Best Practices for Assessing an Organization's Wellness[1]

The purpose of this guide is to help foundations assess the general wellness and well-being of organizations that they either fund or seek to fund. This guide considers financial well being as well as other factors, such as mission alignment and measurement of outcomes. Although the guide focuses on financial issues, we encourage you to look beyond the numbers and ask questions that assess organizations in a holistic manner.

What should I look for on Form 990?

Form 990 is the tax form filed by nonprofits every year. The 990 consists of 12 parts and has schedules A through P for additional information. If an organization has gross receipts less than $200,000 for the year and total assets under $500,000, then the organization can file a Form 990-EZ, which is an abbreviated version of the full 990. Below is a summary and brief explanation of relevant information in each section of the full Form 990:

- Part I-- Summary
  The summary contains the key information contained in the rest of the 990, including a brief mission statement. When reviewing a 990, be sure to check the Heading and Summary to ensure that you are reviewing the 990 for the correct organization. Additionally, please reference Part X (Balance Sheet) to better understand what to look for in terms of assets, liabilities, and numeric ratios.
- Part II-- Signature Block
  Part II contains the signatures of the officer who approved the 990, as well as any preparer if relevant.
- Part III-- Statement of Program Service Accomplishments
  Part III contains the organization's mission statement and brief explanations of its programming. It also contains the information about the amount spent on each program, which can help the reader gauge the relative importance of each program.
- Part IV-- Checklist of Required Schedules
  The checklist contains 38 questions regarding the organization's activities over the last year. If an organization answers any of the questions in the affirmative, then it must file the indicated schedule. Questions inquire into matters such as engagement in political activities, gaming revenue, and paid fundraiser expenses.
- Part V-- Statements Regarding Other IRS Filings and Tax Compliance

[1] This guide was developed by the Sillerman Center for the Advancement of Philanthropy. Please contact Sheryl Seller (sseller@brandeis.edu) with questions around use of this guide.

Part V contains a list of 16 questions inquiring into other tax forms. While nonprofits are tax exempt, they may still be required to file tax forms relating to such things as employee wages.

- Part VI-- Governance, Management, and Disclosure

  Part VI contains questions regarding best practices for various internal policies around issues such as conflicts of interest, whistleblowers, document retention and destruction, executive compensation, and procedures for making documents public. The rationale behind these questions is that organizations following the best practices are more likely to be in compliance with IRS requirements.

- Part VII-- Compensation of Officers, Directors, Trustees, Key Employees, Highest Compensated Employees, and Independent Contractors

  In Part VII, the organization must list current officers, directors, trustees, key employees, the five highest paid employees, and some former officers and employees. Part VII defines key employees[2] as those who are in the top 20 highest paid employees, received more than $150,000 in compensation for the given year, and controlled 10% or more of the organization's assets. Independent contractors making more than $100,000 are also listed. Part VII provides insight into an organization's payment structure and board of directors. The reader can compare executive and board compensation to similar situated nonprofits. The reader can also consider whether the board consists of a family vs. a broad public representation. To avoid mission drift, boards should consist of members who are committed to the nonprofits mission. Generally, board members should not be compensated. While some organizations reimburse board members for things like travel, it is unusual for board members to receive compensation.

- Part VIII Statement of Revenue

  Part VIII outlines the amount and types of revenue an organization received over the year. From Part VIII, you can determine the organization's fundraising efficiency by dividing the average fundraising expenses by average total contributions (average of Part IX line 25D/average of Part VIII line 1h). The ideal ratio will indicate that an organization is spending less to raise more. By looking at the sources of revenue, you can also determine the organization's diversity of revenue. Typically, no more than 40% of funds should come from one or two donors.

- Part IX-- Statement of Functional Expenses

  Part IX breaks down expenses between program services, management, general, and fundraising costs. By looking at expenses, you can see how much an organization spends on one facet of the organization versus another. Expense information provides insight into financial efficiency. First, you can analyze the

[2] For more about determining key employees, see https://www.nonprofitaccountingbasics.org/form-990-core-form/definition-key-employee

organization's average performance expense percentage by dividing the average program expenses by average total expenses (Part IX line 25b/Part IX line 25a). This ratio shows how much of its budget an organization puts towards programming. The ideal is that an organization should be putting as much of its resources towards services and programming as it can, so a higher percentage is better. Second, to analyze administrative expenses, you can use a ratio of average administrative expense to average total expenses (Part IX line 25c/Part IX line 25a). There is no exact number to target, but typically administrative costs should look reasonable when compared total costs and programming costs. Third, you can calculate fundraising efficiency by dividing average fundraising expenses by average total expenses (Part IX line 25d/Part IX line 25a). Again, there is no perfect number here, but fundraising costs should look reasonable when compared to other expenses, as well as total amounts fundraised.

