

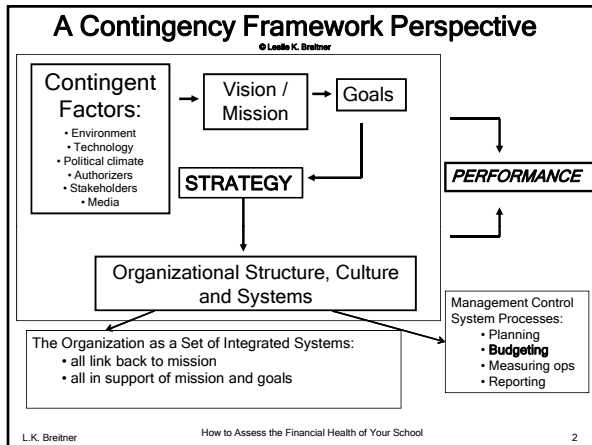
PACIFIC NORTHWEST ASSOCIATION OF
INDEPENDENT SCHOOLS

*How to Assess the Financial Health
of Your School*

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Financial Statement Red Flags: *Quality of Earnings*

- Lack of diversity in revenue sources
- Relatively low current ratio (poor liquidity)
- Negative cash flow from operations (what does it mean?)
- Negative unrestricted net assets (what does it mean?)
- High administrative cost ratio
- Unexplained trends or budget variances
- Extraordinary events to achieve a surplus (unsustainable activities)

From E. Floyd (Moss-Adams LLP)

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Key Concept:
Financing Growth with Leverage

Leverage - The use of debt to purchase more assets than you can with only generated surpluses.

Advantages: grow faster, serve more, increase revenues

Disadvantages: interest fees, cash flow challenges, meeting debt service obligations

LEVERAGE ALLOWS AN ORGANIZATION TO HAVE MORE ASSETS ON THE BALANCE SHEET THAN EQUITY ALONE WOULD PERMIT. THEREFORE . . .

WHY NOT FINANCE AS MANY ASSETS WITH DEBT AS YOU CAN?

From E. Floyd (Moss-Adams LLP)

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What's Wrong with Leverage?

Financial Risk	High	Possible	Danger Zone
	Low	Very Safe	Necessary
		Low	High
		Business Risk	

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How Much is Enough?
It Depends.

- Operating reserves = unrestricted fund balances
 - Cushion for unexpected events, changes in revenue sources
 - Enhance flexibility to develop new programs
 - Expand opportunities for growth or expansion of current programs
- Liquid reserves - what are they?
- Operating revenues
 - Reliability of sources
 - Seasonality/timing of cash flows
- Financing
 - Availability of external financing
 - Stability of expenses
 - Nature of liabilities

From Thomas J. Raffa

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Fundamental Financing Issues

Leverage
(Level of Debt)

And

The Role of Surplus
(Revenues less Expenses or Expenditures)

Nonprofits Need Surplus Too

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Surplus and Growth - Summary

Nonprofits need Surplus (profit):

1. Replace assets
2. Finance growth and/or diversify assets
3. Protect against uncertainties, fluctuations
4. Note that understanding cash flow is critical

Use of Leverage:

1. Increasing debt is an alternative
2. Debt has risks, advantages and disadvantages

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Managing an Endowment

- ★ What is it?
- ★ How does it work?
 - Links to the operating budget
 - Links to the permanently restricted net assets
- ★ What's the relationship to a capital campaign?
- ★ How does it differ from annual giving?

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Supporting the Operating Budget

- ★ Endowment returns
 - Cash and dividends
 - Total return
 - Realized vs. Unrealized gains
- ★ Subsidizing operating revenues
 - How much to support the budget?
 - How much to preserve purchasing power of the endowment?

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Other Endowment-Related Issues

- ★ Investment Management Strategies
 - Socially responsible investing
 - Borrowing from the endowment
 - Fiduciary responsibility
- ★ Future capital campaigns - development
- ★ Sustainable sources of revenue

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Performance Management and Related Performance Measures



- ★ Logic Models
- ★ Balanced Scorecards
- ★ Links to the budget
- ★ Links to the underlying organizational cost structure
- ★ Links to the organization's mission and goals
- ★ Can you "follow the money" to the outcomes?

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Why do you want a performance measurement system?

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Logic Model Approach

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Resource/
Inputs

→

Activities

→

Outputs

→

Outcomes

→

Impact

Operational
Planning

Strategic Planning and
Intended Results

Questions to ask:

1. Relationship to mission, goals?
2. Link planning to results?
3. Link delivery of services to financial measures, by program?
4. Link RESULTS to financial measures.
5. What is the roadmap of *related* events?

