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Putting Charities to The Financial Test

Is an organization about to go bust? Before you give them money, you need to do some due diligence.

By [JENNIFER HOYT CUMMINGS](#)

Judging a charity by its efficiency gets a lot of attention. But in today's uncertain economy, potential donors sometimes have to make a much more basic assessment: Is this charity going bust?

A lot of charities are "really strapped" and will be "for the foreseeable future," says Elizabeth Keating, a lecturer in accounting at Boston College who focuses on nonprofit issues. After plunging in 2008 and 2009, charitable giving isn't expected to return to pre-crisis levels for five to six more years, according to Giving USA Foundation, a Glenville, Ill., nonprofit clearinghouse of information about philanthropy in the U.S.

In times like these, philanthropists have to do even more due diligence than usual—digging into the charity's financial statements, visiting the organization, meeting with management and talking to third-party observers.

That said, however, experts say that benefactors shouldn't necessarily walk away if a charity turns out to be struggling. Philanthropists by definition may be more willing than investors to risk their money, especially if the group serves a cause they really care about.

"Without risky investments, we really lose the opportunity to learn and to be a meaningful partner in making the world a better place," says Betsy Brill, president of Strategic Philanthropy Ltd., a philanthropic advisory company in Chicago.

Ms. Brill had a client a few years ago who wanted to help improve access to housing and food for older adults. The client knew that some of the groups she wanted to help might not survive. But she took the risk, Ms. Brill says, and gave several strategic grants of between \$20,000 and \$40,000. Her donations helped the groups stabilize their operations and create pilot programs that attracted new donations.

"What's very important for donors is taking calculated risks," Ms. Brill says.

With that in mind, here are ways to gauge a charity's financial health:

Prudent Approach

Some steps to consider if you're trying to make sure a charity you'd like to support has staying power

- ◆ **Give the gift** incrementally so that you have time to get to know the group before making a big commitment.
- ◆ **Get help from** the experts, like a philanthropic adviser if you're giving a big gift.
- ◆ **Check evaluations** of the charity on websites like GuideStar.org, CharityWatch.org and CharityNavigator.org.
- ◆ **Make a site visit**, volunteer or serve on the board. If you don't have time to do those things, reach out to someone who has done so to get their take on the charity.
- ◆ **If you want to donate** to a small local charity that doesn't have public financial records, find out if the group has someone handling the its finances and ask to take a look at the organization's budget.

Source: WSJ reporting

Look at the Financials

Start with the Form 990. Most charities have one, unless they're a small organization. It's the annual filing that tax-exempt organizations make to the Internal Revenue Service. The forms are posted on many charities' websites, but can also be found through nonprofit information sites like GuideStar.org and FoundationCenter.org.

A Form 990 can tell you right away if a charity is in the red. Look at the net assets, shown on Line 22 on the first page. A negative number indicates the organization has more debt than assets and could be struggling financially.

Be careful not to confuse this figure with the annual net income or net loss, shown on Line 19. A negative number there doesn't necessarily mean the charity is in poor financial health. It may just mean the group had a lot of demand for its services that year—like a food bank during a recession.

Look at multiple years of Form 990s to see how the charity's revenue and expenses have changed over time.

Another revealing section of Form 990 is the Statement of Revenue, which breaks out the different contribution streams for the charity. If a big chunk comes from the government, bear in mind that public budget crunches may hurt the charity's funding. That said, some people argue that charities with a lot of government funding are very efficient because they often are held accountable for how they spend grants and often have to devote less money to fund raising.

Audited financial statements can be important, too. Audits are often required by law—it varies by state—but midsize and large charities usually choose to be audited by certified public accountants of independent auditing firms.

"A smart organization will make that readily available, but not everybody does," says Christine L. Manor, a CPA and consultant in the Washington, D.C., area for nonprofit organizations.

A key part of an audit can be the notes section found at the end of the report. Notes can reveal critical information, like loans to and from people affiliated with the organization, difficulties paying employees' salaries or pending lawsuits that could affect the charity.

Caveats to the Financials

If a charity stops making audits available, it could be the result of budget cuts and a sign that the group is struggling. Some states don't require disclosure of those documents. To find out the law in your state, go to www.nasconet.org, a website for the National Association of State Charity Officials, where you'll find links to each state's responsible office.

Another caveat: Information found in 990s and audit reports is at least a few months old, if not much older. For more recent information, try asking the charity for a copy of its latest budget. Also remember that there can be nuances to nearly every figure in the financial reports, so tread carefully.

"Charities' financials are just as complicated as those of a corporation, if not more," says Laurie Styron, an analyst with the nonprofit watchdog service CharityWatch, based in Chicago. "Be careful as a layman of reading too much into these." It's important to do financial checks, Ms. Styron says, but when in doubt, she advises donating to a charity that has a good reputation.

Also keep in mind that some charities have multiple entities that each file their own Form 990s. So a donor may home in on one entity's financials without realizing it's not the full picture. You can determine if there are other entities by checking a charity's Form 990 for a Schedule R, which is a disclosure that shows the group's related organizations, says Ms. Manor.

Beyond the Numbers

It's critical to understand that financials are only a starting point for determining whether a charity is viable. Use them to get familiar with an organization, but give the charity a chance to respond to your concerns.

In 2007, Joanne Florino, executive director of Triad Foundation, a family foundation based in Ithaca, N.Y., that focuses on education, found she was losing faith in the financial stability of a local charity her group had been supporting for years. The foundation was giving the group sizable grants, but the charity wasn't picking up support from other parts of the community, Ms. Florino says. It was kind of stagnant, she says.

The charity, which Ms. Florino declines to name, served a vital role in the community. But after doing some research and talking to management, Ms. Florino found that it was losing donors and hadn't done an audit in a couple of years because of the expense.

Ms. Florino's foundation decided to give the charity one last chance with a grant twice the size of its usual gift, aimed at bringing in auditors and consultants. The donation helped turn things around for the charity, which is now merging with another local group.

"When donors think they can fix an organization, they need to understand what the core problems are," she says. "Money is rarely the only issue."

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