

MARCH 12, 2010



MEASURES THAT MATTER: Tools and Techniques for Monitoring Your Financial Health

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AGENDA

Session 1: Principles of Effectiveness

- Dashboards
- Benchmarking

Session 2: Examples of Effectiveness

- Presentation for nonprofit ministries
- Composite Financial Index

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Dashboards for Nonprofits

- What they are:
 - Summarized management information
 - Designed to highlight key performance indicators
 - Arranged in a graphic (sometimes digital) format
 - Designed to highlight pending problems so that diving into operational details can be avoided — if there is a problem, it will be highlighted

"You see, but you do not observe."

- Sir Arthur Conan Doyle (1859 - 1930), *A Scandal in Bohemia* (Sherlock Holmes)

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Dashboards for Nonprofits

- What they are not:
 - Comprehensive reports
 - Indicative of qualitative measures
 - Tools allowing broad conclusions on key issues

"They are ill discoverers that think there is no land, when they can see nothing but sea."

- Sir Francis Bacon (1561-1626)

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Ground Rules for Dashboards

- Provide concise analysis derived from available data.
- Narrow the focus to important issues and key areas.
- Explain trends, benchmarks, and targets clearly.
- Demonstrate the impact on decision making.
- Stimulate questions that explore issues beyond the data alone.



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Key Steps for Effective Dashboards

Understanding the context
Perceiving the data



Getting the right data
Procuring the data

Presenting the data

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Understanding the Context

Without sufficient context, more data **does not** equal more understanding.

- Do administrators and boards fail to make good decisions because of a lack of information, or a lack of context?
- Do decision makers battling competing priorities have sufficient time to establish the correct context for the data you present?
- Do different users — from “accountants to theologians” — with varying needs and capabilities view the same data and come to the same conclusion?
- Do emotions such as apathy or fear block decision makers from accepting and using new tools?

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Procuring Data: Getting the Details Right

Closely linked to mission and strategic plan

Resolves unanswered questions



Relevant to their level of responsibility

Accurate and timely

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Getting the Details Right

Data is closely linked to the mission and strategic plan.

Goal Area	Goal	Performance	Year-End Status
Enrollment	1000 new students	1031	Exceeded
Quality	1060 SAT, 3.1 GPA	1060 SAT, 3.12 GPA	Exceeded
Diversity	15% minority enrollment	15%	Completed
Persistence	81%	78.8%	Not met
Four-Year Graduation Rate	50%	40.6%	Not met
Job Placement Rate	90th Percentile	91th Percentile	Exceeded

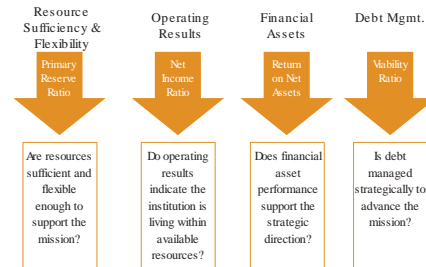
Longwood University

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Getting the Details Right

Board-Level Questions: Ratio Map



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Getting the Right Data

Data resolves unanswered questions.

ATTENDANCE	STUDENT FEES
<ul style="list-style-type: none"> What are the estimated numbers of new members by year and type of member (career, family, senior, etc.)? What are the estimates for transfer members vs. new converts by year and type? Impact on member profiles in terms of gender, race, marital, and other characteristics? What are the member retention rates by year and type? 	<ul style="list-style-type: none"> What are assumed gross student fees per student by year and type of student? What % of the students are in financial aid by year and type of student? What are the other costs associated with growth (new faculty, admissions and marketing, classrooms and offices, etc.)? Per student? Per credit hour? What is the net revenue per student by year and type of student?

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Getting the Right Data

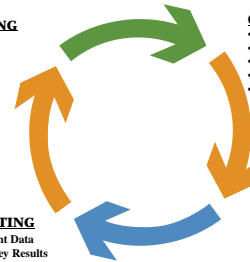
Data is accurate and timely.

