To recap, it makes sense for organizations that are constantly pressed for funds and are locked out of equity markets and greatly limited in the use of debt to investigate the behavioral implications of funding sources. Emphasis on funding sources is not new.⁴⁶ However, a new and logical implication is a greater value for liquidity, which up to the time of the study of faith-based organizations had only been highlighted by Grønbjerg.

Summarizing our discussion, the advantages to the donative nonprofit of having a high degree of liquidity are the ability to fund disbursements, earn interest revenue, protect against adverse developments, manage funding risk, and seize unforeseen opportunities. That is not to say that more is always necessarily better. Too much liquidity

is disadvantageous to the organization because it absorbs funds that could be used in program delivery or expansion. Furthermore, some donors may react negatively and give elsewhere. An organization is considered liquid “if it has enough financial resources to cover its financial obligations in a timely manner with minimal cost.”⁴⁷ The implication? There is a desirable level of liquidity for each organization that balances benefits and costs. In Chapter 1 we proposed the following as the primary financial objective for most nonprofits: “To ensure that financial resources are available when needed, as needed, and at reasonable cost, and are protected from financial impairment and spent according to mission and donor purposes.” The first part of that objective implies that there is a target liquidity level that organizations should set and strive to achieve.

Before addressing your internal view of that liquidity target, it is important to know that outside parties are imposing a one-size-fits-all to externally assess the appropriate liquidity range. These “charity watchdog agencies” have spoken on the topic of liquidity management, so we survey and critique their views.

(d) WATCHDOG AGENCY STANDARDS ON SOLVENCY AND LIQUIDITY. Among the three major charity watchdog agencies, only Charity Navigator does not prescribe a maximum liquidity level. In the standards set by the BBB Wise Giving Alliance, a maximum liquidity (actually solvency) standard is applied, and CharityWatch (formerly the American Institute of Philanthropy, formerly AIP) prescribes a maximum liquidity (again solvency) standard that is similar to the BBB standard.

(i) BBB Wise Giving Alliance Standard. In its Standard 10, the BBB Wise Giving Alliance states:

Avoid accumulating funds that could be used for current program activities. To meet this standard, the charity’s unrestricted net assets available for use should not be more than three times the size of the past year’s expenses or three times the size of the current year’s budget, whichever is higher.⁴⁸

It is interesting to note that this standard has been revised upward: The BBB standard upon which this standard is based formerly limited organizations to two years or less of liquid funds. Now Standard 10 states that net assets available for use in the following fiscal year are not usually to be more than three times the current year’s expenses or three times the next year’s budget, whichever is higher. To arrive at available assets, BBB makes this calculation: Available assets = (unrestricted assets + temporarily restricted assets + deferred revenue – liabilities). We underscore the need for BBB to correctly interpret nonprofits’ financial health, as there is evidence that meeting BBB standards is associated with increased following-year donations.⁴⁹

(ii) CharityWatch Standard. CharityWatch is very unforgiving of organizations that have more than three years of budgeted expenses on hand. It downgrades organizations to increasingly severe degrees the farther over three years those available assets are (see Exhibit 2.4). Organizations that have been downgraded are shown in Exhibit 2.5.

(iii) Charity Navigator Standard. Of all of the charity watchdog agencies, Charity Navigator has done the most work in evaluating the liquidity needs of various types of nonprofit organizations. We also underscore the need for Charity Navigator to correctly interpret

Charities with Large Asset Reserves

AIP strongly believes that your dollars are most urgently needed by charities that do not have large reserves of available assets. AIP therefore reduces the grade of any group that has available assets equal to three to five years of operating expenses. In AIP's view, a reserve of less than three years is reasonable and does not affect a group's grade.

These reductions in grades are based solely on the charities' asset reserves as compared to budget. If you agree with these charities that reserves greater than three years' budget are necessary to enhance their long-term stability, you may wish to disregard the lower grades that AIP assigns on the basis of high assets.

AIP's definition of "years of available assets" includes funds currently available for the charity's use, including investments that the charity has set aside as a reserve but could choose to spend if it wanted to do so.

Source: CharityWatch, <http://www.charitywatch.org/>.

