Financial Trend Analysis

Presented to:

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Agenda

Welcome & Introductions

Where has Multicultural Institute been financially?

- MI’s Business Model
- MI’s Capital Structure

Wrap Up

Nonprofit Finance Fund: Where Money Meets Mission

Nonprofit Finance Fund™

We unlock the potential of mission-driven organizations through tailored investments, strategic advice, and accessible insight

$60 million loan portfolio
$220M New Markets Tax Credit allocation
Museums, Theaters and Community Art Centers
Federally Qualified Health Centers
Charter Schools

Financial planning
Business model adaptation
Scaling
Mergers and collaboration

Bringing facts to a word fight
State of the Sector survey

MI's Strategic Plan

Priority 1: Purchase/renovate West Berkeley Building as MI's permanent administrative headquarters and as a community center.

Priority 2: Undertake multiple efforts to ensure long-term organizational sustainability:

- Develop and maintain a robust individual donor program
- Build MI's reserves
- Be prepared for mission linked opportunities that become available as nonprofits or government programs seek high capacity agencies like MI to partner with or absorb their Programs.

Key Financial Observations

Multicultural Institute (MI) is emerging from a period of growth that has impacted both operations and balance sheet.

- MI's expense base increased from $504K in FY2010 to $730K in FY2014. Revenues increased from $507K to $730K during this same period.
- Amidst this period of growth, MI has generated ongoing surpluses, ranging from 1% (FY2010) to 27% (FY2012) of operating expenses.
- MI additionally purchased and renovated its headquarters in Berkeley, growing the organization's overall balance sheet. MI's asset are now increasingly dominated by its building (and not cash as was the case prior to FY2011).
- MI has done a laudable job paying down the debt related to the building, ending FY2014 debt free.
- Despite growth in MI's overall net assets, MI's liquidity has decreased year over year. At FYE 2014, MI had cash sufficient to cover half a month of expenses.

Key Indicators of Financial Health

Business Model

1. **Profitability & Savings:** Are costs covered? Are surpluses sufficient to pay for debt principal payments and facility or equipment purchases? Are you generating adequate savings?

2. **Revenue Dynamics:** Where does your money come from? Are revenue streams reliable or at risk?

3. **Expense Dynamics:** How are you spending your money? Are expenses predictable? How well do you understand what is fixed vs. variable? Is management responsive to operating changes and prepared to make difficult decisions?

Capital Structure

4. **Health of Balance Sheet:** Are the size, nature and distribution of assets, net assets and liabilities appropriate to support the organization's business and programs over the long term?

5. **Liquidity:** Is there enough cash available to cover current obligations? How quickly can you convert receivables to cash? How liquid are your net assets? Is some cash restricted or spoken for?

Can the Board Answer These Questions?

- Is the organization generating annual operating surpluses consistently? Is operating performance improving?
- Has the organization been able to cover the “full cost of business” (depreciation, debt, savings) each year?
- Do revenue streams appear consistent and reliable over time? Which are at risk and what are the plans to replace them or explore offsetting cost savings?
- Has revenue composition changed over time and if so, why?
- Is in-kind revenue a large source of income?
- What has the impact of any facility been on the organization’s capital structure and profitability? How has the organization financed the facility and its improvements?

Can the Board Answer These Questions? (continued)

- Does the organization have a manageable amount of debt? Are surpluses sufficient to cover annual principal payments?
- How many months of cash and short-terms investments are on hand? Does the amount seem appropriate given internal dynamics and external risk factors?
- Are net assets largely unrestricted? How much are liquid?
- Is the organization able to set aside savings each year (or according to a pre-defined plan)?
- Does the organization have one or more board-designated reserves? What is the purpose of any reserves? How are they accessed? Do any specific policies govern their usage and replenishment?

Understanding MI's Business Model

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Business model: how an organization makes and spends its money in the service of its mission

It is influenced by:

- Vision and strategy
- Local market
- Business drivers
- Lifecycle stage/time horizon

It comprises:

- Revenue composition (earned and contributed)
- Revenue predictability and reliability
- Expense composition
- Expense fixity vs. flexibility

Business Model Can Be Seen on the Income Statement

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INCOME STATEMENT
REVENUE
Earned
Contributed
Private Sources
Government
EXPENSES
Personnel
Professional fees
Occupancy
Program Costs
Admin Costs
Other
Surplus/Deficit

Revenue Dynamics:

- Where did your money come from?
- Were revenue streams reliable or at risk?
- Do revenue streams appear diverse?

Expense or Cost Dynamics:

- How did the organization spend its money?
- Were expenses predictable?
- Was management responsive to operating changes?

Profitability & Savings:

- Were costs covered?
- Was the organization able to generate savings?

Profitability & Savings

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Nonprofits need profits. Surpluses are necessary to fund debt, facilities, equipment, savings and growth. NFF encourages nonprofits to budget and manage to annual surpluses appropriate to meet their short- and long-term needs. Breaking even is rarely enough.