MAY MEETING

- Faculty Salaries
- Staff Salaries

OCTOBER MEETING

- Student Enrollment
- Student Quality (SATs, Average GPA)
- Student Diversity (Racial, Geographic)
- Diversity of Faculty and Staff
- Retention



MARCH MEETING

- Student Placement Data
- Satisfaction Survey Results

DECEMBER MEETING

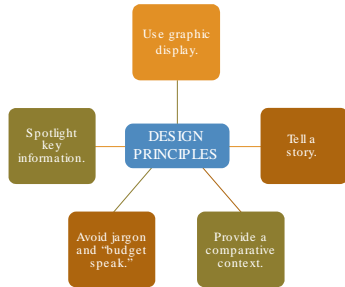
- Strategic Indicators
- Financial Ratios

Courtesy of Rick Staisloff, College of Notre Dame

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Presenting Data: Keys to Successful Dashboards



Adapted from *Guide to Board Information Systems* by L. Butler (AGB).

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Deciding What to Measure

- Six Approaches:
 - Outcomes
 - Mission as Spine
 - Strategic Initiatives
 - Drivers of Success
 - Risk Factors
 - Service/Resource Matrix

Courtesy of *The Nonprofit Dashboard: A Tool for Tracking Progress* by Lawrence M. Butler
Available from www.boardsource.org

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Presenting Data: Common Pitfalls

- Cool trumps useful – Be sure that the actual business use remains the primary focus.
- More is better – Fewer key performance indicators are better than more.
- Lack of relation between strategy and action – Keep the data focused on information users can actually act upon.

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Presenting Data: Suggested Data for Churches

- Weekly per capita income – Robert Morris Associates (RMA) benchmark is \$15 to \$20 (should be adjusted for demographics and region).
- Total debt service per giving unit – RMA benchmark range is \$1,000 to \$7,500.
- Debt multiplier – RMA benchmark is maximum of 2.5 x annual income.
- Compensation as a percent of total expense – Hammar's annual *Compensation Handbook for Church Staff* benchmark is 46% to 48%.

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What is Benchmarking?

A purposeful comparison against an internal or external individual or group.

The comparison is qualitative, quantitative, or both, and focuses on inputs, process, outputs, and/or impacts.

It is based on the desire to be "typical," "better," or "best."



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The Need for Benchmarking

Key Challenges Facing Most NPOs:

- Maintain financial viability
- Demonstrate accountability
- Operate strategically
 - Plan realistically
 - Allocate resources appropriately
 - Support decision making
 - Assess outcomes



Participants in CIC/AIR/NCES Management Institute, 2002-2004

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Cost vs. Benefit

- **Costs**
 - Time, money
 - Organizational friction
- **Benefits**
 - Mission focused
 - Frame for reflection
 - Fact-based function
 - Comprehensive view
 - Reinforces performance
 - Reality based
 - Historically valid



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Why Benchmark Now?

- **Competitive situation**
 - Financial viability at risk
 - Money and donors scarce
 - Sales and services competitive
- **Complex environment**
 - Accountability
 - Transparency
 - Raised public expectations of leadership



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Steps in Benchmarking

- Audit your situation
- Select measures
- Form groups
- Collect data
- Monitor outcomes
- Use results
- Adjust process



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Selecting a Comparison Group

- **Primary Factors**
 - Demographics
 - Location/region
 - Financial structure
 - Relative size
- **Secondary Factors**
 - Religious affiliation
 - Program functions (churches with and without schools)

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Guiding Principles for Best Practices

- Is there a proven track record of success for this benchmark?
- Are the results sustainable?
- Can the idea or practice be replicated in your context?
- Does it help you achieve your mission?

From *Benchmarking for Nonprofits: How to Measure, Manage, and Improve Performance* by Jason Saul (Fieldstone Alliance Publishing Center)

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Are You Ready?

- **Quick reality check questions:**
 - Are your board and top management satisfied with the information they currently receive?
 - Do the board and top managers feel they need more meaningful measures of performance or mission effectiveness?
 - Do the board and top management know what these measures should be?
 - What kind of data is currently being compiled, and could it be used to address these needs?
 - How difficult would it be to provide the data to fuel the desired dashboard measures?