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Logic Model Approach

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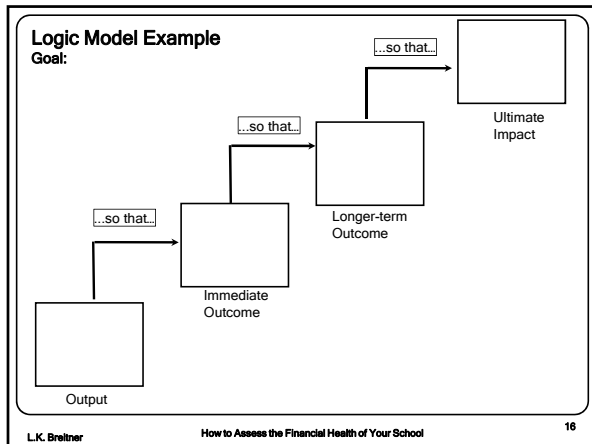
Map forward from inputs and activities to answer, "Why is this desirable?"

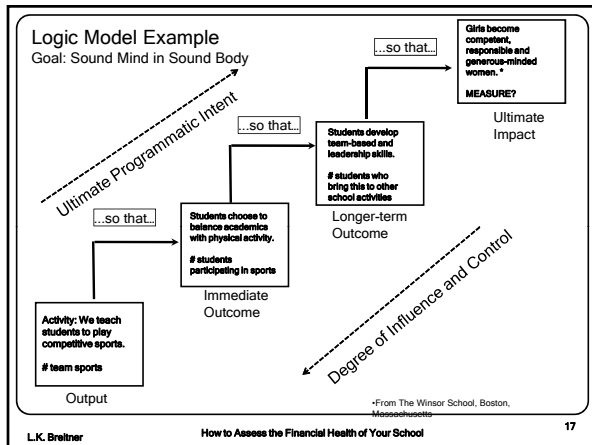
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Map backwards from high-level outcomes to answer, "How to create this result?"

←

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The Balanced Scorecard in Nonprofit Organizations

1. What non-financial results would you like?
2. What are your financial objectives and constraints, and how will you measure them?
3. Who are your clients and what must you do to satisfy them?
4. What internal processes are key to your success and how will you know if they are functioning properly?
5. What employees are key to your success and how will you know if they are satisfied with their jobs and doing a good job?

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The Balanced Scorecard

Mission Driven

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    graph LR
      A[Resource/Inputs] --> B[Activities]
      B --> C[Outputs]
      C --> D[Outcomes]
      D --> E[Impact]
      F[Measures] -.-> B
      F -.-> C
      F -.-> D
      F -.-> E
  
```

- Focus on measures that are most critical.
- Translate general mission statements to specific measures.
- Processes, decisions, and actions occur throughout an organization.
- Be careful about the Mission/Money tradeoffs!

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Don't Neglect the Importance of Assumptions and Causal Linkages

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    graph LR
      A[Assumptions] --> B[Resource/Inputs]
      B --> C[Activities]
      C --> D[Outputs]
      D --> E[Outcomes]
      E --> F[Impact]
      G[Your Beginnings] --- B
      H[Your Planned Work] --- C
      I[Your Intended Results] --- D
  
```

Assumes causal linkages among program components.

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The Strategy to Performance Gap

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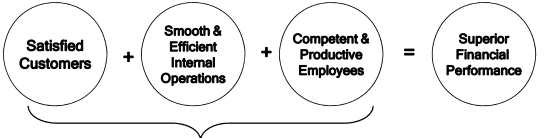
    graph LR
      A[Resource/Inputs] --> B[Activities]
      B --> C[Outputs]
      C --> D[Outcomes]
      D --> E[Impact]
  
```

- Short-term measures
- Intermediate-term measures
- Long-term measures

1. Discuss resource deployments early.
2. Translate priorities into action items.
3. Create a tight link between the strategy, the plan, and performance.
4. Continuously monitor performance.

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Theory Behind the Balanced Scorecard



Leading Indicators of Financial Performance:
Manage them well and you will have superior financial performance.

From David W. Young

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Performance Management and Related Performance Measures

- | Logic Models
- | Balanced Scorecards
- | Links to the organization's mission and goals
- | Links to the budget
- | Links to the underlying organizational cost structure
- | Can you "follow the money" to the outcomes?

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Budgets, Costs, Benchmarks and Performance Measures

- | Need to understand the cost of operations and programs.
- | Identify opportunities for cost reduction.
- | Cost data necessary to establish benchmarks for measuring financial performance.

- | Follow the money from investment in programs to outcomes produced!

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The Role of Data

- | What is the problem that needs a “fix”?
- | What are the data that allowed you to identify this problem?
- | What would successful results look like?
- | What data are necessary to demonstrate your success?
- | How do you establish causality?

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Outcomes and Impacts are SMART

- | Specific
- | Measurable
- | Action-oriented
- | Realistic
- | Time targets

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Sustainable Activities?

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