'Profitability & Savings' focuses on Multicultural Institute's trends in revenue relative to expenses.

Does Revenue Consistently Cover Expenses?

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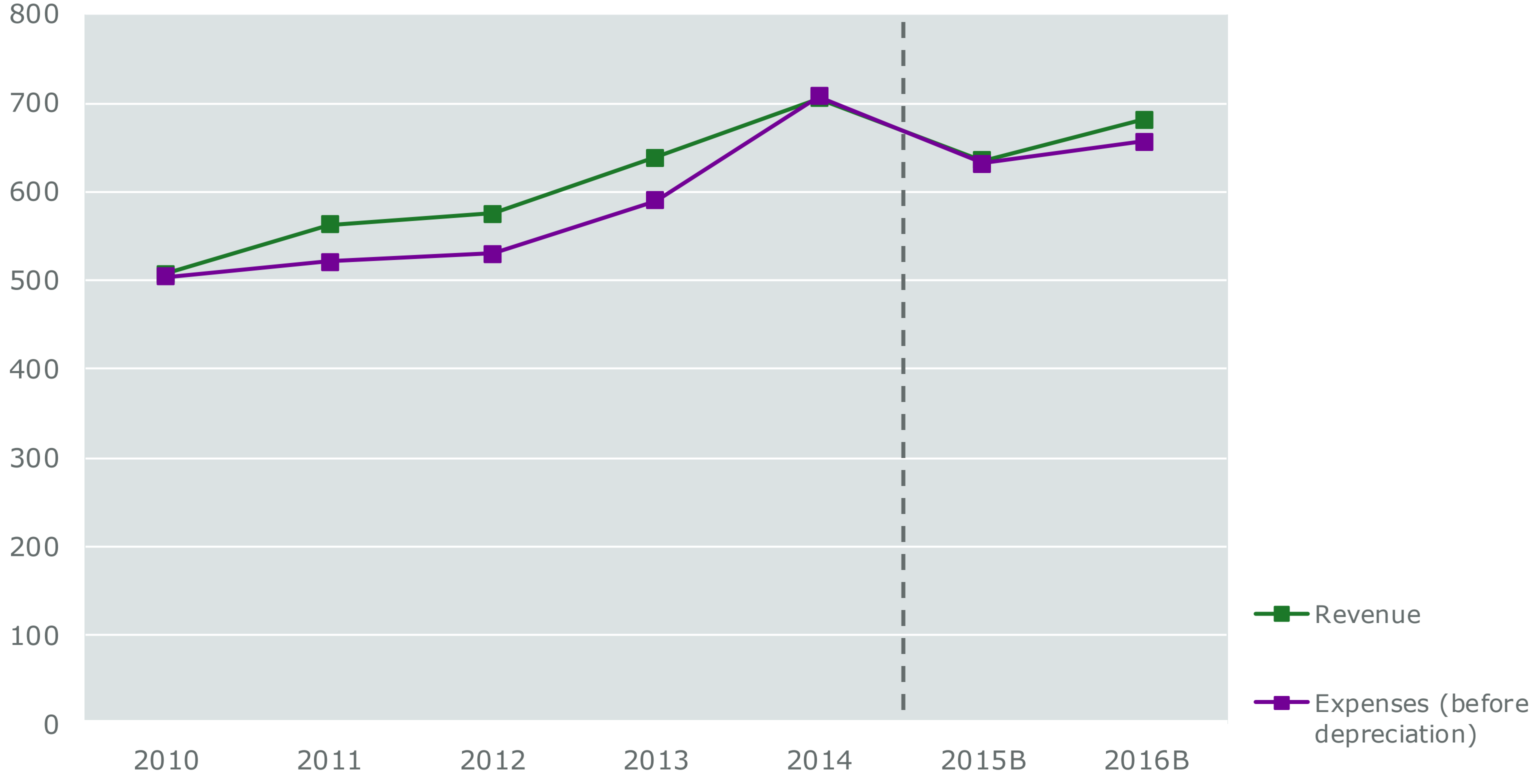
Operating Revenue & Expenses

($ in thousands)



Operating revenue represents funds received as unrestricted or released from temporary restriction to cover operating expenses. Excluded are one-time/episodic sources of income (such as capital campaign receipts, realized/unrealized investment gains and losses, gains from sale of property, and/or other extraordinary items) and all restricted revenue.

Operating expenses are regular costs of doing business. Excluded are one-time, extraordinary or capital items such as funds passed through to other agencies, losses from sale of property, realized/unrealized investment gains or payments of debt principal.

Does Multicultural Institute Consistently Run Unrestricted Surpluses?

