

# Financial Metrics and Benchmarking for Non-Profit Organizations

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# Objectives

- At the end of this session you will...
  - Understand why non profit organizations use accounting measurements and metrics
  - Review several measurements and metrics that can be useful to non profit organizations
  - Understand why benchmarking is important
  - Learn what benchmarking tools are available (benefits / limitations)

# The Importance of Non Profits

- Increasingly important economically
  - Non profit share of the GDP is approximately 6%
  - More than 1.5 million non profits registered with the IRS
  - 9% of economy's wages / 10% of jobs
- Funded by government - billions annually
- Increasing role in provision of valuable services (being provided by non profits in partnership with government)
- Many have argued that non profits perform important social functions better than either government or for-profit organizations

# Challenges of the Non Profit Sector

- Has suffered from notable scandals and negative publicity
  - United Way of Central Carolinas
  - Mecklenburg County Open Door
  - New Jersey Symphony Orchestra
  - Adelphi University
  - Milwaukee Public Museum
- Increased IRS and legislative scrutiny
- The new normal economy

# So what does this mean?

- Financial management more important due to increased scrutiny, economic challenges and increased competition
- Executives and Board members need financial information to make key decisions

# Why use Accounting Measurements and Metrics?

- To help summarize organizational performance
- Provides a snapshot approach that is easy to understand
- Can be used to improve financial decision making
- Used in benchmarking
- Helpful in identifying trends



# Why use Accounting Measurements and Metrics? (Continued)

- Accounting measurements and metrics are most useful if they are:
  - Calculated using reliable and accurate information
  - Calculated consistently from period to period
  - Used in comparison to similar organizations
  - Viewed at a point in time and also as a trend over a period of time
  - Interpreted using internal and external factors

# What are Some Typical Accounting Measurements and Metrics?

- Financial analysis applicable to the *for profit* world may not be useful for *non profits*
  - Profit margins apply in some but not all cases
  - Financial statements do not look alike
  - Revenue streams are different
  - Equity is much different
  - Non profit focus on serving its mission



# What are Some Typical Accounting Measurements and Metrics? (Continued)

**So What are Some Good Metrics for Non Profits and What Do They Measure?**



# But First, A Quick Refresher.....

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>
<b>REVENUES AND SUPPORT</b>			
Programs Fees	\$ XXX		
Contributions and Support	XXX	\$ XXX	\$ XX
Net Assets Released from Restrictions	XX	(XX)	
Total Revenues and Support	XXXX	XX	XX
<b>EXPENSES</b>	(XXX)		
<b>CHANGE IN NET ASSETS</b>	\$ XXX	\$ XX	\$ XX

# Measurements and Metrics – Days Cash on Hand

## Operating Cash

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### Cash Expenses per Day

- How many days can the organization operate if no additional funds were received before investments would need to be liquidated

## Cash + Investments

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### Cash Expenses per Day

- How many days can the organization operate if no additional funds were received before requiring borrowed funds



# Measurements and Metrics – Days Cash on Hand (Continued)

## Cash Expenses per Day

Operating Expenses

(-) depreciation and amortization

(-) in-kind expenses

(-) unusual one-time expenses

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Cash Expenses

Divide by 365 to arrive at Cash expenses per day.

# Measurements and Metrics – Current Ratio

$$\frac{\text{Current Assets}}{\text{Current Liabilities}}$$

- Measures the financial health of the organization
- Ratio > 1 represents the ability to meet short-term obligations including maturing short-term debt and upcoming operational expenses

# Measurements and Metrics – Aged AR and AP Ratios

## Accounts Receivable over 90 Days Total Accounts Receivable

- As AR becomes older and more delinquent, may indicate potential collection problems and cash flow issues



## Accounts Payable over 90 Days Total Accounts Payable

- If this ratio is increasing over time, may indicate the organization has cash flow problems

# Measurements and Metrics – Investments



Portfolio's Rate of Return -  
((S&P 500 Rate of Return x (Equity Portfolio Inv. %)) +  
(Bond Rate of Return x (Bond Portfolio Inv. %)))