EXHIBIT 2.4 CHARITYWATCH STATEMENT ON CASH AND INVESTMENTS

nonprofits' financial health, as there is evidence that a "one-star" increase in the Charity Navigator rating (out of five stars possible) is associated with an almost 20 percent increase in the organization's following-year donations.⁵⁰

The most important deficiency in Charity Navigator's framework is its inclusion of long-term investments in its working capital ratio. Charity Navigator recognizes this shortcoming but points out that IRS Form 990 does not allow one to distinguish between short-term and long-term investments. Its comment, regarding this, that it uses this all-inclusive measure consistently and thus treats all organizations fairly, is an overstatement: Consistency when one has an impaired measure of what one is trying to measure (short-term investments) does not guarantee fairness. An organization with all of its investments in 3-month Treasury bills is certainly more liquid than one with all of its investments in 30-year Treasury bonds, but this fact is hidden by the equal treatment in the ratio.

In Charity Navigator's defense, we argue that organizations *should* be able to self-fund capital investments, and at times this includes investing in some longer-term investments – particularly when one begins the funding 5 or 10 or more years in advance of a major capital investment. This fact suggests that the exact breakdown of short-term (one year or less in maturity) and long-term (more than one year in maturity) is not as important as it might at first appear. Second, to its credit, Charity Navigator does not penalize an organization with very large amounts of cash and investments, choosing instead to cap its score on the working capital ratio at a value of 10 no matter how high the organization's working capital ratio (see Appendix 7B.2).

(iv) *Philanthropic Research, Inc. (GuideStar) Standard.* Although a data provider and not technically a watchdog agency, Philanthropic Research, Inc. (PRI) in conjunction with the Nonprofit Finance Fund publishes financial data useful to and possibly used by the same audiences as those targeted by BBB, CharityWatch, and Charity Navigator.

Philanthropic Research, Inc. publishes its findings on its outstanding Web site (www.guidestar.org). GuideStar and Nonprofit Finance Fund have joined together to provide three ratios (measures) that provide liquidity-related information:⁵¹

1. Months of Cash

Months of Cash = Total Cash / (Total Expenses / 12)

	Grades Reduced for Charities with Large Asset Reserves				 in 000's		
 August 2006 American Institute of Philanthropy 	1. Army Emergency Relief	93	3	17.6	307,288	A+	F
	2. Research to Prevent Blindness	89–90	7–15	13.8	233,405	A	F
	3. Shriners Hospitals for Children	94	1	12.7	8,620,682	A+	F
	4. Air Force Aid Society	93	3	10.1	172,209	A+	F
	5. YWCA of the USA-N.O.	66	25	8.9	63,006	B-	F
	6. Guide Dogs for the Blind	79–80	8–10	8.8	253,342	A-	F
	7. Cal Farley's Boys Ranch and Affiliates	74	30	8.7	429,738	B	F
	8. Diabetes Trust Foundation	82–83	9–10	8.4	5,259	A	F
	9. Seeing Eye	82	10	8.4	208,700	A	F
	10. Hole in the Wall Gang Fund	86	8	6.8	50,375	A	F
	11. Give Kids the World	80	7	6.3	78,659	A-	F
	12. Southern Poverty Law Center	51–67	20–34	6.2	152,866	C-	F
	13. Amer Action Fund for Blind Children and Adults	59–77	18–33	5.5	19,563	C	F
	14. Girls and Boys Town/Fr. Flanagan's	86–88	29–36	4.9	916,494	B	D
	15. Brookings Institution	78	6	4.8	248,204	A-	C-
	16. Navy-Marine Corps Relief Society	94	2	4.8	158,722	A+	C
	17. Omaha Home For Boys	74	48	4.8	101,873	C+	D
	18. Ploughshares Fund	87	10	4.7	26,033	A	C
	19. Fresh Air Fund	75	23	4.4	104,514	B+	C-
	20. ACLU Foundation	81	8	4.3	175,910	A	C
	21. Accuracy in Media	85	11	4.2	5,922	A	C+
	22. Hadassah	83	9	3.8	579,425	A	C+
	23. Japan Society	71	19	3.8	90,183	B	C
	24. Boy Scouts of America - National Council	90	6	3.7	597,503	A+	B-
	25. Human Rights Watch	75	15	3.5	88,593	A-	C+
	26. Rosebud Educational Society (Little Sioux)	61–68	33–42	3.5	16,941	C	C-
	27. Asian Relief/World Villages for Children	44–54	27–35	3.4	33,555	D	D
	28. Carter Center	70	14	3.4	286,497	B+	C+
	29. American Printing House for the Blind	77	19	3.0	83,350	A-	B-
	30. Resources for the Future	81	16	3.0	30,066	A-	B-

Source: American Institute of Philanthropy (AIP). AIP now uses the name CharityWatch.

