CERINI & ASSOCIATES LLP
CERTIFIED PUBLIC ACCOUNTANTS

Nonprofit Board Training

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Connected to your governance... Connected to your constituents... Connected to your mission

Thank you!

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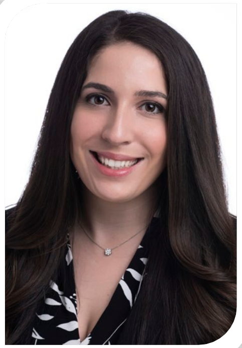

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Cerini & Associates, LLP is a full service accounting firm with a staff of 65, 8 partners, and a foundation built on value-added ideas and integrity. We serve many industries, including healthcare, nonprofit, technology, special education, startups, school districts, and construction, among many others.

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Financial Analyses and Trends

- The information presented in an organization's financial statements can be further explained by use of various calculations, ratios, and trends.
- The most common types used for not-for-profit organizations are:
  - Liquidity measures.
  - Days in cash.
  - Days in receivables.
  - Debt-to-assets.
  - Trends in net assets.
  - Expendable net assets.
  - Program trend analysis.
  - Fundraising event profitability.
  - Program service percentages.
  - Budget-to-actual performance.

Liquidity Measures

- Liquidity:
  - Measures the organization's ability to meet its financial needs in the next fiscal year.
  - This generally consists of two calculations:
    - Working capital – current assets minus current liabilities.
    - Current ratio – current assets divided by current liabilities.
    - Quick ratio – current assets convertible to cash within ninety days divided by current liabilities.
    - "Current" in these measures refers to an asset converting to cash or a liability to be settled within one year.
  - Does the organization have the resources to meet its current obligations with the current assets it has available?

Liquidity Measures

- Liquidity:
  - Organizations should strive for current ratios of approximately 1.5 to 1 and positive working capital. Both indicate the ability to meet financial obligations in the next twelve months.
  - Current ratios less than 1 to 1 and negative working capital are both worrisome signs that should spark questions about the organization’s plans for sustaining itself during the next year.
  - Quick ratios usually compare cash and equivalents, receivables, and investments to current liabilities. A quick ratio of 1 to 1 is generally considered positive.
  - Falling short of these benchmarks should spark inquiries of management about organizations’ short-term abilities to fund current operations.

Days in Cash

- Days in cash:
  - The number of days the organization can operate with its cash balance as of a specific date based on an assumed daily cash "burn rate."
    - Burn rates are calculated by dividing expected total cash expenses by 365 days.
      - Total cash expenses may be calculated by starting with total expenses on the SOFE and subtracting non-cash expenses, such as depreciation and bad debts, as well as one-time items that are not expected to be repeated in the coming fiscal year.
  - This provides a quick insight into whether or not an organization is having, or is going to have, cash flow issues.
  - An appropriate amount of days in cash depends on the type of funding that the organization receives. Generally speaking, sixty to ninety days of cash on-hand is indicative of an organization with adequate cash reserves. Any less means that the organization could experience challenges meeting its financial obligations if funding is cut, if collections on receivables are delayed, and/or if cash demands are accelerated. Obviously, the higher, the better here.

Days in Receivables

- Days in receivables:
  - Receivables represent amounts owed to an organization for services provided or other commitments committed-to by donors or other funding sources.
  - Days in receivables calculates the average number of days it takes an organization to collect on its receivables.
  - The main sources of funding will determine what is an appropriate number of days; however, the fewer days, the better. It means cash is collected faster.
  - Typically, the number of days should be no more than 45-60 and should ideally decrease over time, or at least remain consistent.
    - Some organizations that work with government agencies may have higher days figures though, which is not necessarily an indication of weakness, rather, unavoidable inefficiencies at the funding source level. For such organizations though, other sources of funding and/or financing are likely needed to bridge the gap between the cash-in and cash-out cycles.
  - This ratio is more relevant to those organizations that have regular revenue streams (fee for service, government contracts) than those that are more fundraising-driven.

Debt-to-Assets

- Debt-to-Assets:
  - This calculation measures and organization’s leverage and if its debt levels may be excessive in proportion to its overall assets. It is calculated as total debt (below) divided by total assets.
  - To calculate it, you need to identify actual debt balances (not total liabilities in general), including:
    - Lines of credit.
    - Mortgage payable.
    - Equipment loans payable.
    - Related party notes payable.
  - A ratio of 1.25 to 1 is considered acceptable. An amount less than this should be questioned.

