



Where the **Power of Business**
Meets the **Passion of Giving**



Capacity Building Seminar:

Business Operations & Financial Management

October 10, 2009



Where the **Power of Business**
Meets the **Passion of Giving**



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Today's topics

- Why are Business Operations Important?
- The Non Profit Starvation Cycle
- Financial Management
- Financial Statements tell your story
- Financial Analysis
- Ratios and "Benchmarking"
- Capacity, Growth, and the effect on your numbers
- Working with the rating agencies
- Resources

Why are Business Operations important?

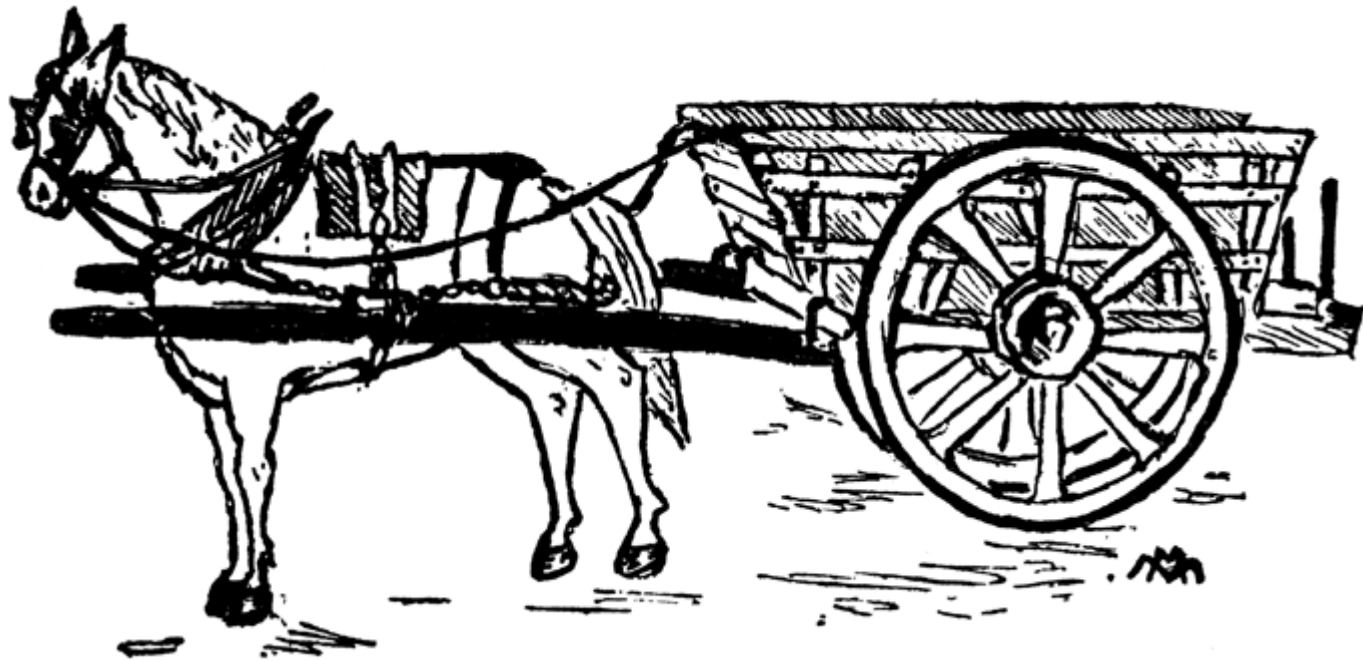
Business Operations could also be called
“non program operations”

Business Operations is a critical part of
organizational capacity.

What do we mean when we talk about
Business Operations in the Not for Profit
Environment?

Business Ops

Program Delivery



Business Operations in NFP's

- All of the activities in an organization that are designed to support programs, analysis, decision making, data flow, and outcome measurements
 - Bookkeeping
 - Financial Accounting
 - Managerial Accounting
 - > Cost accounting
 - > Outcome measurement
 - Metrics may be financial OR non financial
 - Database management : donors and volunteers and clients
 - IT (may also be part of program services)

Business Operations in NFP's

- More of the daily activities needed to run the non program side of the organization:

HR and benefits

Legal

Insurance

Payroll processing

Payment Gateways

Banking

Treasury and Investments

Office management and administration

A Quick Note about Donor Management

- Donor Management is an important part of Business Operations...so important that it is often treated as a standalone focus area.
- DM stands at the intersections of:
 - Fundraising
 - Marketing
 - I. T.
 - Financial Accounting
 - Managerial Accounting
 - Data base management

The Need for Efficiency

- All of these processes are “Mission Critical”
- So why don't Funders want to pay for them?

