FINANCE 101: Financial Terms & Statements - Overview

Financial Basics
#1 There are two basic types of income

- Revenue—self-generated fees for service/sales
- Support—charitable contributions and grants

#2 Financial information is based on periods of time

- Past = Financial Statements (prepared monthly, quarterly, annually to reflect historical activity)
- Present Reality = Cash Flow Projections (include current and near-term cash projections)
- Future = Budget (prepared in anticipation of future activity)

#3 Numbers are meant to be compared

- Actual vs. budget
- Current year to date vs. prior year to date
- Current month vs. prior month
- Budget vs. historical averages

#4 Anticipation is the key to financial stability

- Managers need TIME to adjust if revenues are not coming in according to plan
- Tools like cash flow projections and budget to actual reports can help

#5 Financial health is essential for the effective delivery of services.

- You cannot accomplish mission without a base level of financial health and solid financial management.

Type and Uses of Financial Statements
Financial Statements is a term that refers to two statements/reports that schools should be producing on a monthly basis. Those statements are most commonly referred to as a Balance Sheet and an Income Statement. They may also be referred to by other terms as shown in the chart below.

Generic (For Profit)	Nonprofit	Governmental
Balance Sheet	Statement of Financial Position	Statement of Net Assets
Income Statement	Statement of Activities & Changes in Net Assets	Statement of Activities

<u>The Balance Sheet</u> shows the organization's financial position at a particular point in time (Month End, Year End). It includes:

- ASSETS: Economic resources the organization owns or has been promised.
- LIABILITIES: Financial obligations; what the organization owes to others.
- NET ASSETS: The difference between total assets and total liabilities. NET ASSETS represent the accumulation of surpluses or deficits the organization has achieved since it began operating.

<u>The Income Statement</u> shows the organization's financial activities from one point in time to another. (YTD, Full Year). It includes:

- Sources and amounts of income
- Expenses by category or activity
- How much income was left (surplus)/How much income was overspent (deficit)

Audited Financial Statements have been examined and tested by independent certified public accountants, using protocols established by the Financial Accounting Standards Board. They are issued once a year and are accompanied by an "Independent Auditors' Report" which expresses an opinion as to whether the financial statements have been presented fairly by the organization's management.

Internal Financial Statements are produced on a monthly basis to track revenues and expenses. Internal statements should include some basic comparisons. Actual vs. budget, current year vs. prior year, etc. Should reflect program-based accounting, where readers can see both revenues and expenses by program, whereas the audit usually shows only expenses by program.

Budget reflects planned revenues and expenses, not actual revenues and expenses.

Other Financial Reports could include Cash Flow Statement/Projections, Enrollment Variance Reports, and Rolling Financial Projections

Measures for Understanding Financial Health

Current Ratio = Current Assets/Current Liabilities

- Measures the school's ability to pay its obligations over the next 12 months.
- Target: Ratio of 1.1 OR ratio between 1.0 and 1.1 and one-year trend is positive

Unrestricted Days Cash = Unrestricted Cash/((Total Expenses – Deprecation Expense)/365)

- Measures how many days a school can pay its expenses without another inflow of cash.
- Target: 60 days or 30-60 days and the one-year trend is positive

Enrollment Variance = Actual Enrollment/Budgeted Enrollment

- Measures how accurately (or conservatively) does a school project its enrollment/how close is the school's revenue going to be to budgeted projections
- Target: Enrollment equals or exceeds 95% of budget

Debt Default

- Measures if a school is current on debt obligations.
- Target: School is not in default and is not delinquent on any debt service payments.

Total Margin = Net Income/Total Revenue
Aggregated Total Margin = Total 3 Year Net Income/Total 3 Year Revenues

- Measures whether a school operates with a surplus or deficit during a given time period.
- Target: Aggregated three-year margin is positive OR aggregated three-year margin is better than -1.5 and the two year trend is positive.

Debt to Asset Ratio = Total Liabilities/Total Assets

- Measures the extent to which the school is leveraged (i.e. relies on borrowed funds to finance operations).
- Target: Debt to asset ratio of less than 0.90

Cash Flow = Prior year cash – current year cash

- Measures the trend of a school's cash balance over time.
- Target: Multi-year cash flow is positive and cash flow in most recent year is positive

Debt Service Coverage Ratio = Net Income + Depreciation + Interest Expense)/(Annual Principal, Interest, and Lease Payments)

- Measures whether a school can produce enough cash to cover its debt, including lease payments, in a given year.
- Target: Debt to asset ratio equal to or greater than 1.1