- Measures portfolio return for the Organization against overall market
- Are we underperforming?
- Use of alternative investments

# Measurements and Metrics – Debt Ratio

$$\frac{\text{Total Debt}}{\text{Total Assets}}$$

- Measures the proportion of assets to debt
- High values may indicate potential for future liquidity issues
- High Values = Highly Leveraged
  - Could reduce capacity for future borrowings





# Measurements and Metrics – Debt Ratio (Continued)

## $$\frac{\text{Total Debt}}{\text{Unrestricted Net Assets}}$$

- Should only consider unrestricted net assets in this calculation
- Can also use total liabilities rather than total debt
- Measures how much the organization is relying on funding from others
- High Values = Highly Leveraged
  - Could reduce capacity for future borrowings



# Measurements and Metrics – Net Assets

## Temporarily Restricted Net Assets (Cash + Investments + Pledges Receivable)

- Useful in determining if an organization may be spending restricted cash for purposes other than the intended purpose
- This ratio should be  $< 1$  (lower is better)

# Measurements and Metrics – Income Reliance Ratio

## Income Source Total Income

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- Analyze proportion of income streams to total income
  - Individual /Corporate contributions
  - Grants
  - Program service revenues
  - Dividends and interest
  - In-Kind
  - Net assets released from restrictions
  - Membership dues
  - Special events
- What does the trend look like?



# Measurements and Metrics – Earned Income Ratios

$$\frac{\text{Earned Income}}{\text{Total Income}}$$

- Measures relationship of earned income to all income
- Organizations with a higher percentage of earned income tend to have more autonomy and flexibility

$$\frac{\text{Earned Income}}{\text{Total Expenses}}$$

- Measures proportion of operating expenses which are covered by earned income
- Self-sufficiency

# Measurements and Metrics – Program Service Expenses

$$\frac{\text{Program Service Expenses}}{\text{Total Expenses}}$$

- Measures relationship of program expenses to all expenses
- Can vary widely from industry to industry and by the size of the organization
- BBB Wise Giving Alliance → standard of 65%
- Charity Navigator → standard of 66.7%
  
- Conversely, one can also look at the support services as a percent of total expenses

# Measurements and Metrics – Fundraising Efficiency

## Fundraising Expenses Contributions



- Calculates how much the organization spends to generate \$1 in charitable contributions
- Charity Navigator gives highest rating to those with less than \$0.10
- Charity watch indicates \$0.35 is reasonable for most charities

# Measurements and Metrics – Savings Indicator

$$\frac{\text{Income} - \text{Expense}}{\text{Total Expenses}}$$

- Measures the rate of savings
- Simple way to determine if organization is adding to or using up its net assets base
- Should be considered in combination with adequacy of resources indicators