The Need for Efficiency

- Often, these costs don't add value in the eyes of our customers (clients and funders).
- Funders often have an unrealistic view of what it costs to run an organization.
- We need to manage our business operations as efficiently as possible while still being effective and supporting our mission.
- There are several different ways to do this.

The Need for Efficiency

- Outsourcing
- Investment in Technology and Software
- Hiring the right people
- Investment in Training
- Measuring the right things.....
- And many others. The right answer depends on you.

The Need for Efficiency

- Most small business organizations (not just non profits) don't invest enough in this area and the irony is that in the long run they end up spending MORE, not less to run the business side of the organization.
- In the worst case, the mission is jeopardized.

Study from the Bridgespan group

- “Our research reveals that a vicious cycle fuels the persistent underfunding of overhead. The first step in the cycle is funders’ unrealistic expectations about how much it costs to run a nonprofit. At the second step, nonprofits feel pressure to conform to funders’ unrealistic expectations. At the third step, nonprofits respond to this pressure in two ways: They spend too little on overhead, and they underreport their expenditures on tax forms and in fundraising materials.”

- Ann Goggins Gregory and Don Howard, “The Nonprofit Starvation Cycle”, Stanford Social Innovation Review, Fall 2009 www.ssireview.org

"The Non Profit Starvation Cycle"

- "What Grantees Can Do"

- "The burden of breaking the cycle of nonprofit starvation does not rest solely with funders. Nonprofit leaders also play a role. As a baseline task, they should commit to ***understanding their real overhead costs and their real infrastructure needs.***" (*emphasis added*)

- Ann Goggins Gregory and Don Howard, "The Nonprofit Starvation Cycle", Stanford Social Innovation Review, Fall 2009 www.ssireview.org

What Else Can we Do?

- Run it like a business...because it is.
- Get Efficient
- Get Effective
- Measure and reward performance
- Make sure your systems communicate with each other
- Invest in technology and infrastructure
 - Take a long term view. Remember that long term investments don't affect your percentages much (more later)
- Hire the right people for the right jobs
- Train Board and Staff (see resources at the end of the presentation)