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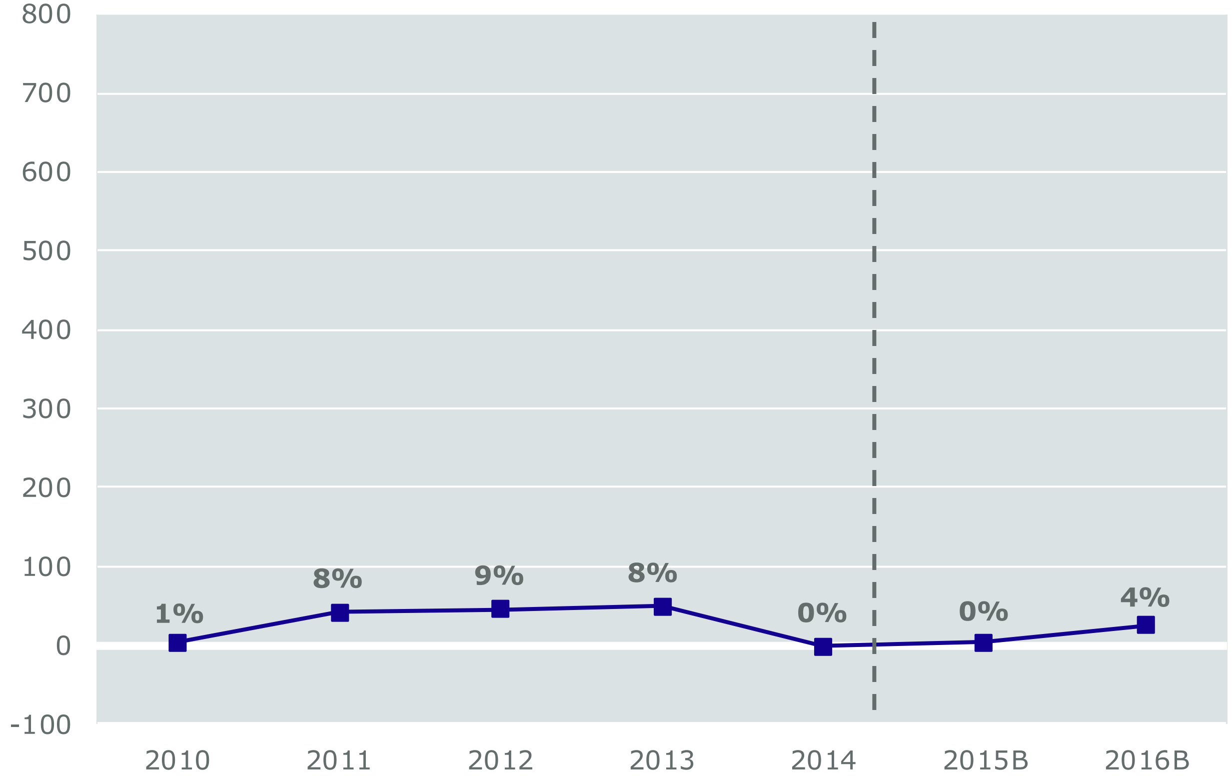
Operating Surplus (Deficit) Before Depreciation

Surplus/deficit as a % of expenses ($ in thousands)



Depreciation is a non-cash expense associated with reducing a fixed asset's book value due to general wear and tear over its defined accounting or useful life. Depreciation is only an approximation of the amount needed to replace fixed assets.

Revenue Dynamics

The degree of predictability and reliability of revenue often is an indicator of financial health.

Revenue includes payments for services, donations from individuals, foundations and corporations, contributions and contract payments from government agencies, income from investments and other activities (for example, rentals).

‘Revenue Dynamics’ focuses on the patterns in sources of revenue and examines the impact of restrictions.

Are There Notable Trends in Revenue?

