

Exploring the New World of Nonprofit Financial Ratios: A Guide to Using Ratios as Financial Leverage

March 26, 2024

Webinar Sponsor:

blackbaud[®]

**NONPROFIT
FINANCIAL
COMMONS**

Enter your burning questions in the Chat,
monitored by NFC moderators, to have them
answered during our interactive Q&A session

Dana Britto
NFC Moderator



Wade Rogers
NFC Moderator



Today's Presenters



John Summers
Managing Director,
BDO



Ruth McCambridge
Director of Content,
Nonprofit Financial
Commons



Anthony Fullington
Senior Vice
President, Chief
Finance Officer at
United Way of New
York City



Michael Anderson
Principal and Founder,
Michael Anderson
Consulting

Today's Agenda

- ▶ What are ratios and how do we use them?
- ▶ The ratio that haunted the nonprofit sector: Overhead
- ▶ A ratio that is broadly applicable: LUNA
- ▶ An Interview with Anthony Fullington - Making ratios your own as a leadership act
- ▶ Questions and answers

WHAT IS A RATIO?

A mathematical comparison between two numbers. It can be expressed in a number of ways. For instance, to show two:

Reliance ratio

$$\frac{\text{Largest revenue stream}}{\text{Total annual revenue}} = \%$$

WHAT ARE RATIOS GOOD FOR?



To focus attention on one quantitative relationship as relatively more important than others.



To create a unified set of financial priorities



To compare performance:

- against goals (incremental innovation)
- across time (Trend monitoring)
- against “industry standards” (Benchmarking)



To spark immediate action

Ratios should be chosen to aid in managing the challenges in your particular organization

Examples:



Ratios for nonprofits...

Ratios for nonprofits on the edge

Ratios for nonprofits building their individual donor bases

Ratios for nonprofits with very slow payables

etc. etc.

Choose them and use them wisely

“Ratios for Nonprofits on the edge”
Thank you, for keeping it real, Steve Z.

Payroll Ratio

$$\frac{\text{Cash in the bank}}{\text{Semi-monthly payroll expense}} = \%$$

Ratios for Nonprofits in a certain kind of growth mode

Restricted to
unrestricted funds

$$\frac{\text{Cash and accounts receivable}}{\text{Net assets with donor project restrictions}} = \%$$

Remember that there are attention tradeoffs - Ratios reflect priorities

CASE TO PONDER

Efficiency Focus
(overhead
obsession)

Vs

Equity Focus
(justice)