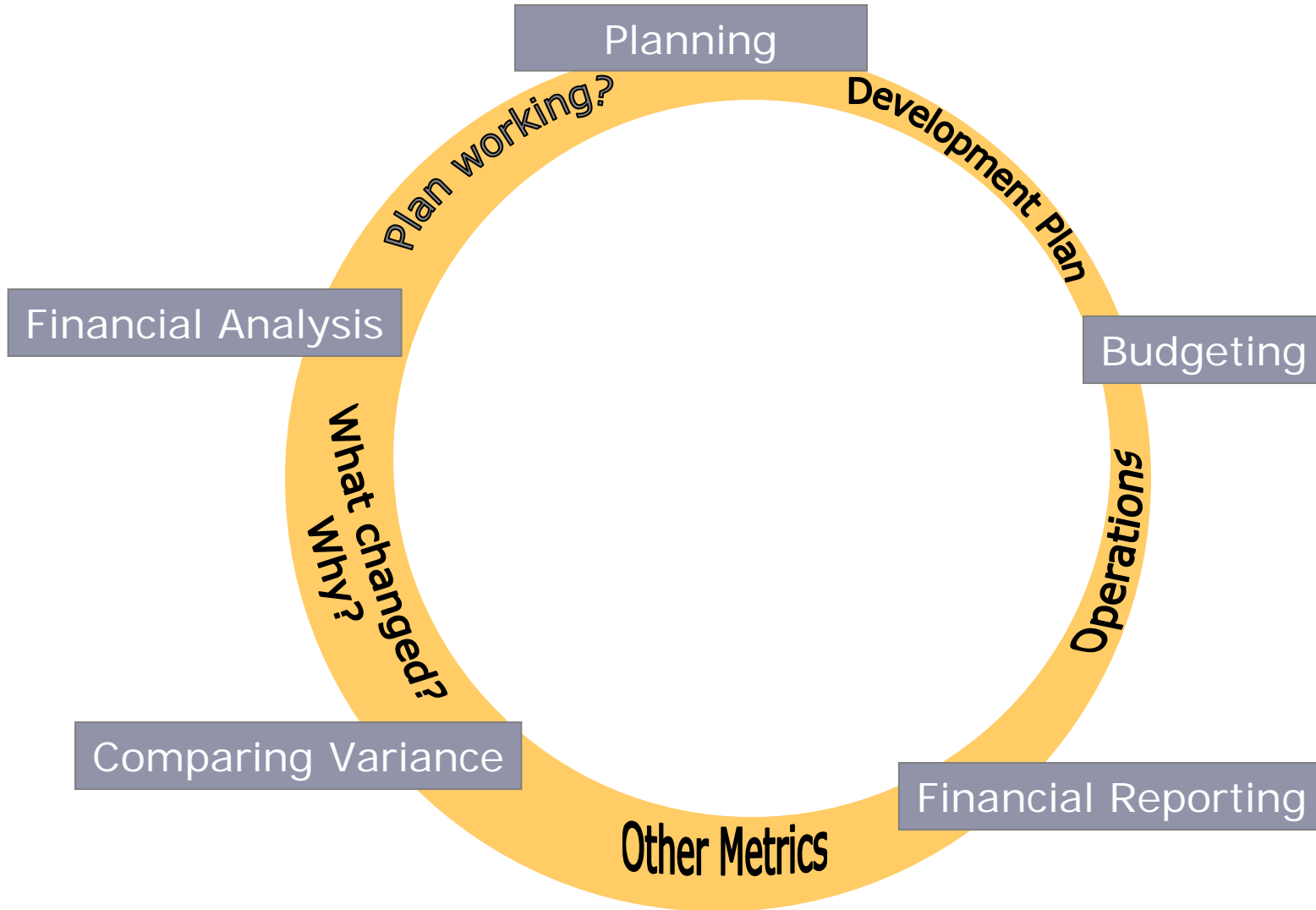
What else can we do?

- Communicate with your funders and make the case for operating support, not just program support.
- And this is our segue to.....

Part Two

What is Financial Management?

The Financial Management Cycle



Financial Management Responsibilities

- Financial control over assets
- Bookkeeping and accounting
- Financial reporting and tax compliance
- The relationship with outside ranking agencies
- Financial and Cash flow projections and cash management
- Operational and outcome reporting
- Cost accounting
- HR and payroll
- Insurance and Risk Management
- Banking
- Legal
- Etc.....

Financial Controls

What is the purpose of internal financial controls?

- To Safeguard Assets (protect against fraud)
 - To ensure that financial reporting is accurate and timely (and therefore useful)
 - To ensure compliance with governmental regulations and fiduciary obligations (manage risk)
 - To ensure compliance with grantor and donor requirements
-
- This subject has been much in the public eye since the Enron debacle and Sarbanes-Oxley and is a particular concern in the non profit sector as public funds are at risk.

Financial Controls

- The level of sophistication of the system of internal controls will vary greatly by size of entity. This is no different from any other business.
- For most smaller non profits, the key areas to consider are:
 - Segregation of Duties
 - Management oversight and approval
 - Board oversight and approval
- When you get an outside audit, the auditors are required to issue a report on your systems of internal control.

Financial Controls

For example, in a small organization there is often only one bookkeeper or accountant. This person typically makes the deposits, writes the checks, and keeps the books. What to do?

- It is important that someone else (such as the Executive Director) sign the checks (with a second, board level signature over \$X).
- The Board treasurer should either reconcile the bank account themselves or review the reconciliation on a timely basis. Some organizations have the bank statement and cancelled checks sent to a Board member, not the office.

Financial Statements Tell Your Story

- Why are financial statements so important? Who uses them?
 - Management....to run the organization
 - The Board of Directors....to oversee Management
 - Funders....to oversee, and to make funding decisions
 - Donors....to see if you are using donations well
 - The Public at large
 - The IRS, FTB and Secretary of State
- Individual donors may not always look at your financial statements, but large donors certainly do.

