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
So What are Some Good Metrics for Non-Profits and What Do They Measure?
But First, A Quick Refresher…..

<table>
<thead>
<tr>
<th>REVENUES AND SUPPORT</th>
<th>Unrestricted</th>
<th>Temporarily Restricted</th>
<th>Permanently Restricted</th>
</tr>
</thead>
<tbody>
<tr>
<td>Programs Fees</td>
<td>$ XXX</td>
<td>$ XXX (XX)</td>
<td>$ XX</td>
</tr>
<tr>
<td>Contributions and Support</td>
<td>XXX</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Assets Released from Restrictions</td>
<td>XX</td>
<td>XX</td>
<td>XX</td>
</tr>
<tr>
<td>Total Revenues and Support</td>
<td>XXXX</td>
<td>XX</td>
<td>XX</td>
</tr>
</tbody>
</table>

| EXPENSES | (XXX) |  |  |
|          |  |  |  |

<table>
<thead>
<tr>
<th>CHANGE IN NET ASSETS</th>
<th>$ XXX</th>
<th>$ XX</th>
<th>$ XX</th>
</tr>
</thead>
</table>
Measurements and Metrics – Days Cash on Hand

Operating Cash

\[
\frac{\text{Cash Expenses per Day}}{1} \times \text{Operating Cash}
\]

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

Cash + Investments

\[
\frac{\text{Cash + Investments}}{\text{Cash Expenses per Day}}
\]

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

Operating Expenses

(-) depreciation and amortization

(-) in-kind expenses

(-) unusual one-time expenses

Cash Expenses

Divide by 365 to arrive at Cash expenses per day.
Measurements and Metrics – Current Ratio

Current Assets

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

<table>
<thead>
<tr>
<th>Accounts Receivable over 90 Days</th>
<th>Total Accounts Receivable</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Accounts Payable over 90 Days</th>
<th>Total Accounts Payable</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

- If this ratio is increasing over time, may indicate the organization has cash flow problems
Measurements and Metrics – Investments

Portfolio's Rate of Return - 
\[ (((S&P\ 500\ Rate\ of\ Return \times (Equity\ Portfolio\ Inv.\ %)) \ + \ (Bond\ Rate\ of\ Return \times (Bond\ Portfolio\ Inv.\ %)))) \]

- Measures portfolio return for the Organization against overall market
- Are we underperforming?
- Use of alternative investments
Measurements and Metrics – Debt Ratio

\[
\text{Debt Ratio} = \frac{\text{Total Debt}}{\text{Total Assets}}
\]

- 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)

- 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

\[
\text{Temporarily Restricted Net Assets} = \frac{\text{(Cash + Investments + Pledges Receivable)}}{\text{Net Assets}}
\]

- 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

<table>
<thead>
<tr>
<th>Income Source</th>
<th>Total Income</th>
</tr>
</thead>
</table>

- 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

**Earned Income / 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

**Earned Income / Total Expenses**

- Measures proportion of operating expenses which are covered by earned income
- Self-sufficiency
Measurements and Metrics – Program Service Expenses

Program Service Expenses

<table>
<thead>
<tr>
<th>Program Service Expenses</th>
<th>Total Expenses</th>
</tr>
</thead>
</table>

- 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
Fundraising Efficiency

- 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

**Income - Expense**

**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
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)

<table>
<thead>
<tr>
<th></th>
<th>Organization A</th>
<th>Organization B</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Expenses</strong></td>
<td>$100,000</td>
<td>$100,000</td>
</tr>
<tr>
<td><strong>Program Expenses</strong></td>
<td>$90,000</td>
<td>$70,000</td>
</tr>
<tr>
<td><strong>Program Expense Ratio</strong></td>
<td>90.0%</td>
<td>70.0%</td>
</tr>
<tr>
<td><strong># of Clients Trained</strong></td>
<td>85</td>
<td>65</td>
</tr>
<tr>
<td><strong># of Clients Placed in Job</strong></td>
<td>76</td>
<td>55</td>
</tr>
<tr>
<td><strong>Starting Salary</strong></td>
<td>$10 / hr</td>
<td>$10 / hr</td>
</tr>
<tr>
<td><strong># of Clients Employed After 2 Yrs</strong></td>
<td>30</td>
<td>50</td>
</tr>
<tr>
<td><strong>Avg. Salary of Clients Employed After 2 Yrs</strong></td>
<td>$12 / hr</td>
<td>$15 / hr</td>
</tr>
</tbody>
</table>
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
ABC Organization
Financial Indicators - Liquidity Ratios

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.

![Days Cash on Hand Chart]

- 2009: 87
- 2010: 80
- 2011: 63
- Peer Group 1: 102
- Peer Group 2: 88
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) –
  - NASAE’s Association 990
Using Guidestar to Gather Benchmarking Data...

https://www.iisecure.com/asae990/login.aspx
Thank You!!!

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