Financial Indicators Important to CAP Agencies

➢ Does your agency have the following tools in place to assist in making sound financial decisions?

• Financial Policies & Procedures
• Technology Tools for Fiscal Reporting
• Monthly Analysis of Budget vs. Actual Expenditures
• Account Analysis & Financial Forecasting
• Financial Ratio Analysis

Financial Policies & Procedures

• Critical for ensuring the accurate and timely reporting of financial information.
  ✓ It should address how the fiscal management system meets the standards set forth in OMB’s administrative requirements (Circular A-110 for nonprofits and the Common Rule for units of government).

• It should be reviewed and updated on a regular basis.
  ✓ Schedule periodic reviews of individual sections of the policies and procedures manual to avoid information overload of committee members.

• It should be readily available to employees.
  ✓ Electronic versions of the policies on an employee web page that is password protected is a good way of distributing this information.
Financial Policies & Procedures

- The most important procedure is to review the trial balance on a monthly basis.
  - A system must be in place that requires balances to be reviewed and reconciled on a regular basis.
  - If the numbers are not reliable, the financial statements and analysis presented to funding sources and board members will be incorrect.
- Items to look for when reviewing the trial balance:
  - Does the bank reconciliation agree to the general ledger?
  - Are there credit balances in your asset accounts or debit balances in your liability accounts?
  - Is there supporting documentation for all balance sheet accounts?

Financial Policies & Procedures

- Policies and procedures should establish timelines for the reporting of information.
  - Sample policy:
    For purposes of the preparation of the Agency's monthly financial statements, all vendor invoices that are received, approved and supported with proper documentation by the tenth day of the following month shall be recorded as accounts payable as of the end of the immediately preceding month if the invoice pertains to goods or services delivered by month-end.
Technology Tools for Fiscal Reporting

- Technology is critical in helping fiscal staff perform their jobs more efficiently. Many financial packages allow for the following:
  - Financial reports can be generated and e-mailed to program managers and funding sources in a one step process.
  - The creation of journal entries and budgets in Excel for importing directly into the software saving on data entry time.
  - Budget modifications and forecasts can be tracked and completed in a more efficient manner.

- When considering a conversion of financial software, it is important to keep the following in mind:
  - Software conversions often require many staff hours during the implementation phase.
  - Frequent updates and upgrades often require a staff member to commit time throughout the year keeping the software current.
  - The agency should have a data backup and disaster recovery plan.
  - Technology is only as good as the end user.

Monthly Analysis of Budget vs. Actual Expenditures

- This is required in both Head Start and CSBG programs.
- The analysis is only as good as the budget figures used to produce the report.
- The following are characteristics of a well prepared budget:
  - The budget assumptions should be realistic and clearly identifiable.
    - Difficult decisions are often avoided with overly optimistic budget assumptions.
  - Items to pay particular attention to:
    - Vacancy and turnover rates.
    - Anticipated costs increases for both personnel and non-personnel costs.
    - Program funding assumptions.
    - Fundraising revenue.
    - Entrepreneurial revenue.
  - Using historical data, modified to reflect changes in the current economic and funding environment is a good starting point in developing the budget.
Monthly Analysis of Budget vs. Actual Expenditures

✓ If a program does not operate year round, the budget should not make that assumption. The budget should reflect activity during certain times of the year, not equally throughout the year (straight line budget).

✓ A challenge for CAP agencies is board turnover. There may not be enough experience at the board level to ask the right questions when the budget is presented for approval.

Account Analysis & Financial Forecasting

• Comparing year-end balances to the prior year and understanding the reasons for the changes should be done prior to the audit.

• Asset accounts to pay particular attention to:
  ✓ Cash
    • Your receivables, payables and deferred revenue accounts all have a direct impact on cash balances.
  ✓ Prepaid balances
    • Have expenses been recorded in the proper period?
  ✓ Property and Equipment
    • If this account has increased, has there been a corresponding increase in depreciation expense?
    • If there is a decrease in this balance, has disposals been properly recorded?
Account Analysis & Financial Forecasting

- Liability accounts to pay particular attention to:
  - Accounts Payable
    - If this balance has increased, is it a result of an overall increase in agency expenditures or is it a sign the agency is experiencing cash flow problems?
  - Accrued Wage & Fringes
    - Has this account increased in proportion to the increase in wage rates?
    - Has there been a significant change in staffing levels? Are these changes reflected in these liability accounts?
  - Notes Payable
    - Has the agency incurred new debt during the year? If so, has the short term and long term portions been properly classified?
  - Deferred Revenue
    - Has the agency experienced a change in funding source advances? If so, it will often be reflected in this account balance.