Financial Statements Tell Your Story

- Studies have shown that more and more smaller donors are using sites like Guidestar and Charity Navigator to make giving decisions.
- So what story do you want to tell?
- Should you publish your financials? Or rely on your 990?
- Or publish an “annual report”?
- Is there a difference?

Financial Statements Tell Your Story

- Services such as Guidestar, Charity Navigator, and BBB Wise Giving Alliance use **the 990** to “rank” and benchmark you.
- Your GAAP financial statements are designed to reflect economic reality.
- Your 990 is an offspring of Congress and the Treasury Dept. It contains what they have decided the public needs to know.

These may not be same thing.

The IRS doesn't care about that?

- A major source of revenue for many non profits is donated professional services.
- You are REQUIRED to report this value on your GAAP financial statements.
- You are NOT ALLOWED to report this on your 990.
- Why not?
 - There is no tax deduction for providing services to a non profit. The IRS doesn't need the data.
 - Nobody cares if the non profit "wastes" donated time. They do care if they waste public money.
- More on this later.....

Standard Non Profit Financial Statements

Assets and Liabilities at a point in time	Statement of Financial Position or Balance Sheet
Operations and Activities over a time period	Statement of Activities
	Statement of Functional Expenses
Cash Flow Activity	Statement of Cash Flows
Budget Comparison	Budget vs. Actual

A Note About Financial Reporting

- To get the most benefit out of financial information it needs to be both

**TIMELY
AND
ACCURATE**

The Statement of Financial Position

How strong is the organization?

- The basic accounting equation:
 - $\text{Assets} - \text{Liabilities} = \text{Net Assets}$
- Net Assets – What do we call the difference between assets and liabilities?
 - For a for profit business, it is often referred as "owner's equity."
 - For a nonprofit organization, it is called "***net assets.***"

We Care Community Organization				
Statement of Financial Position				
December 31, 2007 and 2006				
			Assets	
			2007	2006
Current Assets				
	Cash		56,000	76,000
	Pledges Receivable		24,000	37,000
	Prepaid Expenses		3,000	2,000
		Total Current Assets	83,000	115,000
Long Term Assets				
	Long Term Pledges Receivable		787,000	592,000
	Deposits		6,000	6,000
	Property and Equipment Net		49,000	23,000
	Foundation Endowment		62,000	51,000
		Total LT Assets	904,000	672,000
Total Assets			987,000	787,000
Liabilities and Net Assets				
Current Liabilities				
	Accounts Payable		5,000	5,000
	Accrued Expenses		5,000	2,000
		Total Current Liabilities	10,000	7,000
Long Term Liabilities			-	-
Total Liabilities			10,000	7,000
Net Assets				
	Unrestricted		137,000	137,000
	Temporarily Restricted		787,000	592,000
	Permanently Restricted		53,000	51,000
Total Net Assets			977,000	780,000
Total Liabilities and Net Assets			987,000	787,000

The Statement of Activities

- Basic accounting equation:
 - $\text{Revenues} - \text{Expenses} = \text{Excess of Revenues over Expenditures}$
 - The Excess of Revenues over Expenditures is the same as the increase or decrease in Net Assets.

Revenues

- Contributions
 - Cash
 - In kind goods
 - Donated Professional Services *
 - Restricted
 - Temporarily restricted
 - Unrestricted
- Grants
- Contracts
- Exchange Revenue ("sales")
- Special Events
- Unrelated Business Income ("UBI")
- Dues and Memberships

		We Care Community Organization						
		Statement of Activities			GAAP			
		For the Year Ended December 31, 2007						
					Temporarily	Permanently	Total	Total
					Restricted	Restricted	2007	2006
		Unrestricted						
Support and Revenue								
	Contributions	127,000	592,000	2,000	721,000	772,000		
	Grants	30,000			30,000	30,000		
	In-Kind Services	113,000			113,000	117,000		
	Investment Income	11,000			11,000	3,000		
	Other Income	27,000			27,000	3,000		
		308,000	592,000	2,000	902,000	925,000		
	Net Assets Released from Restrictions	397,000	(397,000)					
Total Support and Revenue		705,000	195,000	2,000	902,000	925,000		
Expenses								
	Program Services	444,000			444,000	221,000		
	Management and General	109,000			109,000	178,000		
	Fundraising	152,000			152,000	95,000		
Total Expenses		705,000	-	-	705,000	494,000		
Excess of Support and Revenue over Expenses (or Increase/Decrease in Net Assets)		-	195,000	2,000	197,000	431,000		
Net Assets at Beginning of Year		137,000	592,000	51,000	780,000	349,000		
Net Assets at End of Year		137,000	787,000	53,000	977,000	780,000		