EXHIBIT 2.5 ORGANIZATIONS DOWNGRADED BY AIP DUE TO "EXCESS SOLVENCY"

2. **Months of Unrestricted Liquid Net Assets**, where Unrestricted Liquid Net Assets represent that portion of net assets available for operations

Months of Unrestricted Liquid Net Assets = $[\text{Unrestricted Net Assets} - (\text{PPE} - \text{PPE Debt})] / (\text{Total Expenses} / 12)$, where PPE is Property, Plant & Equipment (long-term fixed assets, in other terminology), and PPE Debt is long-term debt up to the amount of PPE, and is presumably arranged to finance PPE.

3. **Working Capital (or, Net Working Capital)**

Working Capital = Current Assets – Current Liabilities

Months of Cash, which is related to the Cash Reserve Ratio (see Chapter 7), is a commonly calculated measure of liquidity. Months of Unrestricted Liquid Net Assets overstates liquidity but gives an interesting and broader view than Months of Cash. Working Capital, more commonly called Net Working Capital in the business world, is a solvency measure that is deficient in that it does not take into account nearness to cash of either current assets or current liabilities. We add here that, as noted elsewhere in this chapter, GuideStar and the Nonprofit Finance Fund offer a fee-based report called the Financial SCAN™ Report that gives much more insight that one might gather from these three ratios.

(e) **ASSESSMENT OF WATCHDOG STANDARDS.** Ideally, the information provided by these charity watchdog agencies and PRI can reduce the unobservability dilemma: Donors cannot observe the effectiveness or efficiency with which their funds are managed. More and better publicly available information affects public image. By doing so, it increases the likelihood that potential effects on an organization's public image and reputation may align the decisions and behavior of the nonprofit's managers with donors' and society's best interests. This is especially important in cases where boards are ineffective because they are weak, disinterested, or uninvolved. Boards can potentially provide an information mechanism to deal with mismanagement. For example, a greater proportion of outside directors and possibly a greater proportion of directors having business experience might thwart opportunistic, self-seeking behavior on the part of managers.

Regardless of possible usefulness, the standards of BBB and CharityWatch, in particular, are open to criticism on five grounds:

1. Three of the four sets of standards or metrics focus on solvency, leaving out the more valuable insights from liquidity or financial flexibility (which includes strategic liquidity) perspectives. Put differently, all of the agencies except GuideStar/NonProfit Finance Fund are using the weakest measures available for what they are trying to measure. In their defense, it is difficult for these agencies to get the necessary information to make their assessments.
2. Apparently the BBB and CharityWatch agencies believe that the agents (managers) are either (a) too risk-averse – and are more risk-averse than typical donors; or (b) prone to take and use excess funds for purposes other than mission achievement. Regarding (a), we counter that the form of backup spending capacity should not be dictated by a charity watchdog agency. Why not hold liquid reserves in the form of cash and marketable securities instead of used or unused borrowing capacity? We view penalizing the former while ignoring the latter as either an unjustified value judgment or an oversight on the part of the watchdog agencies. Possibly the value judgment has not been recognized due to the solvency focus taken. Regarding (b), which relates to managers either pursuing interests dissimilar to those of donors, spending that money later on their own “perks” such as nonsalary benefits or excessive spending on offices or travel and entertainment, or spending that money later

- on higher salaries, we counter with these possibilities suggested by Fisman and Hubbard:⁵² donors might prefer to have an endowment/cash reserves/precautionary savings rather than annually fund spending needs due to four factors: (1) superior managerial information about present and future investment opportunities, (2) superior managerial information about present and future financial needs that might be faced, (3) the costliness of having to raise additional funds from donors when facing intrayear shortages, and (4) donor establishment of an endowment might stimulate other donors to give more annual gifts due to the “guarantee of permanence” that endowments signal to would-be donors.
3. When donors restrict long-term investments (an endowment fund) instead of the board (quasi-endowment), the result is a lower number for “net available assets,” which reduces the probability that the organization will be flagged by BBB or CharityWatch for excess liquidity. However, from a strategic liquidity perspective, it is preferable to have these funds in a board-designated endowment. For some interesting thinking on this, see Ashworth.⁵³
 4. The most serious indictment is that the BBB and CharityWatch standards are focusing nonprofit managers too much on excessive liquidity when most organizations are grappling with insufficient liquidity. The BBB standard 6D does deal with insufficient liquidity, but again uses the weakest (solvency) type of measure. Even if their organization is never rated by any of the charity watchdogs, most of the nonprofits in the United States, their boards, donors, and local media may utilize these widely available standards to castigate the organization’s managerial policies. This possibility alone may provide the wrong signals to financial managers and boards of these organizations.
 5. The BBB and CharityWatch organizations indicate that they make exceptions in applying their liquidity standard, but evidently only very rarely. One should look at *present-year* capital investments (which are not shown in the present year’s budgeted expenses) as well as future capital investments in determining when to make exceptions in the application of standards. A similar argument is made by a consultant writing anonymously for the National Federation of Nonprofits, who stated that the operating plan should be consulted instead of mindlessly calculating financial ratios to assess the appropriate level of liquidity.⁵⁴

