



Ventura County  
Community  
Foundation

## **ASSESSING THE FINANCIAL HEALTH OF NONPROFIT ORGANIZATIONS**

### **Summary**

The term “financial due diligence” in philanthropy refers to the process through which a funder or donor researches an organization’s financial health in order to guide a grantmaking decision. It is important to note that a decision to fund or not to fund is often based upon consideration of several factors, including objective data analysis, insight into the general state of organizational health and stability, and intuition. A sound and thorough financial due diligence review is the process through which all the factors that make up that equation are uncovered and understood.

### **Basic Financial Due Diligence**

The financial due diligence process often includes, but is not limited to, the following questions:

- Is the potential grantee organization duly certified and recognized by the IRS as a valid 501c3 organization for which it has a formal IRS determination letter?
- Is the organization in good financial health and fiscally well managed?
- Is the project proposed in the grant request well-conceived and likely to be successful and is the project budget presented in the grant request accurate and is a budget narrative attached which provides rationale for expenses?
- Does the prospective grantee demonstrate the full support of its organizational leadership and the community engaged in the proposed project budget?
- Can we assure that all funding received (including grants and contracts awarded) to the potential grantee will be used for the proposed project in keeping with the foundation’s mission to address unmet needs in the community?

### **Organizations with Net Negative Unrestricted Assets**

An organization with negative unrestricted net assets will need to submit a letter, signed by the Board President and Treasurer on how the nonprofit’s leadership team (Board and Officers) is addressing the situation, including producing an 18-month operating budget forecast.

## **Assessing Financial Health from Multiple Vantage Points**

Beyond these basic questions, it is important to assess the financial health of a prospective grantee using a variety of sources. For example, a project budget is important and will tell you what an organization is planning to spend on a given project but will not provide a picture of an organization's overall financial health. An income statement will provide information on an organization's annual performance in terms of revenue and expenses while a balance sheet will provide information on the organization's total assets and liabilities. When looking at these documents it is important to consider some of the following questions:

- Has an organization's income been increasing at a similar rate to their expenses or not?
- Are they generally bringing in more than they spend in order to grow the organization?
- What is their current cash on hand, do they have enough to meet expenses next month or 3 months from now?
- How many days/months of reserve do they have in case expected funding doesn't come through?
- What is the programmatic budget in relationship to the organizational budget (i.e., does it represent a substantial proportion of the overall budget total?)

Using a financial assessment tool or dashboard can help answer some of these questions and provides a visual representation of the financial health of an organization over time. Please refer to attachment A for an example of a financial assessment tool.

All of these items speak to the financial stability of an organization. While on their own these do not necessarily predict success or failure of a particular project, they do help guide the right financial questions of current and prospective grantees to make sure they can put your funds to good use and have a plan in mind to address any potential challenges.