We Care Community Organization
Statement of Activities for the 990
For the Year Ended December 31, 2007

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total 2007	Total 2006
Support and Revenue					
Contributions	127,000	592,000	2,000	721,000	772,000
Grants	30,000			30,000	30,000
In-Kind Services	-			-	117,000
Investment Income	11,000			11,000	3,000
Other Income	27,000			27,000	3,000
	195,000	592,000	2,000	789,000	925,000
Net Assets Released from Restrictions	397,000	(397,000)			
Total Support and Revenue	592,000	195,000	2,000	789,000	925,000
Expenses					
Program Services	331,000			331,000	221,000
Management and General	109,000			109,000	178,000
Fundraising	152,000			152,000	95,000
Total Expenses	592,000	-	-	592,000	494,000
Excess of Support and Revenue over Expenses (or Increase/Decrease in Net Assets)	-	195,000	2,000	197,000	431,000
Net Assets at Beginning of Year	137,000	592,000	51,000	780,000	349,000
Net Assets at End of Year	137,000	787,000	53,000	977,000	780,000

The Statement of Functional Expenses

- The purpose is to break out expenditures by type:
 - Program
 - Management and General
 - Fundraising
- Required by GAAP for Social Service entities
- Required by the form 990 so everyone does one sooner or later....might as well have an accounting system which can handle it.

We Care Community Organization
Statement of Functional Expenses
December 31, 2007

	Program Services	Management & General	Fundraising	Total 2007	Total 2006
Audio Visual	9,000			9,000	-
Bank and CC Charges			11,000	11,000	-
Depreciation	10,000	1,000	1,000	12,000	-
Direct Program Costs	29,000			29,000	153,000
Events and Fundraising			5,000	5,000	-
Insurance		3,000		3,000	4,000
Miscellaneous		1,000		1,000	13,000
Moving		1,000		1,000	-
Newsletter		1,000	6,000	7,000	3,000
Office Supplies	8,000	1,000	1,000	10,000	21,000
Payroll Expenses	191,000	32,000	79,000	302,000	117,000
Postage and Shipping		1,000	1,000	2,000	2,000
Products	26,000			26,000	37,000
Professional Fees	124,000	41,000	29,000	194,000	81,000
Rent	31,000	4,000	4,000	39,000	34,000
Repairs and Maintenance		5,000		5,000	-
Seminars		15,000	7,000	22,000	-
Telephone	4,000	1,000	2,000	7,000	7,000
Travel and Conferences	12,000		4,000	16,000	22,000
Utilities		2,000		2,000	-
Website			2,000	2,000	-
	<u>444,000</u>	<u>109,000</u>	<u>152,000</u>	<u>705,000</u>	<u>494,000</u>

The Statement of Cash Flows

- “Cash is King”!
- The basic purpose is to explain the difference between changes in net assets (from the Statement of Activities) and changes in cash balances over the course of the year.
- For a VERY simple organization, if the financial statements are prepared on the cash basis, the Statement of Cash Flows will look a lot like the Statement of Activities.

We Care Community Organization
Statement of Cash Flows
For the Year Ended December 31, 2007

Cash Flows from Operating Activities

Excess of Support and Revenue over Expenses	197,000
Adjustments to Reconcile Change in Net Assets to Net Cash Provided (Used) by Operations:	
Depreciation	12,000
(Increase) in Pledges Receivable	(182,000)
(Increase) in Deposits and Prepaid Expense	(1,000)
(Decrease) in Accounts Payable	-
Increase in Accrued Expenses	3,000
Net Cash Provided (Used) by Operating Activities	<u>29,000</u>

Cash Flows from Investing Activities

Increase in Endowment	(11,000)
Purchase of Fixed Assets	(38,000)
Net Cash Provided (Used) by Investing Activities	<u>(49,000)</u>
Net Increase (Decrease) in Cash	(20,000)
Cash Balance at Beginning of Year	76,000
Cash Balance at End of Year	<u>56,000</u>

Comparing Actual Results to Budget

- A well managed entity of any kind compares its results to its plan on a regular basis and makes any needed adjustments.
 - There are many metrics to compare, not just financial, of course.
- The report should be in enough detail so that management can analyze and explain the variances.
- The information has to be TIMELY to be of much use.
- Many entities do this on at least a quarterly basis but for most it is more appropriate to do it monthly.