2.6 WHAT IS THE APPROPRIATE LEVEL OF LIQUIDITY?

It is very helpful to have a bird’s-eye view of the organization’s liquidity, solvency, and financial flexibility. The actual and potential sources of cash flow are identified in Exhibit 2.6. Projections of anticipated cash position to six-month, one-year, three-year, or five-year horizons will provide strong indications of the adequacy of the organization’s current liquidity situation. Two diagnostic tools to assist in this assessment will be presented shortly.

We advocate considering the role of environmental uncertainty in setting liquidity targets. As an aside, faith-based organizations, because of their trust in divine provision, may not be as concerned about outcome uncertainty relative to other donative nonprofit organizations, so they might select lower levels of liquidity. An organization receiving a high proportion of restricted gifts will want to establish higher liquidity targets. An organization that is also donative (highly donation-dependent) will have to ratchet the liquidity target even higher.

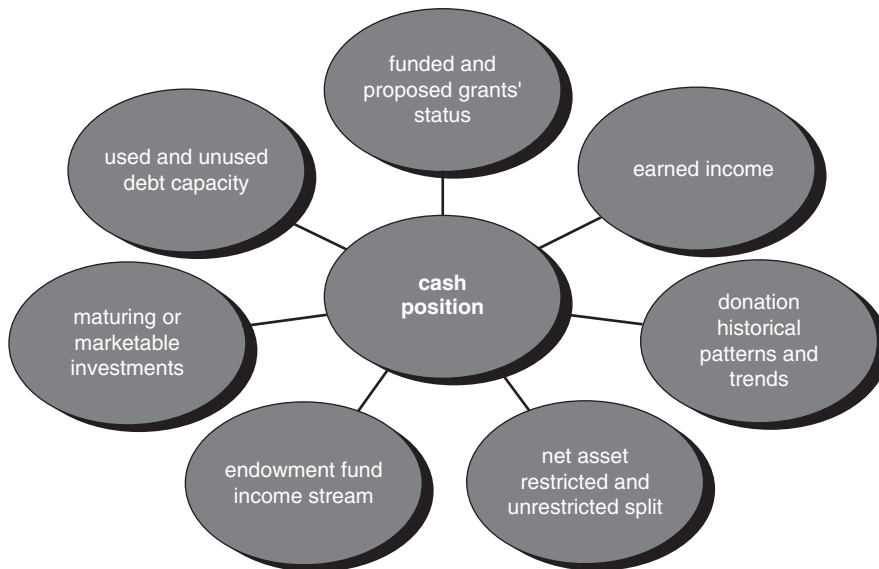


EXHIBIT 2.6 FINANCIAL MANAGER'S VIEW OF THE CASH FLOW AND REVENUE STREAM

(a) ESTABLISHING THE LIQUIDITY POSITION BASED ON FINANCIAL VULNERABILITY. What factors should help set the appropriate level of liquidity? One way to view this is from a risk avoidance posture. Chang and Tuckman provide a short list in an analysis of financial vulnerability.⁵⁵ Their view of vulnerability centers on the ability of the organization to insulate itself from unanticipated financial shocks or financial unpredictability, and includes four dimensions:

- Organization's equity (net assets)
- Level of administrative costs
- Operating margin
- Diversified revenue sources

Higher levels of each of these factors give the organization *more* flexibility to cope with financial shocks. For example, an organization with a high level of administrative costs (which, if excessive, might be viewed as a negative by a donor or foundation) has the flexibility to pare those costs to stave off financial exigency. The first item, equity, is somewhat misleading: Actually what should be measured here is equity balances in conjunction with liquid assets. If all of the organization's equity is tied up in fixed assets or endowment principal, the organization will be illiquid even if solvent. We do acknowledge, however, that more net assets means less borrowing, all other things equal, making the organization less vulnerable. Added to this short list, one should ideally measure the variability and co-movement of revenue sources (how closely they move in tandem through time), based on Bruce Kingma's findings.⁵⁶

(b) DIAGNOSTIC TOOLS TO ASSIST IN SETTING THE APPROPRIATE LIQUIDITY TARGET. Exhibit 2.7 provides a more exhaustive list of factors helpful in setting your