- Part X-- Balance Sheet

  The balance sheet contains information about the organization's assets and liabilities at the beginning and end of the fiscal year, which provide insight into financial sustainability and available resources. First, by looking at Part X column B line 27 compared to Part X column A line 27, you can tell whether the organization has experienced a surplus or deficit for the year. Generally, surpluses are a sign of financial wellness, while deficits are a sign of financial concern, but sometimes deficits are caused by circumstances like timing issues or a large purchase like new computers or office furniture. Second, sustainability can be measured by a liabilities to assets ratio, which is calculated by dividing total liabilities by total assets (Part X line 26/Part X line 16). Sustainable organizations will have fewer liabilities and greater assets, so lower ratios are better (ie. 1:2 is better than 1:1). By looking at types of resources, you can establish an organization's liquidity. Cash and unrestricted assets are more liquid. More liquid assets mean that an organization can generate cash faster, which allows it to better deal with unexpected circumstances or economic downturn. Typically, an organization should have at least 3 months of liquid resources, meaning that, if an organization received no funding, it would have enough resources to survive for 3 months. More than 6 months is ideal, while anything under 3 months is weak. Debt to asset ratios should also be low (between 1:1 and 1:2), meaning that an organization has enough resources to cover looming expenses.
- Part XI Reconciliation of Net Assets

  Part XI contains information regarding total revenue and assets including changes between the beginning and end of the year, and expenses/gains from investments.
- Part XII Financial Statements and Reporting

Part XII contains information about the method of accounting used in the 990, as well as information about financial statements and auditing.

In sum, look for:

- Diverse revenue
- Reasonable expense to asset ratios
- Surpluses or deficits
- Unrestricted/liquid assets
- Clearly articulated mission statement

What are some things you should consider besides the Form 990?

1. Monitoring and planning processes
   Consistent, accurate, and timely filed financial reports are a sign of reliable monitoring and planning processes. Additionally, financial reports should be audited by a qualified professional. If the financial statement contains any notes disclaiming, qualifying, or issuing an adverse opinion, it should raise a red flag that the statements may not be reliable.
2. Board and finance policies
   The most responsive and effective boards will include members of the community that the organization seeks to serve. When nonprofits adhere to strict corporate hierarchical structures, community members are less likely to support, and perhaps benefit from, the organization, and the board is more likely to arrive at tone deaf conclusions. To have the greatest impact, a nonprofit should include democratic principles into its decision making. Turning to finances, an organization should have policies in place to establish how major financial decisions will be made to ensure consistency. Additionally, board members should be aware of their responsibilities regarding finance as well as the necessary commitment to the organization's mission.
3. Don't get too caught up in purely financials
   While funders typically expect nonprofits to run with a low overhead costs, an overemphasis on low overhead can be damaging to a nonprofit in the long term. When forced to operate on a low overhead budget, organizations must cut corners relating to things like infrastructure, equipment upkeep, and IT.

How should I treat and evaluate new, smaller nonprofits versus large, established nonprofits?

Nonprofits have different stages of development, which are often broken down into 7 phases as a part of the "nonprofit lifecycle." The stages consist of: grass-roots, start-up, growth, maturity, decline, turnaround, and terminal.

Grass-roots Phase: At the grass-roots phase, a nonprofit is still being fully fleshed out. It likely lacks formal structure and resembles more of an idea than an organization.

Start-up Phase: Upon entering the start-up phase, an organization becomes incorporated and operates with limited funding. The board usually consists of hands-on friends and mentors, and there is limited structure both in terms of staff roles and programs because everything is still experimental. To progress past this phase, a nonprofit needs support to develop things like a business plan, a strategic plan, job descriptions, fundraising, and a transition from a working board to a governing board. Donors will not be able to rely heavily on finances as a tool of evaluation because nonprofits in the start-up phase typically have a small budget and lack formal accounting capabilities. Instead, funders will have to focus on other aspects of the organization such as mission alignment.

Growth Phase: Once a nonprofit has experienced success in the start up phase, it reaches the growth stage. Here, the focus is on perfecting programs in order to standardize them and improve their ability to meet community needs. There is also a focus on formalizing structures and processes because the endeavor has reached the size where no single person can know everything. Frequently, the organization is still underfunded and has unpredictable funding resources. To become mature, the nonprofit should draft a strategic plan focused on systems, development, capacity, and governance. The best ways to support a nonprofit in the growth stage are larger, multi-year grants to help combat cash flow problems. Capacity-building grants and program grants and development are also particularly helpful in this phase.

Maturity Phase: Once a nonprofit reaches maturity, it has established a reputation with the community it serves, as well as solid organizational structures. At this phase, operations should be led by an executive director and a governing board of directors and executed by a larger, more diverse and specialized staff. The strategic plan should reflect programs, which should now be outcome-based. Funding should now be stable and diversified. Here, the nonprofit needs support through upgrades for current policies and procedures like new software or development systems. The nonprofit should also focus on a strategic plan for management and strengthening programs, as well as options to change things up to avoid stagnancy.

