

Knowing Your Numbers

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The financial knowledge of members of both for-profit and nonprofit boards has come into question recently, as evidenced in numerous newspaper and journal articles. Our sponsored ministries have excellent financial management policies and practices in place. We are not however immune to making decisions without fully understanding what our “numbers” are saying. We need to ensure that our board members and chief executives understand the current financial status and future financial projections for our ministries as one important factor in making strategic and policy decisions for them.

The following excerpts are taken from “The Dirty Little Secret of Nonprofit Boards” by Hildy Gottlieb as it appears on charitychannel.com.

Fact:

On virtually every board of every nonprofit throughout the world, there are board members who do not understand how to read a balance sheet, a profit & loss statement, or any of the other financial data boards typically review and vote on. At best, your board likely contains at least a few such members. At worst, you have a majority of board members who do not have a clue about the financial statements and reports that are regularly placed in front of them.

The consequences of this widely accepted (and completely ignored) truth are many.

- Board members vote to approve the budget, but don't really understand the budget.
- Board members make decisions on whether or not to hire a new staff person, but don't understand whether or not the organization can afford that new position.
- Board members vote on which fundraising approach to pursue, but couldn't do a cost/benefit analysis to determine if that really is the best choice.

Most people would agree that it is bad policy to allow individuals to make decisions about things they do not understand. Yet every day board members make countless decisions without understanding the financial ramifications of those decisions.

And so, herewith, some policy recommendations to help your board move beyond financial ignorance, and then some very basic first-step information to spark your board's thinking about the financial reports they discuss and vote on every month.

Policy Recommendations:

Financial training should be part of your orientation program - with a test at the end. Board members don't need to be budding CPAs, but if they can't answer basic financial questions about the organization's health, they cannot govern - period.

Consider changing your bylaws to prohibit anyone from voting if they haven't evidenced basic financial understanding.

Now Some Finance/Economics Basics

If these concepts are foreign to anyone on your board (maybe even you!), it is time for your board to get some training - and fast!

Overall Economics and Basic Nonprofit Information:

- What does it mean that your organization is Nonprofit? Is the organization allowed to show a profit? What happens if you do?
- Where do most funds come from in the Nonprofit sector? Are they mostly from grants?
- What does “Opportunity Cost” mean? How does that affect your board's decision-making?

Some Economics/Nonprofit Basics:

An economy is a dynamic system where forces play against each other. Economics has more to do with understanding how the world works and how decisions affect other decisions, than it has to do with numbers.

A basic knowledge of overall economics will help you put your organizational decisions into the bigger context of the economy of your community, your state, your world. It will also help you understand how one decision affects others your organization will have to make. How do Nonprofits relate to other parts of the economy? What are Nonprofits allowed to do/not allowed to do? Without this basic information, your board simply cannot govern responsibly.

Balance Sheet:

- What is the balance sheet? What story does it tell?
- Are assets and liabilities good or bad?
- What is a debt/equity ratio? What does it tell about the organization? Can you find the debt/equity ratio on your organization's balance sheet?

Some Balance Sheet Basics:

The balance sheet is a snapshot of your organization's financial status TODAY, describing the relationship between what you own RIGHT NOW vs. what you owe RIGHT NOW.

The question answered by the balance sheet is simple: As of this very moment, how stable is our organization? If we were to put all the facets of our organization on one of those old-fashioned scales, would it tip over towards the side with the debts on it, or would it tip to the side of what we own?

Because the balance sheet is like that balancing scale, one individual number is of no importance without knowing how that number relates to the numbers on the other side of the scale. That relationship will show you how stable the organization is.

So is \$50,000 in debt a lot or a little? If you understand the balance sheet, you will know that the answer depends on the rest of the story. With \$20 million in the bank, \$50,000 is probably not a lot of debt. With \$27.32 in the bank, \$50,000 is a lot of debt. On the balance sheet, no number stands alone - it's all about the relationships that tip your organization's scales in one direction or another.

Profit and Loss/Income/Cash Flow Statement:

- What story does the Profit and Loss Statement tell?
- Can you tell whether your organization's funding comes from many different sources, or just a few big contracts?
- Can you tell what your biggest expenses are? Is it ok that those are high? Why? Why not?
- When your board gets most riled up about a particular expense item, what percentage of the organization's overall expenses does that item represent?

Some Profit and Loss Statement Basics:

The Profit and Loss Statement is like a summary of your checkbook, broken down by category. The P&L answers this question: What did we spend money on, and where did that money come from? One of the most important things to remember about this report is that it looks at the past.

There is little a board can do about the past, but you wouldn't know that from most board discussions of the Profit and Loss Statement! Because this report is so similar to their own finances, most board members feel comfortable picking apart the organization's expenditures, with no real end in mind. They just think that's what they are supposed to do!

There are, in fact, good reasons to examine the expense side of this report. One of those is to examine areas where proactive policies could prevent future problems.

But the area of real value for this report is one most boards ignore - the income side. Most boards miss the opportunity to examine, for example, whether the organization is receiving its funding from diverse sources, or whether all its eggs are coming from one basket - perhaps government funding or grants.

Without understanding the real significance to this "look into the past," boards spend inordinate amounts of time reviewing insignificant line item expenditures. Once this report is seen in context, however, it is easy to understand what really is worth discussing and why.

Budget:

- What story does the budget tell?
- How often should you look at the budget throughout the year?
- Once the budget is approved, can it be changed throughout the year? Why? Why not?

True Story:

Every year, the XYZ Group would create a strategic plan. And every year, the plan wouldn't be implemented. When asked why nothing ever happened, the answer was, "There was no money in the budget to implement the plan."

Some Budget Basics:

The balance sheet describes today. The Profit and Loss statement describes the past. The budget, however, is all about the things the board can control - the FUTURE. The budget is nothing more than a projected Profit and Loss Statement. It tells what you anticipate spending money on, and where you anticipate funds will come from to pay for those expenditures.

The budget is evidence of the board's priorities. A budget that changes little from year to year is often proof of a board with few priorities for what the organization should be accomplishing in the community. A budget that shows marked change from year to year is often evidence of a board with aggressive priorities for making a real difference in the community.

- Will we increase programming in a particular area?
- Will we try to instill more stability into our income stream?

- How will we be aiming for better results for the community?
- Did we plan for implementing our strategic plan?
- The budget should be able to answer those questions.

Your Organization's "Bottom Line"

As you look at the things your board members should know about your organization's finances, and you consider the things they may NOT know, you can see that board members who don't understand the organization's financial matters make it difficult for the board to be accountable - both for the money, and for providing the mission.

Suddenly, understanding the finances isn't a luxury. It's an imperative - not just for the good of the organization and the community, but for each individual board member.

Cost-Benefit Analysis

Cost-Benefit Analysis is a technique designed to determine the feasibility of a project or plan by quantifying its cost (i.e., the total money, time and resources involved) and benefits (e.g., payment, something of value or usefulness to the organization). In other words, **Cost-Benefit Analysis** is the process of weighing the total expected benefits of one or more actions in order to choose the most profitable.