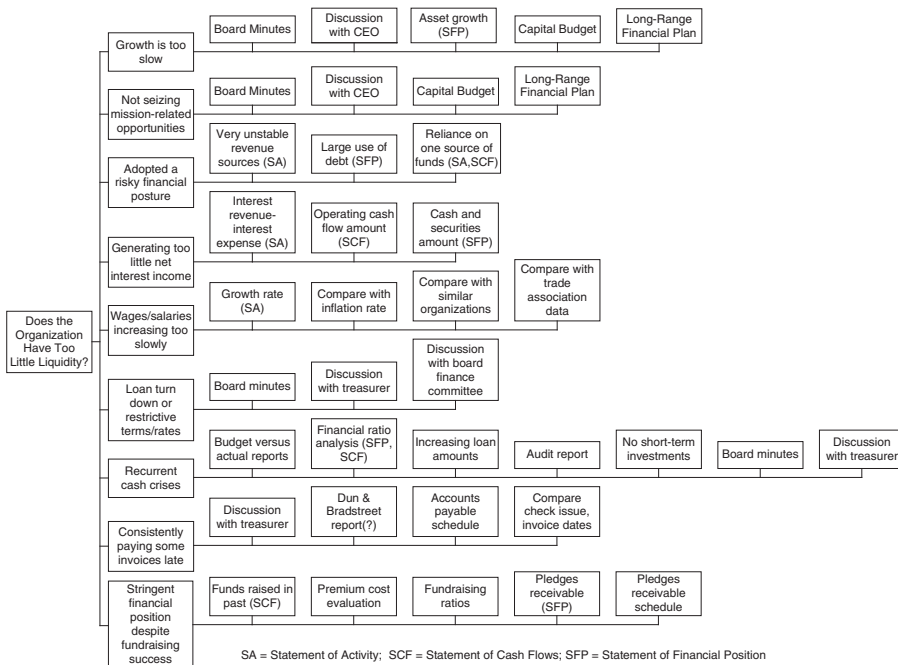


EXHIBIT 2.7 DIAGNOSTIC TOOL FOR SETTING ORGANIZATION'S APPROPRIATE LIQUIDITY TARGET

organization's target liquidity, using a diagnostic questionnaire we developed. In the exhibit, SA denotes the organization's Statement of Activity, SFP denotes the Statement of Financial Position (or Balance Sheet or Statement of Net Assets), and SCF denotes the Statement of Cash Flows. Financial Statements in nonprofits are generally used by management to comply with reporting requirements and to guide operating budget development, but are rarely used to perform an in-depth analysis of liquidity. By using these statements as *data sets*, improved analysis of liquidity can be attained. Leaders of nonprofits (especially CEOs and CFOs) can add value to the strategic aims of the organization by continually monitoring liquidity and avoid cash shortfalls that often surprise the organization's governing body and senior management. This kind of rigor is recommended.

2.7 CONCLUSION

Liquidity policy and practice, so vital for an organization's financial management, has received far too little attention in nonprofit periodicals and textbooks, with the exception of a cash flow management handbook by Dropkin/Hayden and two cash flow management guides by Linzer/Linzer. Despite advances in thinking in this area, often the idea that nonprofit organizations are not businesses, or should be run in a business-like fashion, still prevails. Where the management of cash and short-term investments is discussed, the problem of excess liquidity is the focus. In this chapter we have provided our insights regarding the financial standards developed by watchdog agencies. We showed that these standards do not recognize the relative liquidity of an organization's asset holdings, use an inferior balance sheet or solvency approach, and are more appropriate for commercial nonprofits than donative nonprofits. We provide compelling reasons why your organization should build up large amounts of solvency, liquidity, and financial flexibility. We provide a checklist to determine if your organization has too much or too little liquidity. Our view of proficient nonprofit financial management suggests that the primary financial objective appropriate for most nonprofits is: "To ensure that financial resources are available when needed, as needed, and at reasonable cost, and are protected from financial impairment and spent according to mission and donor purposes." The first part of that objective implies that there is a target liquidity level that organizations should set and strive to achieve.

Many organizations have too little liquidity. Many nonprofits are either setting their liquidity targets too low or not reaching their liquidity targets (if they are setting these targets at all). We do not share the view of some critics that nonprofits are too risk averse. To other observers who would argue that cash reserves should be minimized in order to maximize current service provision, we respond with this observation made by Carl Milofsky: There may be management practices that appear objectionable to some – "pointless, cumbersome, and inefficient" – but that "actually serve to protect important styles of practice that run against the grain of traditional management practice."⁵⁷ We are delighted that, in the most recent and most broadly-based survey of nonprofit financial managers, financial flexibility and earning surpluses to have money on hand in a difficult economy are the two most popular primary financial objectives.⁵⁸ In Chapters 5 and 15 we provide an approach to crafting financial policies and in Appendix 6B following Chapter 6 we profile the new accounting standard update that shall prompt more disclosure of liquidity relative to an organization's expenditures in the next 12 months.