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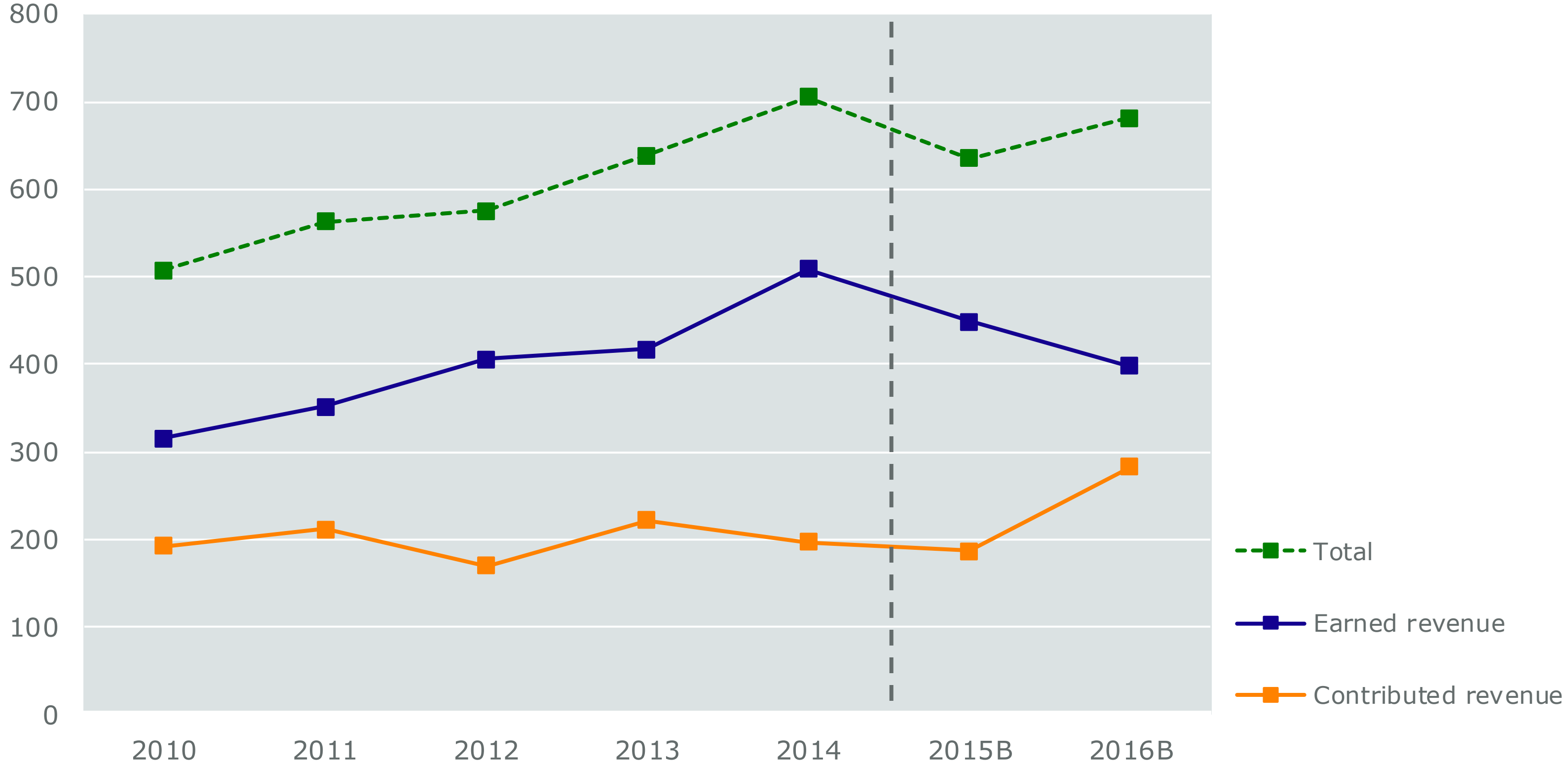
Earned & Contributed Operating Revenue

($ in thousands)



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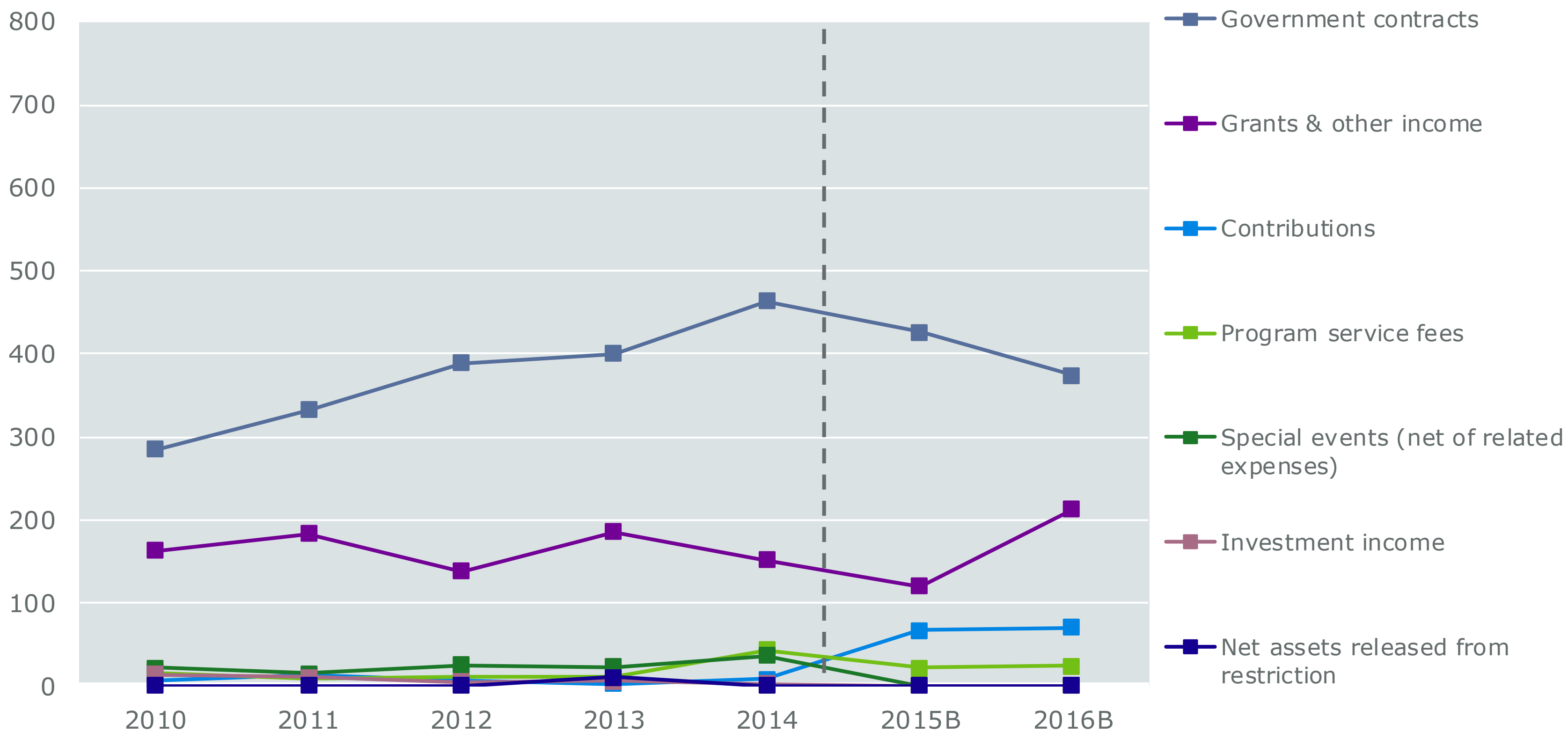
Contributed revenue is received from individual, foundation, corporate, or government donations with no products or services provided by the organization in direct exchange for the funds.