We Care Community Organization						
Budget VS Actual Report						
December 31, 2007						
			Program			
			BUDGET	ACTUAL	VARIANCE	VAR %
Audio Visual			8,000	9,000	(1,000)	-13%
Bank and CC Charges				-	-	
Depreciation			9,900	10,000	(100)	-1%
Direct Program Costs			29,000	29,000	-	0%
Events and Fundraising				-	-	
Insurance				-	-	
Miscellaneous				-	-	
Moving				-	-	
Newsletter				-	-	
Office Supplies			8,800	8,000	800	9%
Payroll Expenses			191,000	191,000	-	0%
Postage and Shipping				-	-	
Products			24,000	26,000	(2,000)	-8%
Professional Fees			120,000	124,000	(4,000)	-3%
Rent			31,000	31,000	-	0%
Repairs and Maintenance				-	-	
Seminars				-	-	
Telephone			5,000	4,000	1,000	20%
Travel and Conferences			10,000	12,000	(2,000)	-20%
Utilities				-	-	
Website				-	-	
			436,700	444,000	(7,300)	-2%

WE'VE REVIEWED THE BVA...

- Now what? DO SOMETHING ABOUT IT.
- Typical reasons for variances
 - Timing...the budget was right but the expense hit in a different month. By the end of the year it will be OK.
 - Error...the budget was wrong. We need to issue a revised budget, assess what we need to do, and get board approval for the change.
 - Overspending....we spent more than budget. We need to determine how to make this up somewhere else or treat as an error.
 - Under collecting....Revenues are coming in much slower than anticipated, we lost a grant, or some other issue. The Board needs to be advised and take action.

Financial Analysis

- Various metrics will tell us how strong this organization was...AS OF THE DATE OF THE FINANCIAL STATEMENTS
 - Liquidity and operational Ratios
 - Trend analysis
 - Other depending on organization
 - “What is good” is dependent on type of organization
- In the quickly changing economic times we live in it is critical to evaluate current information.
- It is also necessary to look at trends over the last two to three years in order to get a complete picture...which direction is the organization heading and how consistent is their revenue stream?
- This is what the benchmarking and rating organizations do with your numbers.

Ratios for Nonprofits

Description	Purpose	Calculation
Months "cash" on hand	Ability to meet operating expenses	Annual operating expenditures/ "Cash"
Liquidity ("Quick" Ratio)	Ability to pay current debt	Current Assets/ Current Liabilities
Operational Strength	Ability to meet operating expenses	Unrestricted Net Assets/Operating Expense
Debt Ratio	To what extent is debt used to finance assets	Debt/Total Assets
Fundraising Efficiency	Ability to raise funds economically/effectively	Public Support/Fundraising Expenses

Ratios for Nonprofits

Description	Purpose	Calculation
Administrative Expense Ratio	Percent of total functional expenses spent on management/general	Management and General/Total Expenses
Fundraising Expense Ratio	Percent of total functional expenses spent on fundraising	Fundraising Expenses/Total Expenses
Program Effectiveness	How much of funding is spent on program goals	Program Expenses/Total Expenses

<http://www.charitynavigator.org/index.cfm/bay/content.view/cpid/48.htm>

Ratios for Nonprofits

Description	Calculation	We Care Results
Months "cash" on hand	Annual operating expenditures/ "Cash"/12	1.05
Liquidity ("Quick" Ratio")	Current Assets/ Current Liabilities	8.30
Operational Strength	Unrestricted Net Assets/Operating Expense	19%
Debt Ratio	Debt/Total Assets	n/a
Program Effectiveness	Program Expenses/Total Expenses	63%
Fundraising Efficiency (how much is raised per dollar spent)	Public Support/Fundraising Expenses	5.68

Ratios for Nonprofits

Description	Calculation	We Care Results from GAAP FS
Administrative Expense Ratio	Management and General/Total Expenses	15.5%
Fundraising Expense Ratio	Fundraising Expenses/Total Expenses	21.6%
Program Effectiveness	Program Expenses/Total Expenses	62.9%