Notes

1. One of the first places this mission diversion was noted was in Katherine Gallagher and Charles B. Weinberg, "Coping With Success: New Challenges for Nonprofit Marketing," *Sloan Management Review* 33 (Fall 1991): 27–42.
2. Steven Rathgeb Smith, "Managing the Challenges of Government Contracts" (pp. 325–341) in Robert Herman & Assoc. (eds.), *Jossey Bass Handbook of Nonprofit Leadership and Management* (San Francisco: Jossey Bass, 1994): 329–330.
3. Steven Rathgeb Smith, "Managing the Challenges of Government Contracts" (pp. 553–579) in David O. Renz & Assoc. (eds.) *Jossey Bass Handbook of Nonprofit Leadership and Management* (San Francisco: Jossey Bass, 2010): 561.
4. Smith, "Managing the Challenges of Government Contracts," 1994, 329–330.
5. Martha Waggoner, "Some nonprofits can't touch their money," *Associated Press*, March 2, 2009. Also see Daniel J. Wakin, "City Opera Taps Into Endowment," *New York Times*, April 18, 2009. Available at: www.nytimes.com/2009/04/18/arts/music/18arts-CITYOPERATAP_BRFB.html. Accessed 10/25/17.
6. Jarl Kallberg and Kenneth Parkinson, *Corporate Liquidity: Management and Measurement* (Homewood, IL: Richard D. Irwin, 1993): 16.
7. John Zietlow, Matthew Hill, and Terry Maness, *Short-Term Financial Management*, 5th ed. (San Diego: Cognella Academic Publishing, 2017).
8. Richard F. Wacht, "A Financial Management Theory of the Nonprofit Organization," *Journal of Financial Research* 7 (Spring 1984): 37–45; R. F. Wacht, *Financial Management in Non-Profit Organizations* (Atlanta: Georgia State University Press, 1984); Kirsten A. Grønbjerg, "How Nonprofit Organizations Manage Their Funding Sources," *Nonprofit Management & Leadership* 2, no. 2 (1991): 159–175.
9. Murray Dropkin and Allyson Hayden, *The Cash Flow Management Book for Nonprofits: A Step-by-Step Guide for Managers, Consultants, and Boards* (San Francisco: Jossey-Bass, 2002); also consult Richard Linzer and Anna Linzer, *The Cash Flow Solution: A Nonprofit Board Member's Guide to Financial Success* (San Francisco: Jossey-Bass, 2007). Also, *Cash Flow Strategies: Innovation in Nonprofit Financial Management* by Richard and Anna Linzer (Hoboken: Wiley, 2008).
10. Henrietta Hall, "When Cash Doesn't Flow," *Chronicle of Philanthropy* 7, no. 8 (June 1, 1995): 31–33.
11. Aaron L. Phillips, "Treasury Management: Job Responsibilities, Curricular Development, and Research Opportunities," *Financial Management* 26, no. 3 (1997): 69.
12. Nonprofit Times, "Charity Navigator Changes Its Rating System," www.thenonprofittimes.com/news-articles/charity-navigator-changes-rating-system. Accessed 11/22/2016.
13. "GuideStar/NFF Financial SCAN Report for Local Youth Group," <https://learn.guidestar.org/products/nonprofit-data-solutions/financial-scan>. Accessed 12/29/2017. GuideStar and NFF describe the product as follows: "Financial SCANSM helps you better understand or communicate a nonprofit's financial health and resource needs. It combines GuideStar's IRS Forms 990 data and Nonprofit Finance Fund (NFF) expert analysis in an easy-to-use tool with shareable formats that bring insight to financial information and support mission-driven decisions."
14. Kallberg and Parkinson, *Corporate Liquidity*, 17.
15. Andres Ramirez, "Nonprofit Cash Holdings: Determinants and Implications," *Public Finance Review* 39, no. 5 (2011): 675.
16. National Center for Charitable Statistics, cited in Independent Sector, "Facts and Figures About Charitable Organizations," May 9, 2006. Downloaded from [www.independentsector.org/programs/research/Charitable Fact Sheet.pdf](http://www.independentsector.org/programs/research/Charitable_Fact_Sheet.pdf). Accessed 7/17/06.
17. Independent Sector, *The Nonprofit Sector in Brief*, 2015, page 4. For pre-UPMIFA guidelines see Lelia Helms, Alan B. Henkin, and Kyle Murray, "Playing by the Rules: Restricted Endowment Assets in Colleges and Universities," *Nonprofit Management & Leadership* 15, no. 3 (Spring 2005): 341–356.