Net Assets Measures

- Trends in net assets:
  - Net assets should increase over time, or at least remain fairly consistent.
  - A steady or continuous increase in net assets means the organization is operating efficiently (*i.e. programs are appropriately run and expenses are controlled*). Growth in net assets typically means better cash flows and better liquidity.
  - It's important to note that if depreciation is significant, it may be useful to add depreciation back to the overall change in net assets to "normalize" it. Depreciation represents an accounting charge and not an actual cash or operating outlay.
- Expendable net assets:
  - Net assets that are absent of any donor restrictions or tied up in long-term assets (PP&E, security deposits). To calculate this, deduct PP&E and related secured debt from total net assets without donor restrictions. Organizations should strive to have positive values in such a calculation.
  - This determines the level of usable net assets the organization really holds as opposed to what is illiquid. After all, bills can't be paid with buildings.

Program Trends

- Program trend analyses:
  - A significant measurement of an organization's operating effectiveness is based on the success of its programs. It's important to see if a program is profitable, break-even, or operating at a loss.
  - Depending on the organization's funding sources, examples include:
    - Program revenue less program expenses (or by funding source).
      - Organizations should avoid money-losing programs if they can't be otherwise subsidized.
    - Concentrations of revenue.
      - Be aware if the organization is too reliant on a small pool of funders.
    - Trends in units of service over time.
      - If organizations perform fewer services, their revenues will shrink.
    - Revenue and/or expense per unit of service performed for such organizations.

Fundraising Events

- Fundraising event profitability:
  - Measured by the total revenue raised less the total expenses associated with events.
  - This measurement can assist in determining if events are worth continuing or should be modified to potentially generate more income.
  - A good rule of thumb is that events should generate at least three times the related direct expenses.
  - Trends in fundraising profitability should also be reviewed to identify slippage.

Program Service Percentage

- Program service percentage:
  - This represents the percentage of total costs that are spent on running the organization's programs.
  - The higher the percentage, the more dollars targeted to program activities, and the more attractive the organization is to outside parties (funders, the press, the IRS, etc.).
  - The nature, size, and funding sources of an organization will all impact program service percentage.
  - Larger organizations, government-funded organizations, and health and welfare organizations all tend to have higher program service percentages, typically in the 75%-90% range.
    - Beware organizations with program service percentages less than 70%. Inquire as to why the metric isn't higher and what the organization is doing to increase this over time. For some, there are reasonable explanations. For others, it could be a red flag.
  - This is an attention-grabbing metric that all nonprofits should monitor and manage.

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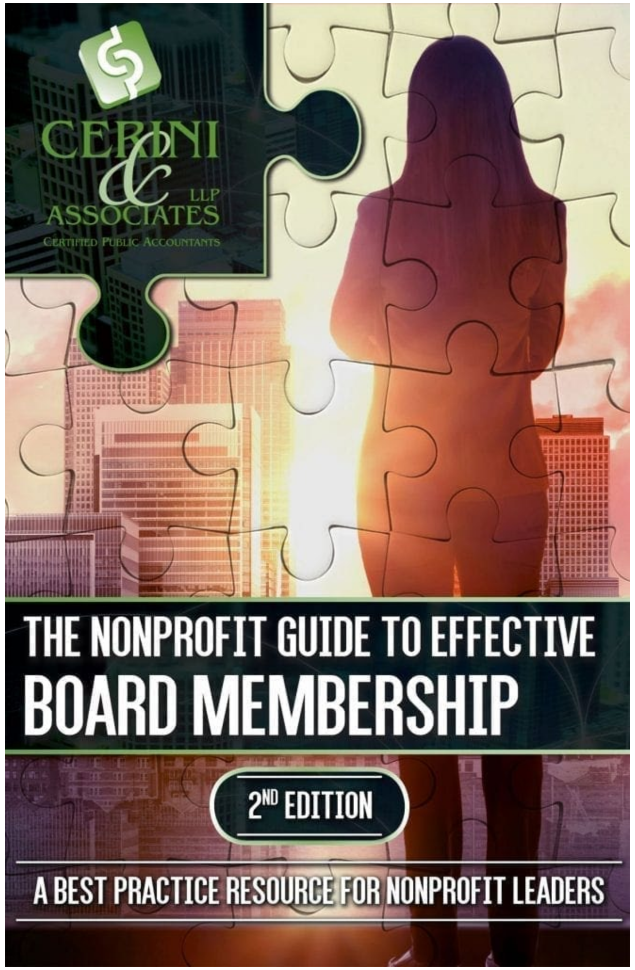
Budget-to-Actual Performance