Decline Phase: After a nonprofit has reached maturity, it can sometimes fall into a decline period where processes have stagnated and the nonprofit is too distant from the community and changing needs. Typically, this phase is characterized by inaction or complacency among leadership and silencing of new ideas or suggestions. At this point, the organization needs assistance with doing an assessment of the operation as well as developing a plan to fix or change things that are no longer working effectively.

Turnaround Phase or Terminal Period: From here, a nonprofit will either enter a turnaround period, where the nonprofit successfully regains commitment to its mission and community to bring it back to the growth stage, or a terminal period where the nonprofit eventually comes to an end. An organization entering turnaround will likely be led by a strong and committed director and board. It will reconfigure programs to best fit current community needs, cut budgets where necessary, and simplify processes. If an organization becomes terminal, it means it was unable to turn around and will eventually dissolve.

How much and for how long should I fund different types of organizations?[3]
The appropriate amount and duration of funding for a grantee depends on a variety of factors, but most notably hinges on organizational maturity and mission alignment. As discussed above, nonprofits typically experience seven stages of growth. As a start up, a nonprofit usually has a smaller budget, and grant amounts will likely be lower. Because of a lack of accounting capabilities and financial records, the foundation should consider how well the nonprofit's mission and programs line up with the foundation's own mission and values. As a nonprofit enters the growth stage, needs shift towards capacity building. In order to reach maturity, the nonprofit must establish strong processes, systems, and staff. Grants for capacity building and seed funding for programs and operations can aid in this process.

Once mature, a foundation should consider whether the organization is a good candidate for multi-year general operating support, which usually consists of larger, unrestricted grants over the span of several years. General operating support grants allow nonprofit leaders to keep the lights on and direct funds to where they are most needed. The TCC Group lists critical factors for deciding whether an organization is ready for general operating support, which include a clear vision, organizational credibility, an engaged board of directors, adaptive capacities, strong financial management, clear staff roles, technical capacity, commitment to an issue, and an open and honest "learning culture."

Providing unrestricted funding also requires trust and a strong mission alignment. If the nonprofit's mission does not fully align with the foundation's mission, but one of its programs does, the foundation may want to consider giving program support rather than general support. The foundation also has to consider whether it wants to make a long term commitment to building up an organization. If the foundation is only interested in the short term, then program support may be a better option.

3 For a helpful decisionmaking flowchart, see Appendix D on page 12 of the TCC Group's "Capturing General Operating Support: An Evaluation Framework for Funders and Evaluators."

How do I measure outcomes?

Measuring the success of an organization's programs can be a good gauge of an organization's efficiency and commitment to mission. This is especially true in the case of new or small nonprofits, which may not generate enough revenue to file a full Form 990. When seeking information about outcomes, dialogue with the grantee should be centered around outcomes. Funders should know which outcomes they want to track, and should seek to collaborate with grantees, other funders, and community leaders operating in the same ecosystem to increase outcomes tracking in the ecosystem.

In measuring outcomes, funders should avoid putting an excess burden on grantees. If evaluations are not conducted properly, they can detract from a nonprofit's already restricted time and money. Funders should approach evaluation collaboratively. Rather than asking for one large report at the end, funders can ensure the nonprofit is maintaining course and step in to help as needed by conducting check ups throughout the grant period even through a brief phone conversation.

If providing general operating support, the TCC Group highlights metrics to hone in on including program effectiveness, organizational development, funder mission achievement, and system strengthening. When evaluating program effectiveness, it is important to focus on how the nonprofit has furthered its mission. Some indicators for positive program development are higher program quality, new programs, lower program costs, or programs with higher capacity. Outcomes related to organizational development are leadership and capacity related. Some indicators of improved organizational development include better strategic partnerships, longer term planning, financial stability, and staffing effectiveness and longevity. Accomplishment of funder goals should be based on how the nonprofit utilized the funds in line with the funder's mission. Indicators for improved funder mission achievement include deeper relationships with grantees and improved effectiveness and trust with grantees. Lastly, funders should consider the impact on the entire ecosystem that the funder and organization are operating within. Indicators of a positive impact at the ecosystem level include improved adaptability and responsiveness, increased field capacity, and strengthened connections within the ecosystem.

How do I assess whether an organization has mission alignment or if it is experiencing mission drift?

Mission drift occurs when a nonprofit organization loses sight of its original goals and values and instead aligns its programs and decisions based upon where they can find grant dollars. Some indicators of mission drift include high staff and board turnover, disinterested leaders, stagnant and decreasing numbers, and seeking publicity rather than impact. A mission statement embodies an organization's purpose, philosophy, and values. It should be the driving force behind all programs and decisions. When other factors, whether it be particular staff or a grant, become more influential than the mission, the organization can lose sight of its purpose.

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