18. Wacht, 1984, 41.
19. Richard F. Wacht, *Financial Management in Nonprofit Organizations*, 2nd ed. (Atlanta: Georgia State University Press, 1991): 6.
20. Paul Klein, Joseph Mulligan, Mark Oster, and Matt Unterman, "Reserves planning: A Step-by-Step Approach for Nonprofit Organizations," Grant Thornton LLP, 2013. <https://www.grantthornton.com/~media/content-page-files/nfp/pdfs/2013/130516-NFP-Reserves-Planning-White-Paper-130916.ashx>. Accessed 12/29/17.
21. Wacht, *Financial Management in Nonprofit Organizations*, 6.
22. <http://www.nonprofitfinancefund.org/blog/what%E2%80%99s-left-over-pay-bills-0>.
23. David Hahn and Raj Aggarwal, "More Emphasis Should Be on Working Capital Management," *Hospital Financial Management* (December 1977): 13–14, 16, 18, 79–80.
24. Jeff Marsee, *Cash Management for Colleges & Universities* (Washington, DC: NACUBO, 1986).
25. David R. Campbell, James M. Johnson, and Leonard M. Savoie, "Cash Flow, Liquidity & Financial Flexibility," *Financial Executive* 52, no. 8 (1984): 14–17.
26. Regina E. Herzlinger and Denise Nitterhouse, *Financial Accounting and Managerial Control for Nonprofit Organizations* (Cincinnati: South-Western Publishing Co., 1994).
27. Chris Robinson, "Financial Ratios of Christian Organizations," Master's thesis, University of San Francisco, 1989.
28. Dan Busby, personal correspondence, 2/21/06. This data is based on 1,202 member organizations. Average total income, or revenue, equaled \$11,957,408. Average cash reserves equaled \$1,332,196. Taking each organization's cash reserves and dividing that by the organization's total income gives the 21.00% average cash-to-revenue ratio. Many of these organizations achieve break-even or very close to break-even operating results each year, so the assumption we make that expenses equate to revenues is probably fairly accurate.
29. George Gallinger and P. Basil Healey, *Liquidity Analysis and Management* (Reading, MA: Addison-Wesley, 1987): 3.
30. Kallberg and Parkinson, *Corporate Liquidity*, 17–19.
31. Financial Accounting Standards Board, *FASB Statement of Financial Accounting Standards No. 117*, 1993, Footnote 3, page 69. <http://www.fasb.org/pdf/fas117.pdf>. Accessed 12/30/17.
32. Hall, "When Cash Doesn't Flow."
33. If the fundraising function is considered as a financial function, this statement would have to be altered to say that the single most important financial management function is liquidity management. Development offices are separate from the finance department in almost all nonprofits of which we are aware.
34. This was noted by Kirsten Grønberg in her studies of human service organizations: "How Nonprofit Organizations Manage Their Funding Sources."
35. Bruce Kingma, "Portfolio Theory and Nonprofit Financial Stability," *Nonprofit and Voluntary Sector Quarterly* 22, no. 2 (1993): 105–119.
36. Deborah A. Carroll and Keely Jones Stater, "Revenue Diversification in Nonprofit Organizations: Does It Lead to Financial Stability?" *Journal of Public Administration Research and Theory* 19, no. 4 (2008): 947–966.
37. John T. Zietlow, "Social Entrepreneurship: Managerial, Finance and Marketing Aspects," *Journal of Nonprofit & Public Sector Marketing* 9, no. 1–2 (2001): 19–44.
38. Priscilla La Barbera, "Enterprise in Religious-Based Organizations," *Nonprofit and Voluntary Sector Quarterly* 21, no.1 (1992): 51–67. Karen A. Froelich and Terry W. Knoepfle, "Internal Revenue Service 990 Data: Fact or Fiction?" *Nonprofit and Voluntary Sector Quarterly* 25, no. 1 (1996): 40–52.
39. Vincent A. Fullmer, "Cost/Benefit Analysis in Fund Raising," *Harvard Business Review* 51, no. 2 (1973): 103–110. J. T. Zietlow, "Organizational and Financial Goals and Policies in Religious Organizations," Paper presented at the annual conference of the Association for Research on Nonprofit Organizations and Voluntary Action (ARNOVA), December 4–6, 1997, Indianapolis.
40. This practice is addressed by Dan Busby, *Donor-Restricted Gifts* (Winchester, VA: ECFA, 2006): 34–35. He notes: "When a charity's finances are tight, it is possible to deplete unrestricted net assets. At that point, charities may be tempted to borrow cash held for