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Resources

- *The Nonprofit Dashboard: A Tool for Tracking Progress* by Lawrence M. Butler (Boardsource)
- *Using Performance Measurement to Improve Public and Nonprofit Programs: New Directions for Evaluation* by Kathryn E. Newcomer (Jossey-Bass)
- *Financial Planning and Evaluation for the Nonprofit Organization* by Anthony J. Gambino and Thomas J. Reardon (National Association of Accountants)
- *Benchmarking in Higher Education: Adapting Best Practices to Improve Quality* by Jeffrey W. Alstete (Association for the Study of Higher Education Report no. 5)

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Conclusion

"Governance is decision-making, and decisions can be no better than the quality of information available to inform them."

Preface to *Strategic Indicators for Higher Education: Improving Performance* by Barbara E. Taylor and William F. Massy



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Part 2: Financial Ratios

Agenda for this session:

- Importance of Ratio Analysis
- Composite Financial Index (CFI)
- Other Ratios

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Financial Ratios

Internal Importance of Ratio Analysis

- Audience: Finance committees and boards.
- Purpose: Explains current financial position in a context of past performance to make the most accurate forecast possible.
- Process: Benchmarks key financial data and builds trend analysis.
- Outcome: Informed decision making yields improved internal and external communication.

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Financial Ratios

External Importance of Ratio Analysis

- Outside agencies use ratios to assess the financial viability of the institution.
 - ACSI for Christian schools
 - Higher Learning Commission for colleges
 - Banks and other lending institutions
 - Auditors
 - Investors – Purchasers of bonds issued by your organization

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Financial Ratios

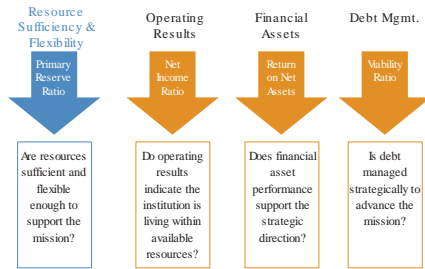
Four Key Ratios that Measure Overall Financial Health

- Primary Reserve Ratio
- Net Income Ratio
- Return on Net Assets Ratio
- Viability Ratio

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Ratio Map



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Primary Reserve Ratio

Asks the question:

Are resources sufficient and flexible enough to support the mission?

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Primary Reserve Ratio

Primary Reserve Ratio

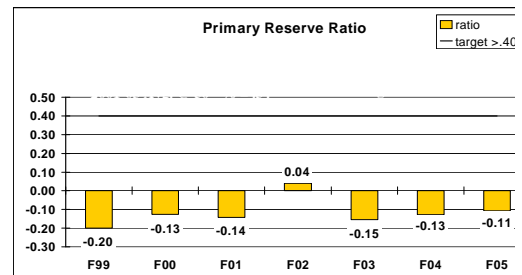
- Measures the financial strength of the institution by comparing expendable net assets to total expenses.
- Expendable net assets are quickly accessed and spent to satisfy debt obligations.
- Indicates how long the institution can function using expendable reserves without relying on additional net assets generated by operations.

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Primary Reserve Ratio

Expendable Net Assets divided by Total Expenses



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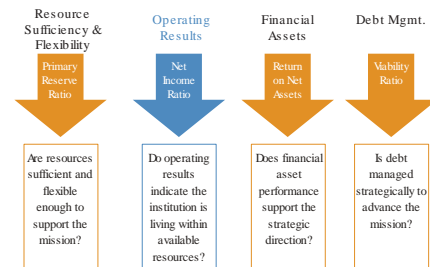
Primary Reserve Ratio

- Target is at least .40 (represents 5 months unrestricted equity on hand).
 - At this level, use internal cash, not short-term borrowing.
 - Reasonable level of facilities maintenance.
 - Capable of managing modest unforeseen adverse financial events.

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Ratio Map



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Net Income Ratio

Asks the question:

Do operating results indicate the institution is living within available resources?