Ratios for Nonprofits

Description	Calculation	We Care Results from the 990
Administrative Expense Ratio	Management and General/Total Expenses	18.4%
Fundraising Expense Ratio	Fundraising Expenses/Total Expenses	25.7%
Program Effectiveness	Program Expenses/Total Expenses	55.9%

Trend Analysis

- Requires multiple years of data
- How fast are revenues growing?
- How fast are expenses growing?
 - In total
 - Program
 - Management and Admin
 - Etc
- Which direction are the ratios moving from year to year?
- Charity Navigator calculates two:
 - Primary Revenue Growth
 - Program Expense Growth

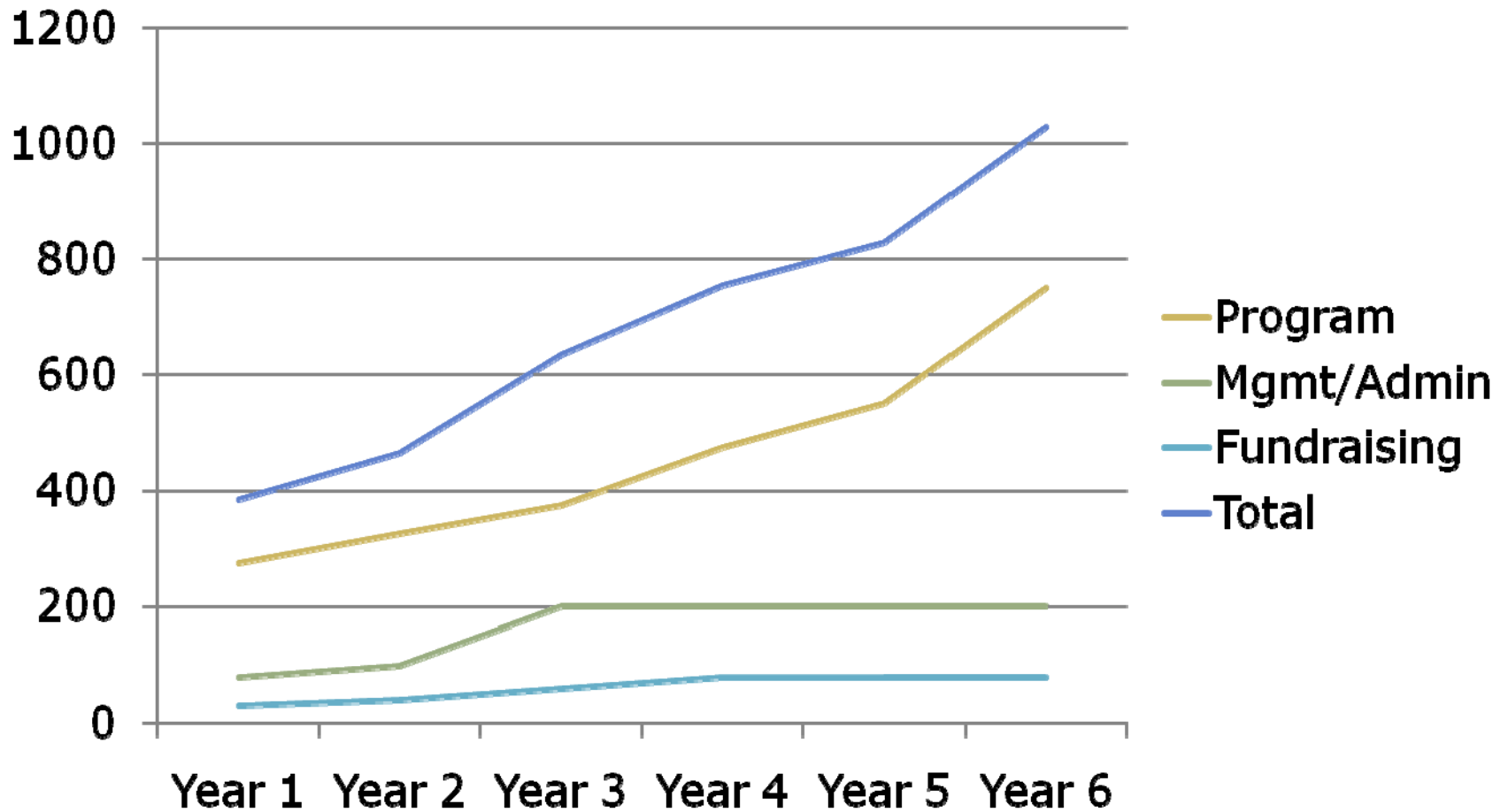
What happens as we grow?