donor-restricted net assets to cover operating expenses ... Nonprofits are legally required to spend restricted net assets to further the intent and purposes expressed by the donor. Therefore, loans from restricted net assets should be avoided. Intraorganizational loans are often more troublesome than other types of loans. State laws generally require that a charity must demonstrate that a loan (an investment transaction from the standpoint of the restricted fund) is prudent. If the loan is simply to fund operating shortfalls or reflecting the organization's financial difficulties, the charity's board will generally have trouble demonstrating that a loan from restricted net assets is prudent as viewed from the restricted fund's vantage point."

41. John T. Zietlow, "Capital and Operating Budgeting Practices in Pure Nonprofit Organizations," *Financial Accountability & Management* 5, no. 4 (1989): 219–232. Zietlow, "Organizational and Financial Goals and Policies in Religious Organizations."
42. Cyril F. Chang and Howard P. Tuckman, "Why Do Nonprofit Managers Accumulate Surpluses, and How Much Do They Accumulate?" *Nonprofit Management & Leadership* 1, no. 2 (1990): 117–135.
43. Thomas A. McLaughlin, "In Cash There Is Opportunity," *NonProfit Times* 9 (March 1995): 35.
44. Howard P. Tuckman and Cyril F. Chang, "How Well Is Debt Managed by Nonprofits?" *Nonprofit Management & Leadership* 3, no. 4 (1993): 347–361.
45. Wacht, "A Financial Management Theory of the Nonprofit Organization," and Wacht, *Financial Management in Nonprofit Organizations*.
46. Kirsten A. Grønbjerg, "How Nonprofit Organizations Manage Their Funding Sources," *Nonprofit Management & Leadership* 2, no. 2 (1991): 159–175. S. Shapiro and D. Grunewald, "Improving Decision Making in Nonprofit Organizations," *Thought* 63 (March 1988): 52–68.
47. Zietlow, Hill, and Maness, *Short-Term Financial Management*, 5th ed.
48. Downloaded from <http://www.give.org/for-donors/the-care-we-put-into-our-reports/>. Accessed 12/29/2017.
49. Greg Chen, "Does Meeting Standards Affect Charitable Giving? An Empirical Study of New York Metropolitan Area Charities," *Nonprofit Management & Leadership* 19, no. 3 (Spring 2009): 349–365.
50. Barış K. Yörük, "Charity Ratings," *Journal of Economics and Management Strategy* 25, no. 1 (Spring 2016): 195–219.
51. GuideStar and Nonprofit Financial Fund, "Nonprofit Financial Health: New Tools for Analysis, Webinar, May 3, 2012. <http://www.guidestar.org/ViewCmsFile.aspx?ContentID=4443>. Accessed 12/29/2017.
52. Raymond Fisman and R. Glenn Hubbard, "The Role of Nonprofit Endowments." Chapter 7 in Edward L. Glaeser, editor, *The Governance of Nonprofit Institutions*, A National Bureau of Economic Research Conference Report (Chicago: The University of Chicago Press, 2003): 220.
53. E. Ashworth, "Endowments: Preparing for a Financially Secure Future," *Federation Folio* (National Federation of Nonprofits) 1, no. 1 (1997): 4–7.
54. National Federation of Nonprofits, "Financial Reserves: How Much Is Enough? How Much Is Too Much?" *Federation Folio* 1, no. 1 (1997): 1–3.
55. Cyril F. Chang and Howard P. Tuckman, "A Methodology for Measuring the Financial Vulnerability of Charitable Nonprofit Organizations," *Nonprofit and Voluntary Sector Quarterly* 20 (1991): 445–460.
56. Bruce R. Kingma, "Portfolio Theory and Nonprofit Financial Stability," *Nonprofit and Voluntary Sector Quarterly* 22, no. 2 (1993): 105–119.
57. Carl Milofsky, "Tradition" (Editorial), *Nonprofit and Voluntary Sector Quarterly* 26, no. 3 (1997): 261–268.
58. The Center on Philanthropy at Indiana University. "Financial Literacy and Knowledge in the Nonprofit Sector," February 2012. <https://philanthropy.iupui.edu/files/research/2012financial-literacy.pdf>. Accessed 12/29/17.