Presenter



Michael Anderson
Principal and Founder,
Michael Anderson
Consulting

Common Uses of Financial Information

➤ Compliance

- Regulatory
- Funders

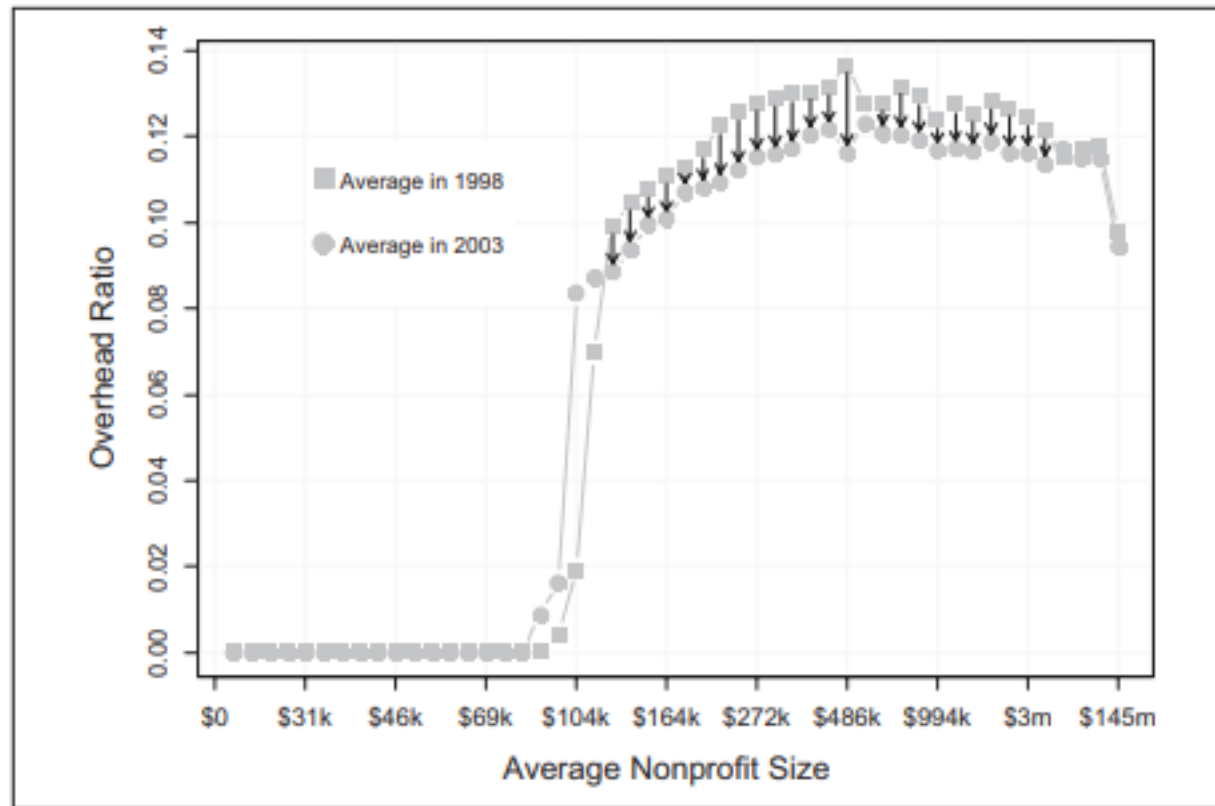
➤ Strategy

- Organizational and program planning
- Decision-making
- Evaluating impact and effectiveness

Problems with the Overhead Ratio

- No common definition
- Inconsistently calculated
- Harms organizations by incentivizing infrastructure deprivation

Overhead Ratios Have Decreased



Anatomy of the Nonprofit Starvation Cycle: An Analysis of Falling Overhead Ratios in the Nonprofit Sector

Jesse D. Lecy and Elizabeth A. M. Searing

Nonprofit and Voluntary Sector Quarterly published online 30 March 2014

NONPROFIT
FINANCIAL
COMMONS

Larger Organizations Have Lower Overhead Ratios



Misuse, misunderstanding and misinterpretation of nonprofit accounting information

Jesse D. Lecy, Elizabeth A.M. Searing and Tianyi Li

Presenter



John Summers
Managing Director, BDO

Liquid Unrestricted Net Assets (LUNA)

- ▶ Broad measure of nonprofit financial health
- ▶ Generally equates to “financial reserves” or “operating reserves”
- ▶ Calculated from balance sheet
- ▶ Elements:
 - ▶ *Liquid* - available as cash or readily convertible to cash (e.g., receivables, publicly traded investments). Excludes property, equipment, illiquid investments, etc.
 - ▶ *Unrestricted* - available for use at the discretion of the organization (not time- or purpose-restricted by a donor)
 - ▶ *Net* - calculated net of balance sheet liabilities
- ▶ Typically expressed in terms of days/months of expenses

Liquid Unrestricted Net Assets (LUNA)

Our Unrestricted
Net Worth



Inaccessible
Net Worth



Operating
Reserves

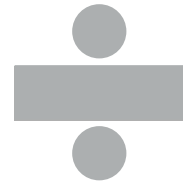


Liquid Unrestricted Net Assets (LUNA)

Operating reserves

How much is spent per month

Months of LUNA



Liquid Unrestricted Net Assets - Formula

From Financial Statements

Balance Sheet (Statement of Financial Position)