- Revenue:
  - If revenue has increased, is it a result of new programs or growth in existing programs?
  - Are funding streams diversified or does the agency rely heavily on a few funding sources?
  - Are donations up? Has there been a new fundraising campaign?

Account Analysis & Financial Forecasting

- Expenses:
  - Salary expense
    - Are changes to salary expense reflective of the changes in staffing levels and wage increases? Does the change in this account correspond with the change in accrued wages and fringes?
  - Space costs
    - Lease agreements often have built in rate increases. Have these increases been built into the budget? Do the lease terms correspond to the agency’s program funding cycle? Do the leases have funding source termination clause?
  - Depreciation expense
    - Does the change in this account correspond to changes in the Property and Equipment account?
  - Interest expense
    - Has cash flow issues required the agency to utilize their line of credit? Does the change in this account correspond with the change in Notes Payable?
Account Analysis & Financial Forecasting

• Bottom Line:
  ✓ Revenues over expenses
    • Does the agency have fee for service contracts?
    • Did the agency have a successful fundraising campaign?
  ✓ Expenses over revenues
    • Was funding lost without a corresponding decrease in expenses?
    • Were programs overspent?

• Trend analysis of the financial data is often useful.
  ✓ Graphing critical data for board members. Pictures are sometimes easier to follow than numbers.
  ✓ It can present a lot of information in a concise manner.
  ✓ Once these reports are created, it is often easy to update the reports on an annual basis.

Account Analysis & Financial Forecasting

• Financial forecasting for the upcoming three-five year period is critical for an agency's long term planning. A good forecast should:
  ✓ Clearly identify all assumptions built into the forecast.
  ✓ Identify major funding sources and anticipated changes.
  ✓ Identify major cost categories and address agency’s ability to control those costs.
  ✓ Identify fixed and variable costs.
  ✓ The capital improvements plan should be built into the forecast.
  ✓ The forecast address cash flow issues.
  ✓ At the minimum, it should be updated on an annual basis.
Financial Ratio Analysis

• Financial Ratios
  ✓ Financial ratios are primarily used to analyze the company’s performance and financial situation. The majority of the ratios can be easily calculated using the information provided in the financial statements.

• Financial Ratios fall into five categories
  ✓ Liquidity
  ✓ Financial leverage ratios
  ✓ Operational efficiency ratios
  ✓ Profitability ratios
  ✓ Dividend policy ratios

Financial Ratio Analysis

• Liquidity Ratios — are used to determine an agency’s level of financial liquidity. The higher the ratio, the better the company’s ability to meet current obligations.

• Three main liquidity ratios:
  ✓ Current Ratio -Current Assets/Current Liabilities
  ✓ Quick Ratio - Current Assets-Inventory/Current Liabilities
  ✓ Cash Ratio – (Cash + Marketable Securities)/Current Liabilities

• Cash ratio is the most conservative ratio.
• General rule is for the ratio to be one or greater.
Financial Ratio Analysis

- **Financial Leverage Ratios** – examine the solvency of a company. As such, they are similar to the liquidity ratios, except while the liquidity ratios concentrate on short term debts, the financial leverage ratios focus on levels of long term debt.

  ✓ Debt Ratio – Total Debt (Total Liabilities or Long-Term Debt) /Total Assets
    - How much of the firm's assets are financed through debt?
    - If the ratio is close to one, most of the company's assets are financed through debt. Companies with high debt/asset ratios are said to be "highly leveraged" and may have trouble paying their debts.

  ✓ Debt to Net Assets Ratio – (Total Liabilities or Long-Term Debt)/ Net Assets
    - How aggressive has the agency financed growth through debt?

* It is important to note that both the debt ratio and the debt to net assets ratio may use total long term debt as the numerator, and not total liabilities. As such, it is important to be careful when defining which liabilities represent financial debt. In general, accounts payables and similar items are defined as operational liabilities, and would not be treated as debt. Loans, notes issued, and bonds issued are some of the most common types of long term debt.

Financial Ratio Analysis

- Other ratios useful to management and board members:
  - **Pay-Off Ratio** – number of times cash and accounts receivable can pay-off accounts payable.
    ✓ (Cash + A/R) / Accounts Payable
  - **Average Expenses Per Day**
    ✓ Total expenses- in-kind / 260 working days
  - **Average Days Cash On Hand**
    ✓ (Total cash & equivalents) / Average Expenses Per Day
  - **Average Days In Accounts Payable**
    ✓ Accounts Payable / Average Expenses Per Day
Financial Ratio Analysis

- **Average Program Revenue Per Day**
  ✓ Program Revenue / 260 working days

- **Fund-Raising Efficiency** – ability to raise funds in an economical manner.
  ✓ Public Support / Fund-raising expense