

Q&A

Nonprofit Counselor

Today

What are the top signs a nonprofit is in trouble and what should the nonprofit board consider?

The most obvious indicator of trouble is the organization's inability to pay its obligations as they come due. But there are usually numerous warning signs prior to that point. As one of my colleagues says, most organizations become insolvent two ways — gradually and then suddenly.

The board is ultimately responsible for understanding exactly where the organization stands financially. This includes fully understanding the direct and indirect costs of programs, projecting future grants and revenue based on previous trends and the (new) external environment, being aware of current and future obligations and understanding its lenders or creditors, and considering a number of scenarios depending on various funding possibilities. At the same time, the board should critically review the organization's mission and current activities for impact and relevance.

From there, the nonprofit's leaders can consider a number of strategies to stretch available funding and try to head off a more serious situation. Those strategies may include some or all of the following: closing down certain programs to focus resources on the remaining programs; closing some locations; collaborating with other organizations to share expenses; seeking in-kind donations or bartering; seeking regulatory waivers to ease burdensome requirements; reconsidering how services are delivered; and seeking forgiveness of debts. (In some cases, a creditor who forgives a debt can take the amount forgiven as a charitable deduction.) And of course, since human resources expenses are typically a significant component of a nonprofit's budget, the organization should consider ways to reduce those HR costs.

What are some of the steps nonprofits can take to reduce human resource expenses?

One approach, of course, is to do a reduction in force (RIF). All the issues that apply to



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RIFs in the for-profit world apply for nonprofits, such as WARN Act notices, concerns about claims of adverse impact on persons in certain protected classes, COBRA continuation of benefits issues and use of separation agreements to name a few. Standard guidance also applies, including the following: making deeper cuts once, rather than continuous smaller downsizings; delivering the news face-to-face; and attention to managing the remaining staff. And nonprofit leaders should not disregard the less obvious costs of downsizing, such as unemployment compensation, severance payments, if any, and effect on morale.

Other, less drastic ways to reduce HR expenses include: furloughs and temporary layoffs; reductions in wages, hours or benefits; increased use of volunteers; and use of independent contractors instead of employees. This last category can be a real hot-spot for nonprofits; many simply choose to regard a worker as an independent contractor when the worker does not really meet the tests for independent contractor. Whichever approach the nonprofit chooses, the Pro Bono Partnership strongly recommends that any HR solution be implemented in conjunction with legal counsel, and we are happy to provide assistance in that regard.

What happens if, despite all efforts, a nonprofit simply cannot continue to operate?

In that situation, as would be the case with a for-profit company, the organization will close its doors and begin the process to dissolve in an orderly fashion. The board and management will use best efforts to pay outstanding debts and may negotiate with creditors and lenders as part of an informal workout. In some cases, some or all of the programs operated by the folding nonprofit will be taken over by another organization.

A nonprofit tax-exempt organization that folds must convey any assets remaining after payment of debts to another tax-exempt organization. Often, the board identifies a similar nonprofit.