Earned revenue is received by an organization in exchange for its products or services, e.g., tuition or performance-based government contracts.

What Are the Notable Trends in Revenue?

Operating Revenue
($ in thousands)



Net assets released from restrictions refers to the transfer of funds from restricted net assets to unrestricted net assets due to the satisfaction of donor-imposed stipulations with respect to timing or purpose of the contribution.

Did Multicultural Institute Raise Enough to Cover the Gap Between Earned Revenue and Expenses?

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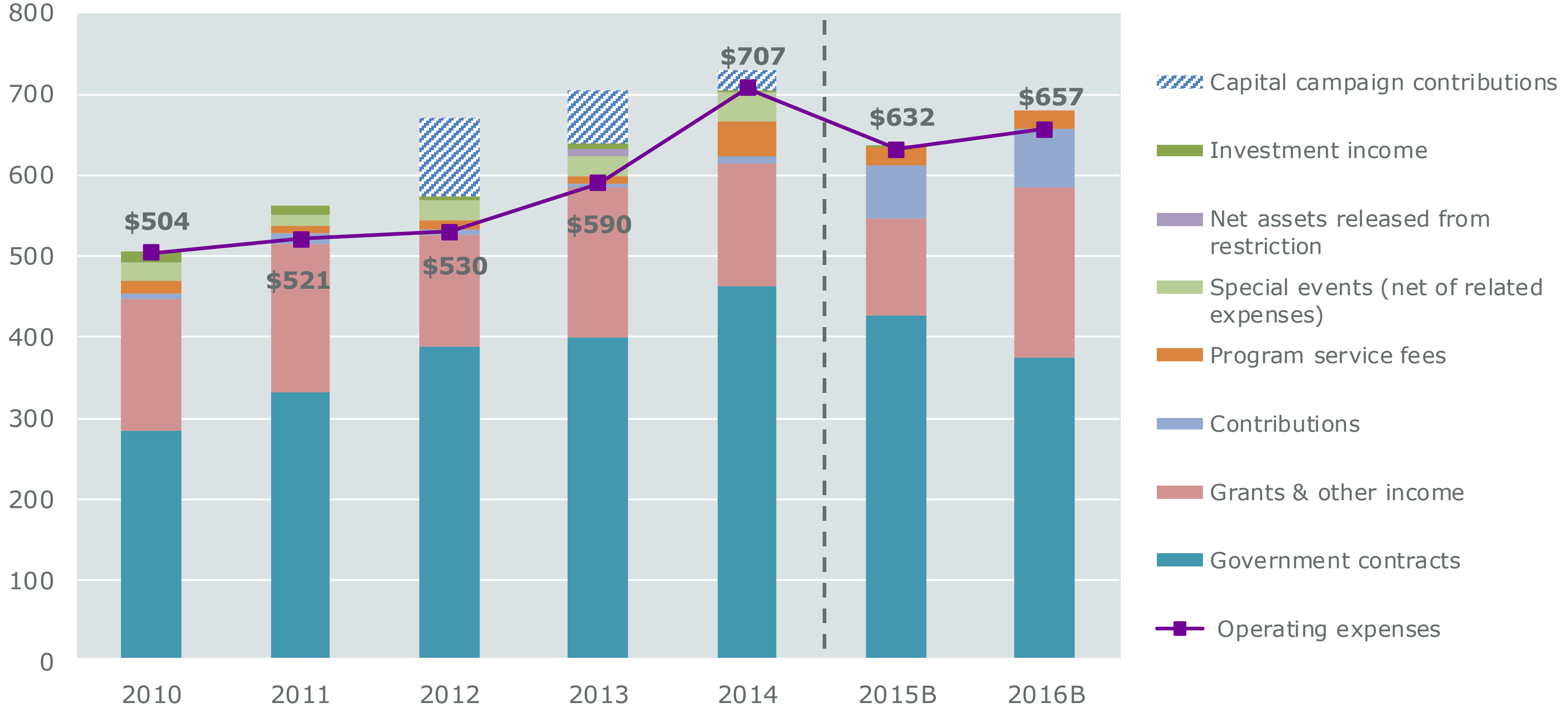
Total Operating Expenses Covered by Operating Revenue

