

# How to Manage Cash Flow in a Nonprofit

---

10 min read



You probably knew you were signing up for a difficult job when you first got involved with your nonprofit. However, you might not have realized just how much of the job of running a nonprofit is actually comprised of money management.

## Key Takeaways

- **Don't Get Caught in the Overhead Starvation Cycle:** According to research and an article from Stanford Social Innovation Review, nonprofits often get themselves caught in a trap they call...
- **Prioritize Your Cash Reserve:** Fewer than 25% of nonprofit organizations had saved a six-month cash reserve, and most did not have even three months of expenses saved.
- **Cash Flow Statements for Nonprofits:** How to Super-Charge Your Organization's Back Office: To effectively monitor your nonprofit's cash flow, you should be looking at your cash flow statements at least monthly. To get a better feel for your current cash flow status and to detect any seasonal trends in your nonprofit's cash flow, we recommend...

As a nonprofit leader, the available time in your work schedule is likely just as strapped as your nonprofit budget, but it's essential that you make time for cash flow management.

Cash flow is essential to daily operations and strategic planning. Plus, your organization's mission depends on it.

# Why Nonprofit Cash Flow Analysis Is Essential to Your Mission

Cash flow in a nonprofit isn't just about quantifying the money in your business. Cash flow doesn't just answer the question of how much do we have? Cash flow is also about answering the questions of when and where the money is going. In other words, cash flow not only shows you how much money you have in your nonprofit but also the timing of when money is coming in and when it's flowing out of the organization.

Keeping close tabs on your nonprofit's cash flow and monitoring your cash flow trends can help you properly time inflowing contributions and other funds with outflowing expenses to ensure you always have enough cash on hand to cover the daily costs of running the

nuts and bolts of a nonprofit (i.e. your overhead expenses) while continuing to deliver on the promises of your mission.

# 7 Tips for Better Nonprofit Cash Flow Management

## 1. Read, Understand, and Evaluate Your Cash Flow Statements

It might seem obvious, but it's so important that it deserves to be the first tip. In order to manage and improve cash flow in your organization, you absolutely must get in the habit of reading and evaluating your nonprofit cash flow statements on at least a monthly basis (perhaps even more frequently if you're experiencing cash flow challenges).

This should include both your regular cash flow statement and a trailing twelve-month cash flow statement.

Pay attention to where your cash flow currently stands in addition to any changes, patterns, and trends. Then think about what this information means for your operations. When looking over your cash flow statements, ask yourself the following kinds of questions:

- Does your cash flow have any seasonal trends?
- Will you have enough funds to cover this month's payroll?
- Will you be able to pay your rent or commercial property loan payment?
- Do you have any major costly events in the near future?
- Will you have enough incoming funds to cover the increased costs?
- What steps can you take now to improve cash flow in the future?

## 2. Smart Restricted Funds Use and the Allocation of Overhead Expenses

Another question you should ask yourself when evaluating your cash flow statement is whether any of the inflowing funds are restricted.

As a nonprofit leader, you're likely accustomed to being given advice that tells you to manage your money just like you would if you were leading a for-profit company. The problem with this advice, however, is that cash flow in a nonprofit is not the same as cash flow in a for-profit.

In a for-profit business, all incoming cash is basically free money. It is not necessarily earmarked, and it can be spent in any way management sees fit. In a nonprofit, however, some of your inflowing money is categorized as restricted funds, which means you can only spend those funds on the items that the donor or grant specifies. As you probably already know, restricted funds complicate cash flow.

**Read More:** [What Nonprofits Can Learn From the Best Well-Run Businesses \(and Vice Versa!\)](#)

For this reason, it is essential that you make the most of your restricted funds by ensuring you use the cash in restricted categories to pay for their category of expenses first.

Additionally, make sure your accounting function is actively and accurately allocating overhead costs (especially if you have funds that come from restricted government grants) to specific projects through the use of time and activity-based job costing. This can help document and allocate the portion of overhead costs that are actually used on specific programs and projects.

As a result, you can then consider some of your overhead costs as direct labor and direct materials to ensure you're getting the most out of your nonprofit's restricted funds.

### 3. Don't Get Caught in the Overhead Starvation Cycle

According to research and an article from *Stanford Social Innovation Review*, nonprofits often get themselves caught in a trap they call the overhead starvation cycle [1]. This self-perpetuating cycle worsens overhead funding which results in persistent cash flow shortages in nonprofits. The cycle consists of four parts:

1. Funders hold unrealistic expectations about how much overhead it actually requires to run a nonprofit (i.e. office space, employees, supplies, insurance, utilities, marketing, outreach, education, etc.)
2. As a result, nonprofits feel pressured to meet these unrealistic expectations.

3. Nonprofit leaders then respond to the pressure by spending too little on overhead and also by underreporting their overhead expenditures on tax forms.
4. The understanding and underreporting then confirm and perpetuate the unrealistic expectations of funders which then become increasingly unrealistic.

**Read More:** [How To Use Historical Data For Smarter Nonprofit Decision Making](#)

Caught in the overhead starvation cycle, nonprofit leaders continuously attempt to cut and cut and cut overhead expenses in an attempt to make themselves appear as if they are operating as leanly as possible, dedicating every possible cent to the mission – even when they already are not incurring unnecessary overhead expenses.

As a result, they continue attempting to do more with less and less, until eventually, the organizations starve themselves.