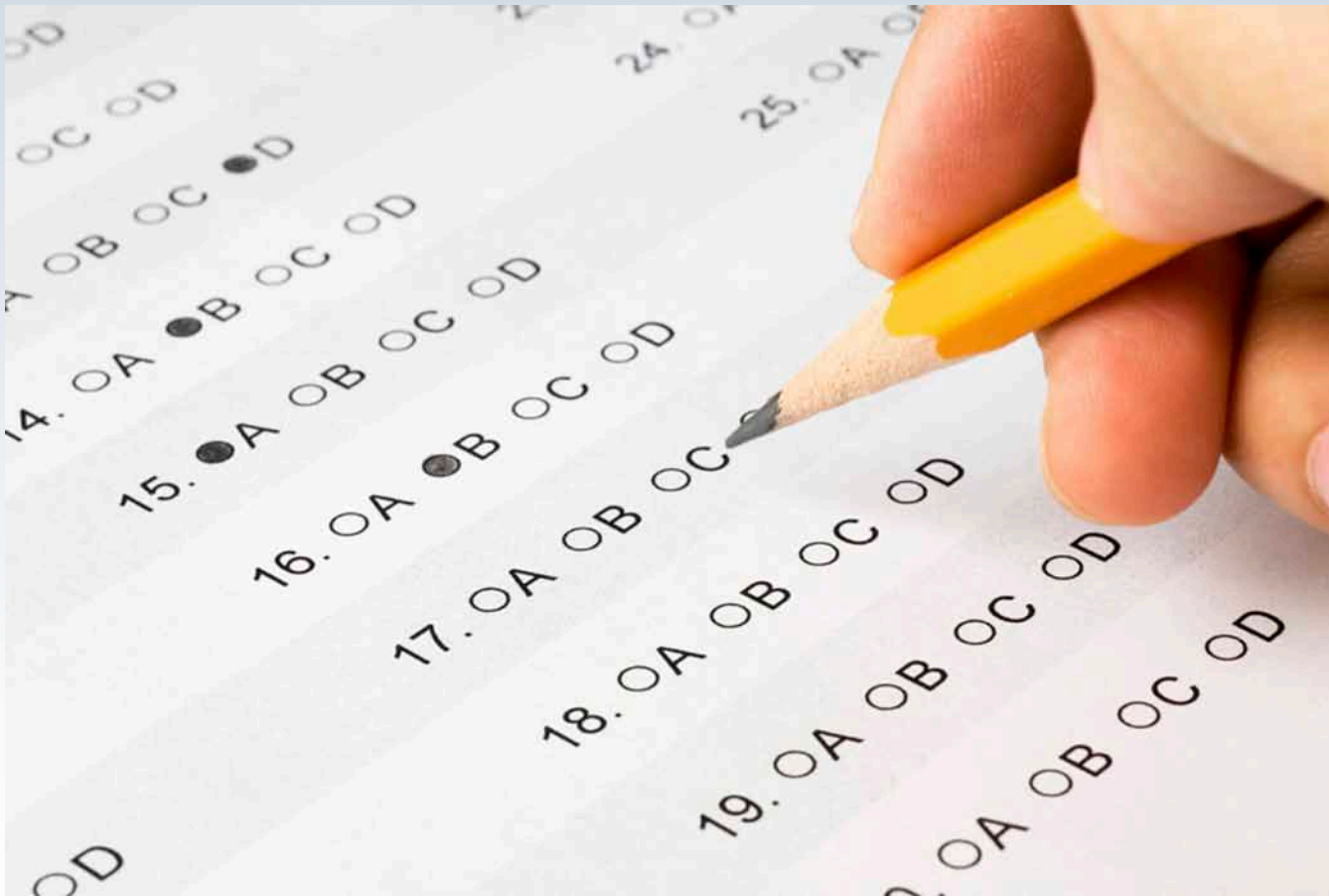


# Measurements and Metrics – Other Financial Ratios

- CEO wages as a percent of total expenses
- Personal costs as a percent of total expenses
- Benefit costs as a percent of total expenses
- Benefit costs as a percent of total compensation
- Cost per Unit of Service
- Revenues per FTE
- Expenses per FTE
- Total Compensation per FTE
- Investments as a percent of total assets



# Quiz



# True or False?

1. The organization's excellent reputation will be included as an asset on the balance sheet

**FALSE**

2. The organization's large donor base is specifically included in the calculation of fundraising efficiency.

**FALSE**

3. An unqualified or disengaged Board of Directors is the denominator to the days cash on hand ratio.

**FALSE**

# Measurements and Metrics – Non-Financial

- Don't forget about non-financial measurements as well!
  - Donors
  - Board members
  - Employees
  - Volunteers
  - Service area / market share
  - Other mission related measurements
- Very important to factor in non-financial aspects of the organization when analyzing financial measurements

# Case Study

Two non profits teach the same skills, are the same size and age, and are located in similar areas. The only real differences are:

- Organization B provides more intensive training on how to be a valuable employee (office etiquette, problem solving, effective communication) than Organization A
- Organization B sponsors support groups for clients who have made the transition from welfare to the working world