Unrestricted Net Assets - Fixed Assets + Secured Mortgages

÷

Income Statement (Statement of Activities) or Statement of Functional Expenses

Total expenses - Depreciation, depletion and amortization

÷

12 (months)

From Form 990

Part X, Balance Sheet

Line 27 (Unrestricted net assets) - Line 14 (Intangible assets) - Line 10c (Land, buildings, and equipment) + Line 23 (Secured mortgages) + Line 20 (Tax-exempt bonds)

÷

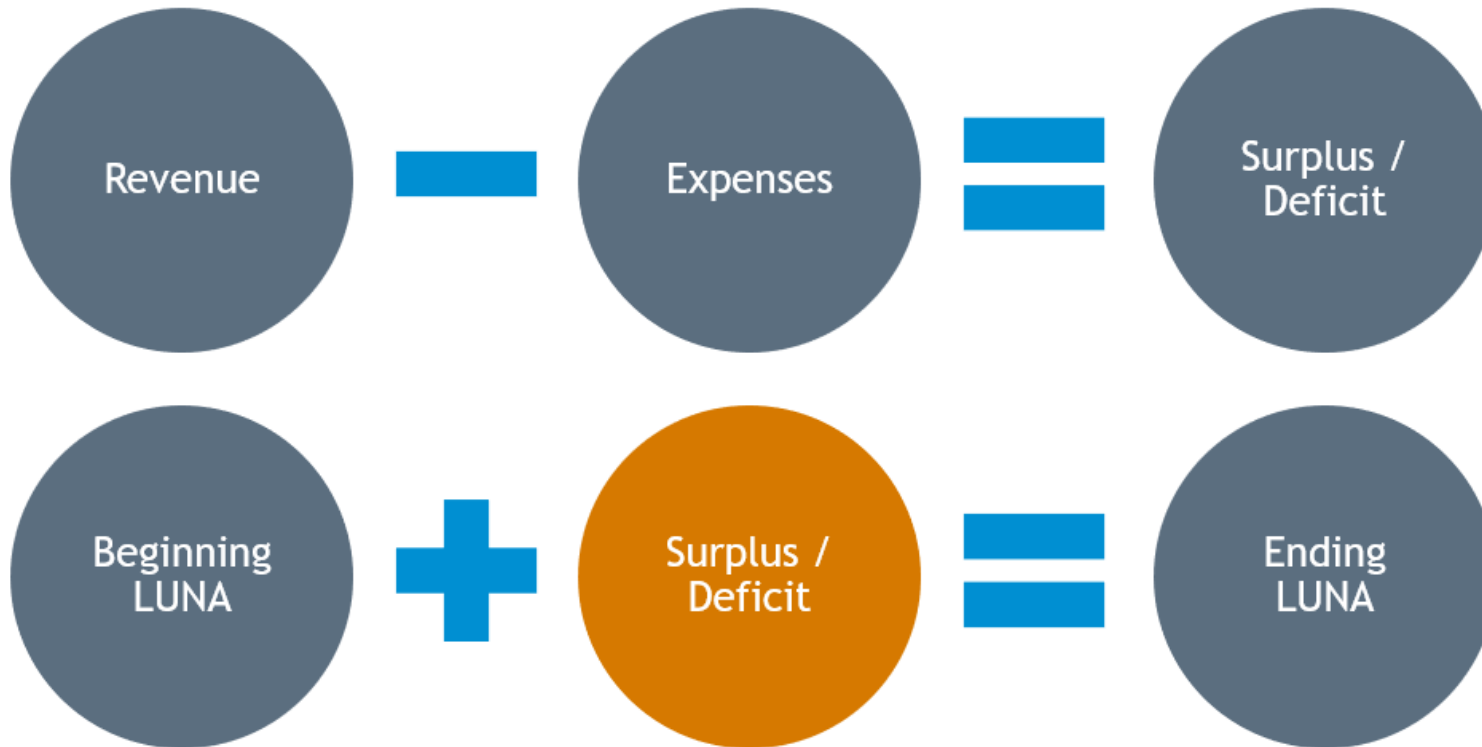
Part IX, Statement of Functional Expenses