($ in thousands)



Operating expenses are regular costs of doing business. Excluded are one-time, extraordinary or capital items such as funds passed through to other agencies, losses from sale of property, realized/unrealized investment gains or payments of debt principal.

Note: Capital campaign contributions represents funds received through contributions from multiple sources (including the City of Berkeley in FY2013) toward the purchase of Multicultural Institutes new facility. These one-time contributions are not considered apart of the organizations operating revenue, and therefore separated from other contributions.

Expense Dynamics

Nonprofits that run into financial challenges are often uncomfortable bringing expenses in line with their revenue reality.

There are costs beyond day-to-day operations that include debt principal payments, capital expenditures, and funds set aside each year for future use. Budgeting to the full cost of doing business is essential for sustained financial health.

‘Expense Dynamics’ examines Multicultural Institute’s full cost of doing business, including operating expenses.

What Are the Notable Trends in Expenses?

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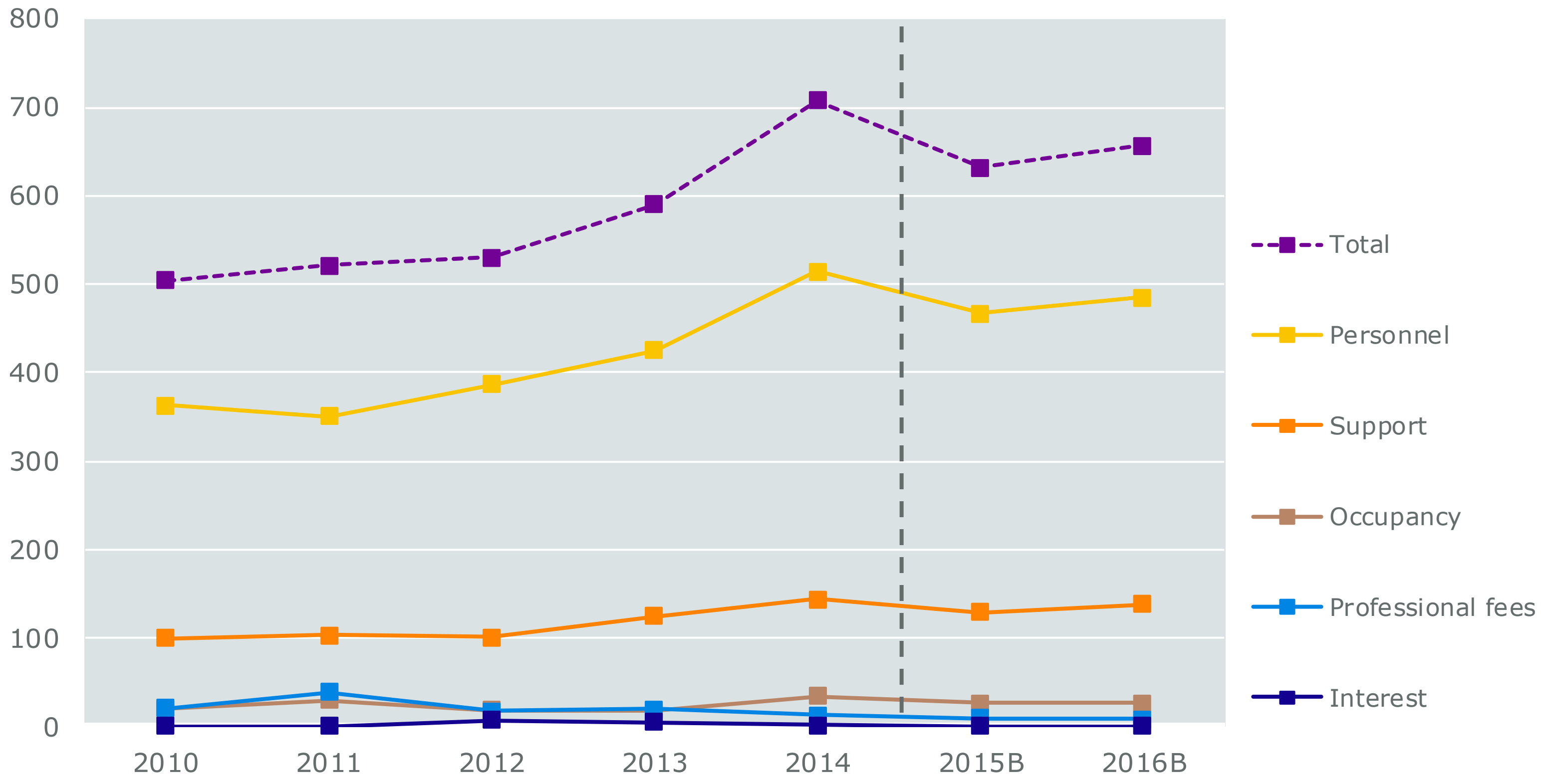
Operating Expenses (before depreciation)