# Case Study (Continued)

	<b>Organization A</b>	<b>Organization B</b>
Total Expenses	\$ 100,000	\$ 100,000
Program Expenses	\$ 90,000	\$ 70,000
Program Expense Ratio	90.0%	70.0%
# of Clients Trained	85	65
# of Clients Placed in Job	76	55
Starting Salary	\$10 / hr	\$10 / hr
# of Clients Employed After 2 Yrs	30	50
Avg. Salary of Clients Employed After 2 Yrs	\$12 / hr	\$15 / hr

So how do we use this information to help our organization?



# Why Benchmark?

Because numbers are meant to be **compared!**

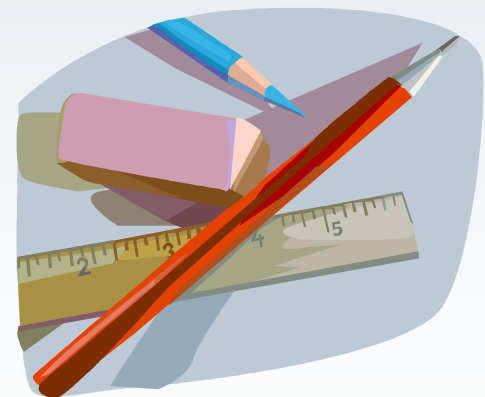
Because the most effective measures of financial health represent **relationships!**

As a way to **share** and **collaborate**, stimulate **conversation** and **reflection**, and **take pulse** of environmental trends.

To get what you want!!!

# Why Benchmark? (Continued)

- Benchmark when you want to...
  - Compare like attributes from similar organizations
  - Make better-informed decisions
  - Answer the question “how do I compare?”
  - Take pulse of your financial health
  - Obtain a single version of the truth





# 5 Key Questions to Consider when Benchmarking

#1

Are available financial resources sufficient to support our mission?

#2

How are our resources used, and are they being used efficiently and effectively?

#3

How are we performing on a relative basis?

#4

What are problem areas we can try to solve?

#5

What areas of superior performance or accountability can we discover?

# In the Boardroom



- Board Meeting Presentations
  - Provide a quick snapshot of the current financial status
    - ◇ Discuss detailed statements and comparisons to budget through the finance committee
  - Provide a summary report of key issues related to the finances of the organization
    - ◇ Use a “Financial Dashboard”
    - ◇ Communicate measurements and metrics in an efficient and effective manner
    - ◇ Color coded



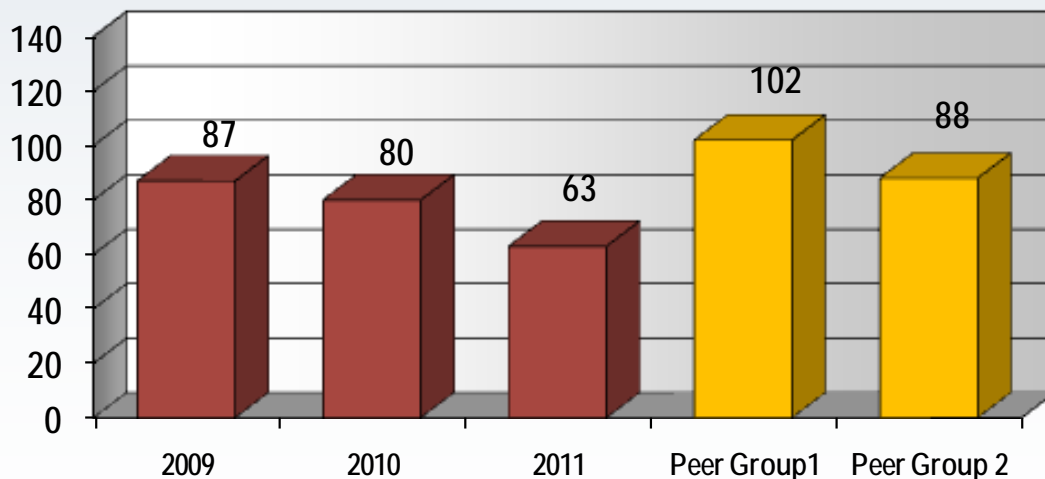
# Days Cash on Hand

## Definition:

Days Cash on Hand measures the number of days of average cash expenses the Organization maintains in cash and investments. High values usually imply a greater ability to meet both short-term obligations and long-term capital replacement needs.