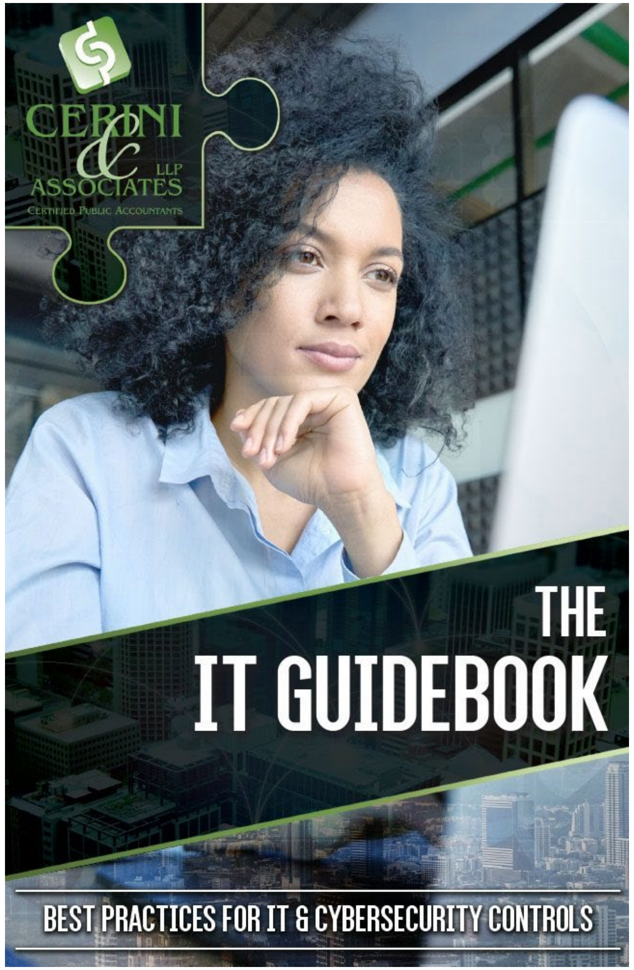
- Budget-to-Actual Performance:
  - All organizations should have comprehensive financial budgets that at least plan the cash inflows and outflows of an organization for the future fiscal year. Some organization may have GAAP-based budgets as well.
  - Effective budgeting is indicative of effective management of the overall organization.
  - Budget-to-actual reporting should be taking place on an ongoing basis (monthly or quarterly, most usually).
  - Compare year-end budget-to-actual performance to identify major variances and understand why (1) the variance came to be and (2) whether or not management was ineffective at foreseeing or planning for such events.
  - Wide variances on budget-to-actual reporting may be indicative of poor management and financial planning, and could call into question any forward-looking plans for the organization.

Other Considerations

- Keep in mind the timeliness of the reports being reviewed. Audit reports will ideally be issued within three months of year-end, but of course this can vary widely. Reviewing stale financial information may be less useful and may require that updated interim financial information be considered in your decision-making process.
- For capital-intensive projects, you should ensure that organizations are properly considering and budgeting for future repairs, renovations, and major capital improvements that may be necessary. The age of assets should be considered as part of this, as well as the levels of replacement reserves and other mandated operating reserves. Are they sufficient? What if they aren't and major capital expenditures are needed? Management should be able to answer these questions.

Additional Resources





2023 Trend Report

We have talked to industry professionals to prepare the 2023 Guide, which covers such areas as: Fundraising/Marketing Trends, Operational Trends, Changes in Technology, and so much more!

Join Us For This Months Nonprofit Trend Webinar!

Register Here:
https://us02web.zoom.us/webinar/register/WN_LtZqyLPeTkSSL2Lj4ySuTA