($ in thousands)



Personnel expenses include all salary, payroll taxes, benefits and related staffing costs.

Professional fees are all contract professionals, such as teachers, artists, musicians, lawyers, accountants, architects. These individuals may not have their taxes withheld by the organization or receive benefits.

Occupancy expenses are all costs relating to the rent, utilities, insurance and maintenance of program and office space.

Support expenses are costs unrelated to personnel, professional fees, interest and occupancy (e.g., postage, office supplies, program expenses).

Have People Costs Changed Over Time Relative to Your Total Expenses?

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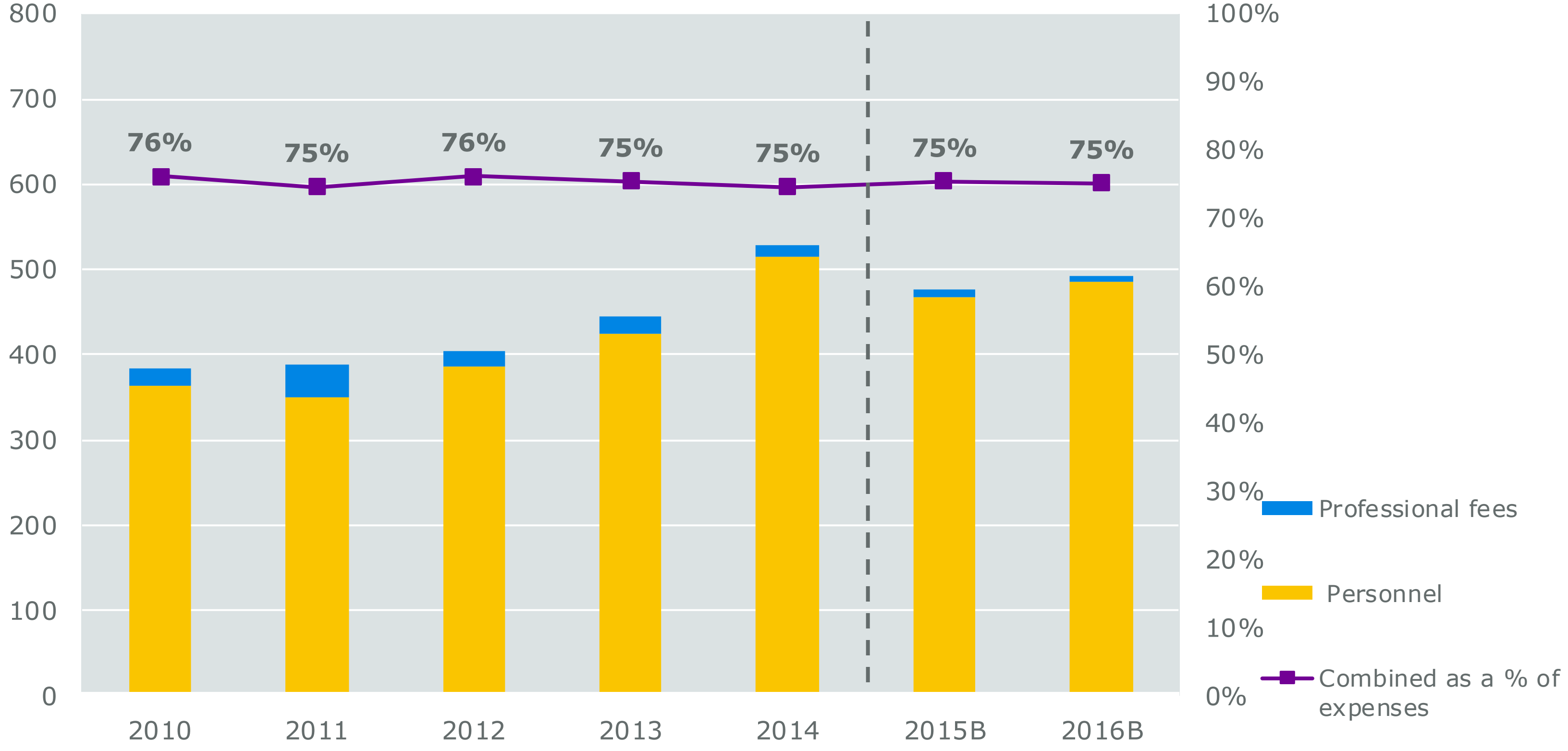
Personnel and Professional Fees