## Comments:

Days cash on hand is used for operating expenses, debt service and for future capital requirements, and expansion of services. Days cash on hand decreased in the current year due a decrease in counseling services provided.



# Debt to Unrestricted Net Assets

## Definition:

This ratio is defined as the proportion of long-term debt divided by unrestricted net assets. Higher values for this ratio imply a greater reliance on debt financing and may imply a reduced ability to carry additional debt.

## Comments:

This ratio decreased in the current year as a result of making scheduled debt payments while maintaining a positive margin. This ratio indicates the Organization remains in a favorable leverage position to obtain additional debt financing in the future as needed.



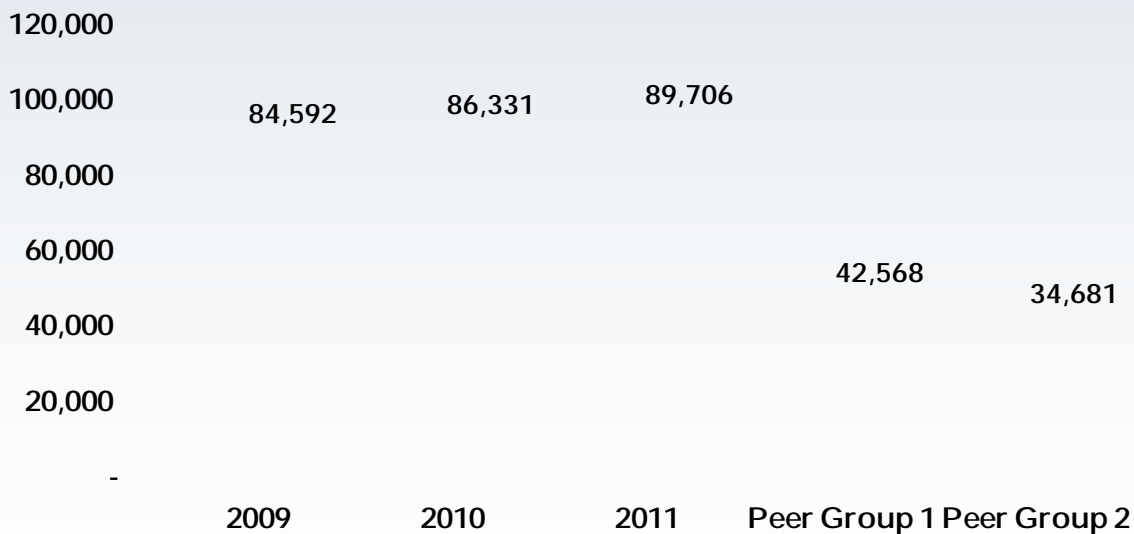
# Program Service Revenues per FTE

**Definition:**

This ratio calculates the average amount of program service revenue per full-time employee.

**Comments:**

This ratio has increased in each of the last 3 years and remains high relative to the peer group medians. This ratio indicates the Organization should consider investing in additional FTEs.



# What Tools are Available - Benefits/Limitations

- Find a peer group of similar organizations and work with them to compile data on a regular basis.
- GuideStar – Lots of free information stemming from filed Federal Form 990s
- More Specific Products (often cost money)
  - *ASAE's Association 990*

# Using Guidestar to Gather Benchmarking Data...



**GUIDESTAR®**

<http://www.guidestar.org/rxq/analyze-nonprofit-data/index.aspx>



<https://www.iisecure.com/asae990/login.aspx>



# Thank You!!!

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