	Program	Mgmt/Admin	Fundraising	Total
Year 1	275	80	30	385
Year 2	325	100	40	465
Year 3	375	200	60	635
Year 4	475	200	80	755
Year 5	550	200	80	830
Year 6	750	200	80	1030

Keep in mind that large investments get capitalized and are not in spending.

Year 1	71%	21%	8%	100%
Year 2	70%	22%	9%	100%
Year 3	59%	31%	9%	100%
Year 4	63%	26%	11%	100%
Year 5	66%	24%	10%	100%
Year 6	73%	19%	8%	100%

What happens as we grow



Working with the rating agencies

- The rating sites utilize financial ratios and measurements of governance to rate charities. They do not measure effectiveness.
- Charity Navigator: “Stars” system for ranking. Uses 990 data and financial ratios. Ranks 5300 out of over 1 million 501(c)3 orgs in US.
 - www.charitynavigator.org
 - Will “adjust for unique circumstances” and allows charities to respond in the online comments area.
- Guidestar: Does not rank, allows Charities to upload annual report, other data:
 - <http://www2.guidestar.org/rxg/update-nonprofit-report/nonprofit-report-checklist.aspx>

Working with the rating agencies

- BBB Wise Giving Alliance: Mainly rates based on inquiries, charity can pay for participation and use of seal
- American Institute of Philanthropy:
 - <http://www.charitywatch.org/criteria.html>
 - Does the most indepth job but only rates about 500 orgs.
- Great NonProfits.org: <http://greatnonprofits.org/>
 - Rates based on reviews; charity can upload data and annual reports. Not a financial review site.

Charity ratings can vary widely and often suffer from incomplete information.

	American Institute of Philanthropy	Charity Navigator	Better Business Bureau
	A to F rating	Out of 4 stars	Must pass 20 of 20 standards
American Cancer Society	C+	★★	Pass
National Wildlife Federation	C	★★	Pass
Physicians Committee for Responsible Medicine	B	★★★	2 standards not met
Farm Aid	A	★★★	4 standards not met
National Council on Aging	A+	★★★	5 not met, 3 unable to

Source:

Bialik, Carl; "Charity Rankings Giveth Less then Meets the Eye", The Wall Street Journal, December 19, 2008

<http://online.wsj.com/article/SB122963299671419401.html>

SVP Resources

- SVPI Organizational Capacity Assessment Tool
- SDSVP Financial Capacity Checklist
- SDSVP Resource Teams
 - Board Governance
 - Fund Development
 - Marketing
 - Strategic and Outcome Planning
 - Information Technology
 - Business Operations

The Business Operations Resource Team

“The San Diego Social Venture Partners Business Operations Resource Team is an interdisciplinary team which enables organizations to improve their capacity in operational management, human resources, financial and operational record keeping and decision making, and management capability, through the involvement of partners with expertise in these areas as well as in leadership and mentoring.”

More Resources

- The Alliance for Nonprofit Management
 - www.allianceonline.org
- Fiscal Management Associates LLC
 - http://www.fmaonline.net/custom/resourcecenter_tools.html
- The Free Management Library
 - www.ManagementHelp.org
 - Basic Guide to Non Profit Financial Management:
 - > www.managementhelp.org/finance/np_fnce/np_fnce.htm
 - Checklist to Assess Financial Activities in Non Profit Organizations:
 - > http://www.managementhelp.org/org_eval/uw_fnce.htm

More Resources

- Independent Sector on Internal Controls:
 - <http://www.independentsector.org/issues/sarbanesoxley.html>
- Accounting Software Package Reviews:
 - http://www.idealware.org/articles/fgt_accounting.php
- Training Resources in San Diego:
 - UCSD Extension
 - > www.extension.ucsd.edu
 - Non Profit Management Solutions
 - > www.npsolutions.org
 - SDSVP Resource Teams, Lead Partners, and Workshops



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Thank You!

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