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Net Income Ratio

Net Income Ratio

- Indicates whether total unrestricted activities resulted in a surplus or a deficit.
- Change in unrestricted net assets divided by total unrestricted income.**

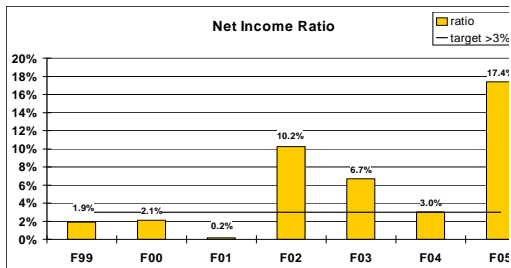
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Net Income Ratio

(used in CFI calculation)

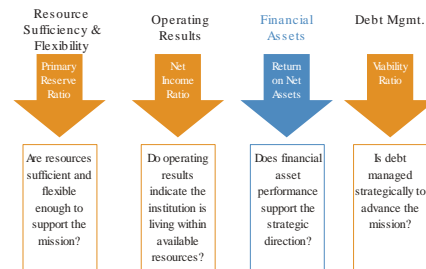
Change in Unrestricted Net Assets divided by Total Unrestricted Income



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Ratio Map



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Return on Net Assets Ratio

Asks the question:

Does financial asset performance support the strategic direction?

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Return on Net Assets Ratio

Return on Net Assets Ratio

- This ratio determines whether the institution is financially better off than in previous years by measuring total economic return.
- Change in net assets divided by total net assets.**

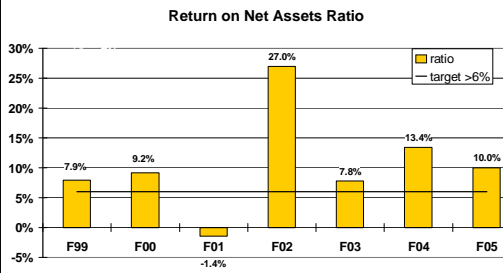
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Return on Net Assets Ratio

(used in CFI calculation)

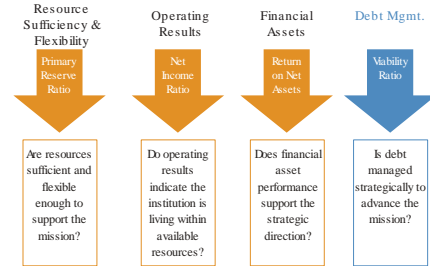
Total Change in Net Assets divided by Total Net Assets



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Ratio Map



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Viability Ratio

Asks the question:

Is debt managed strategically to advance the mission?

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Viability Ratio

Viability Ratio

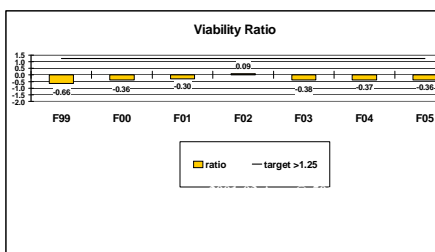
- Measures the availability of expendable net assets to cover debt should the institution need to settle its obligations as of the balance sheet date.
- Expendable net assets divided by long-term debt.**
- A viability ratio below 1.25 indicates that the institution's ability to respond to adverse conditions is diminished and will be driven by fiscal, rather than programmatic, decisions.

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Viability Ratio

Expendable Net Assets divided by Long-Term Debt



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Composite Financial Index

What is the overall level of financial health?

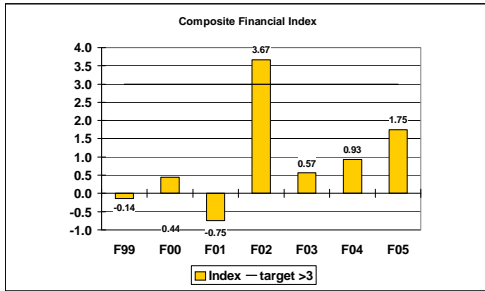
Composite Financial Index (CFI) — measures the financial component of an institution's well-being.

- The values of the four core ratios are computed.
- These figures are converted to strength factors along a common scale.
- The strength factors are then multiplied by specific weighting factors.
- The resulting four numbers are totaled to reach the single CFI score.