Line 25A (Total functional expenses) - Line 22A (Depreciation)

÷

12 (months)

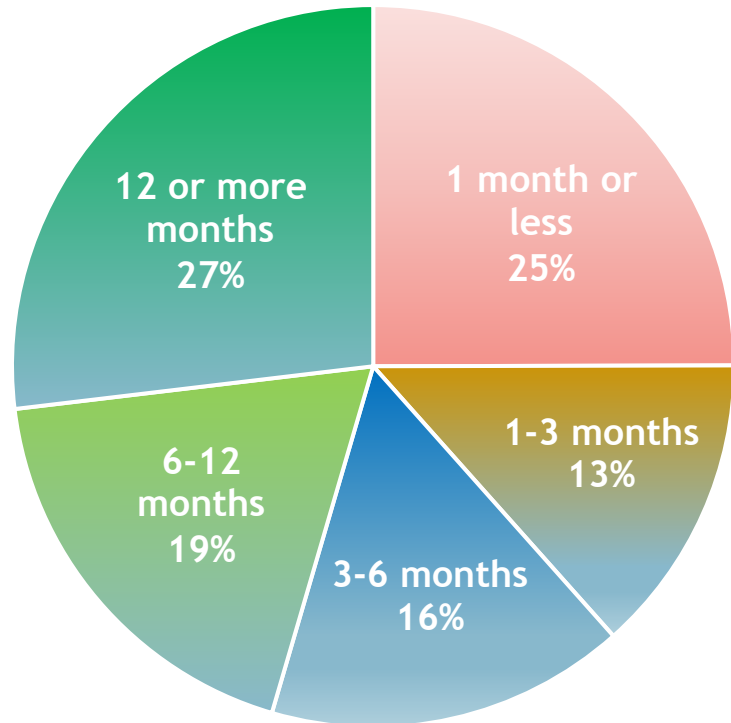
Building (or depleting) LUNA



How much in operating reserves should a healthy organization have?

LUNA in the sector

Months of LUNA - Form 990 Filers



Median Months of LUNA by Budget Size

	Median Months
Under \$1m	6.7
\$1m - \$2m	4.7
\$2m - \$5m	4.2
\$5m - \$10m	3.4
\$10m - \$20m	2.8
\$20m - \$100m	2.4
\$100m or more	1.5
All orgs	5.0

Includes 168,960 organizations filing a full IRS Form 990 with at least \$200,000 in revenue and reporting net assets by category of restriction. Data primarily from fiscal years 2022 and 2023. Budget size in total expenses.

Context for the LUNA metric

- ▶ Does not account for *restricted* funds, which may make up a significant part of an organization's capital structure. If an organization holds restricted funds (e.g., foundation grants, endowment), that should be considered in assessing financial health.
- ▶ May understate actual financial reserves if certain assumptions are not accurate.

Case Study

**NONPROFIT
FINANCIAL
COMMONS**

Q&A

NONPROFIT
FINANCIAL
COMMONS

Key Takeaways

Ratios are useful in creating focus and energy around specific financial issues that matter to your nonprofit. Choose them carefully.

The usefulness of ratios is context specific and is sensitive to size, age, type and mission values.

Resources and Wrap Up

Stay Connected on the Forum

YOUR FORUM AWAITS...

Most commons have a forum where community members can meet to surface mutual concerns and exchange resources. At the Nonprofit Financial Commons, THIS is that space. Any question you have about nonprofit finances, whether it has to do with high strategy or granular practice, can be brought here. Here you can glean the rich wisdom of your peers and share your own hard-won insights and knowledge. Be and spread the change you wish to see.

[Register](#)

[Log In](#)



NONPROFIT
FINANCIAL
COMMONS

Your Next Important Step:
Support our Knowledge Sharing Community
with a Donation that Reflects the Value of
this Session.



[Click to Make a Donation Today](#)

NONPROFIT
FINANCIAL
COMMONS