As we all learn throughout life, honesty is the best policy, and this is even true when it comes to disclosing your overhead costs. Be honest with yourself, your board of directors, and your donors about how much it actually costs to run your nonprofit in order to execute your mission. While you'll always strive to avoid unnecessary overhead expenses in your nonprofit, it's important to ensure funding for the people, spaces, training, supplies, and everything else you need to make your mission happen.

When you're honest with your donors and on your reporting about your true overhead costs, no one will be surprised. The fact is, most donors understand that it is expensive to run any enterprise. They'll be refreshed by your honesty, no less enthusiastic about your mission, and even more eager to help you continue making an impact. (As a bonus, you might even be awarded a GuideStar Seal of Transparency which could help to further boost contributions <sup>[2]</sup>.)

## 4. Don't Be Afraid to Negotiate With Vendors

If you're experiencing a cash flow shortage or chronically encounter shortages, talking with your vendors might actually help. Don't be afraid to negotiate on prices or payment terms. If you find a vendor offering similar supplies or services for less, don't be afraid to switch or to use the lower price as a bargaining chip when attempting to talk a current vendor down.

If you're currently in a lease or other contractual agreement with a vendor, the best time to negotiate is just before your lease or contract term is about to expire. This gives you the most leverage during the conversation.

## 5. Focus on Recurring Revenue Streams

One of the best ways to improve cash flow in a nonprofit is to strengthen recurring revenue and to help your donors understand how much of a positive impact recurring revenue has on your organization's impact.

One great strategy for increasing recurring revenue by offering your donors the ability to give automatically on a monthly basis. If you do not already have the ability to collect donations via ACH transfer with your bank, now is the time to talk with a representative about setting this up for your nonprofit.

Another strategy to apply donation requests can help you increase recurring revenue while also increasing total donations. When a donor pledges an annual gift to your organization, ask them whether they'd be willing to drop a zero and give that amount monthly. For example, a donor who normally gives \$1,000 annually could automatically donate \$100 monthly. This would increase the total donation you receive by 20% while also helping to create a recurring, regular revenue stream to improve your nonprofit's cash flow.

## 6. Prioritize Your Cash Reserve

According to the 2018 State of the Nonprofit Sector Survey report, fewer than 25% of nonprofit organizations had saved a six-month cash reserve, and most did not have even three months of expenses saved [3]. If your nonprofit also struggles to maintain a cash reserve, now is the time to start addressing that issue. Having little to no cash reserve leaves you extremely vulnerable to failure as a result of cash flow shortages and unforeseen expenses.

To start saving a cash reserve, abide by the universal personal financial management advice of paying yourself first. This means you should work an affordable amount into your monthly budget that you will transfer into your nonprofit's savings account each month. Even if you can only afford to put away a little, it will add up over time, and whatever amount you are able to save will help to shelter you during the next cash flow shortage storm.

## 7. Stretch Every Dollar by Focusing on Programs That Maximize Your ROI

You can also improve cash flow by spending smarter. You can optimize your budget to maximize ROI in your nonprofit by evaluating the profit and loss of each of your programs. Then rank the programs to evaluate them by different factors such as the number of donations they bring in, the number of people they serve, and how much they cost. Consider cutting the worst-performing programs in order to reallocate those costs to places where your funds can go further and have a greater impact.

**Read More:** [Nonprofits That Make Data-Driven Decisions at Budget Time Have Better Outcomes](#)

## **Cash Flow Statements for Nonprofits: How to Super-Charge Your Organization's Back Office (Without Busting Your Budget)**

To effectively monitor your nonprofit's cash flow, you should be looking at your cash flow statements at least monthly. To get a better feel for your current cash flow status and to detect any seasonal trends in your nonprofit's cash flow, we recommend looking at both your regular cash flow statement and a trailing twelve-month (TTM) cash flow statement. In addition to helping you identify the current health of your organization's cash flow with respect to current income and expenses, this practice will also help you detect patterns and trends with regard to when more cash is flowing into or out of your nonprofit. Identifying these trends can help you better predict and prepare for future cash shortages and influxes.

When it comes to analyzing cash flow in a nonprofit, having a strong, automated back office is essential to recording the financial data that are necessary for the facilitation of timely and accurate financial reports. Without the necessary processes, tools, and back-office infrastructure, accessing reliable financial data simply isn't possible, and this means that making strategic, data-based decisions on behalf of your organization won't be possible either.

**Read More:** [How Much Do Bookkeeping & Accounting Services for Nonprofits Cost?](#)

Thankfully, our outsourced management accounting services are here to help nonprofits of all shapes and sizes to build better back offices and access the same high-powered financial insights that the largest nonprofits and for-profit businesses use to strategically maximize impact and lead their enterprises into the future. With outsourced accounting, you gain all the benefits of a complete in-house bookkeeping and accounting department at an affordable fraction of the cost. Plus, the services you receive are scalable, so that your back office can grow along with your nonprofit's mission, needs, and budget. As a result, you can work with your nonprofit board to make data-driven decisions to get your



nonprofit cash flow into excellent shape.

[1] [https://ssir.org/articles/entry/the\\_nonprofit\\_starvation\\_cycle#](https://ssir.org/articles/entry/the_nonprofit_starvation_cycle#)

[2] <https://guidestar.candid.org/transparency/>

[3] [https://nff.org/sites/default/files/paragraphs/file/download/341454\\_NFF\\_Survey\\_R1\\_Proof.pdf](https://nff.org/sites/default/files/paragraphs/file/download/341454_NFF_Survey_R1_Proof.pdf)