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Composite Financial Index



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CFI Action

CFI Scoring Range	Action
-1 to 1 0.57 in 2003 and 0.93 in 2004	Assess institutional viability to survive
0 to 2 and 1 to 3 1.75 in 2005	Reengineer Institution
2 to 4 and 3 to 5	Direct resources toward transformation
4 to 6 and 5 to 7	Focus resources to compete in future
6 to 8	Experiment with new initiatives
7 to 9	Experiment with initiatives Design a robust mission
> 9	Deploy resources to achieve robust mission

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Composite Financial Index

- The recent XU study indicates that XYZ College is at the bottom of the 3rd Quartile of the 98 XU institutions that were included in the study.
- The recommendation for those institutions in the 3rd Quartile is to re-engineer the institution.
- Institutions ranked 51 to 74 were included in this Quartile.

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CFI Scoring – What does it mean?

- Unrestricted expendable net assets are negative.
In 2005, unrestricted expendable net assets were -1.974 million. The college must budget for surpluses (including depreciation) and add to unrestricted investments.
- Must continue operating surpluses (after depreciation) to build net assets.
Operating surpluses must continue in order for the college to realize the flexibility necessary to follow its mission.
- Long-term debt too high.
While there has been improvement in debt repayment, the college debt burden is greater than the accepted threshold. The college must continue to reduce debt.

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CFI Scoring – What does it mean?

- Short-term borrowing for operations must be eliminated.
In 2005 the college borrowed funds for operations 4 out of 12 months. Operations should be self-sustaining for cash flow.
- Income must increase at a greater rate than expenses.
Expenses have grown faster than revenues for 4 of the last 6 years. The college should grow revenues faster than expenses.

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CFI Scoring – What does it mean?

- Build unrestricted reserves.
Currently the college has no unrestricted reserves for unexpected, unbudgeted expenses. The college must budget planned surpluses that increase unrestricted net assets.

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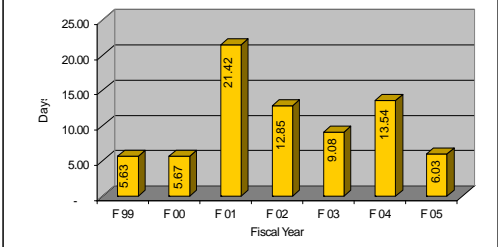
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Supplemental Ratios

Days in Cash Ratio (Unrestricted)

Unrestricted Cash on June 30 x 365 divided by Expenses Before Depreciation

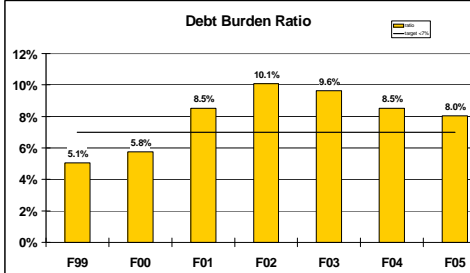


Fiscal Year	Days
F 99	5.65
F 00	5.67
F 01	21.42
F 02	12.85
F 03	9.08
F 04	13.54
F 05	6.03

Measures the number of days expenses could be paid using unrestricted cash on hand if cash inflows stopped.

Debt Burden Ratio

Annual Debt Service divided by Operating Expenses + Debt Service Principal

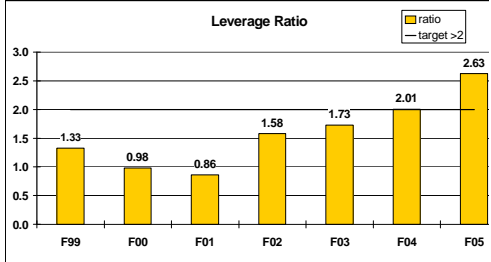


Fiscal Year	Ratio (%)
F99	5.1%
F00	5.8%
F01	8.5%
F02	10.1%
F03	9.6%
F04	8.5%
F05	8.0%

Measures the percentage of debt service to total operating costs.

Leverage Ratio

Unrestricted + Temporarily Restricted Net Assets divided by Long-Term Debt



Fiscal Year	Ratio
F99	1.33
F00	0.98
F01	0.86
F02	1.58
F03	1.73
F04	2.01
F05	2.63

Measures the amount of leverage on the institution's assets; similar to a debt-to-equity ratio.