($ in thousands)



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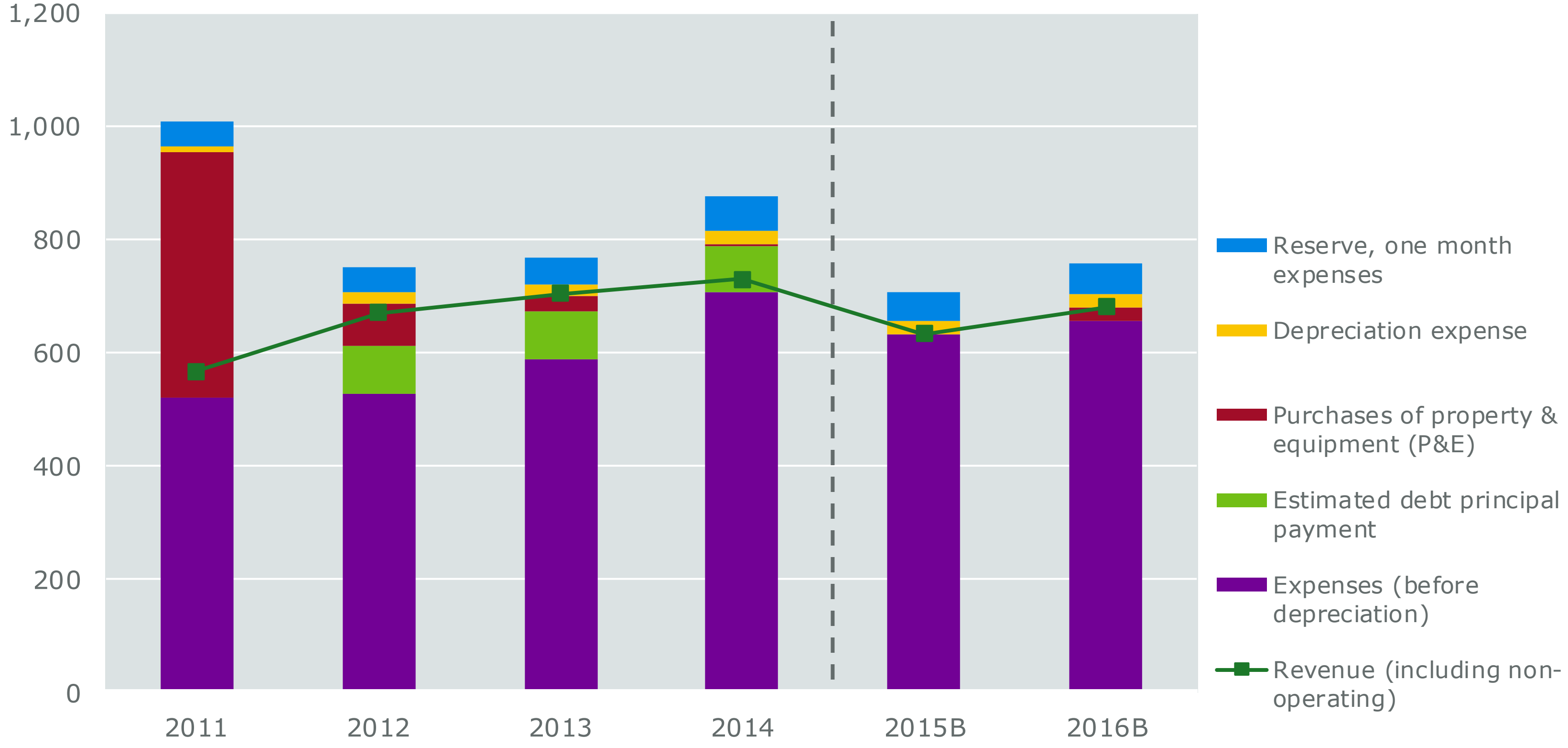
Does Revenue Cover the Full Cost of Doing Business?

Total Cost of All Business Activity

($ in thousands)



Organizations should aim for operating revenue to be large enough to cover all operating expenses, fund depreciation, finance investments in fixed assets, meet debt principal payments and, ideally, contribute to savings.

Depreciation is a non-cash expense associated with reducing a fixed asset's book value due to general wear and tear over its defined accounting or useful life. Depreciation is only an approximation of the amount needed to replace fixed assets.

Property & equipment (P&E), often called **fixed assets**, are physical items an organization owns (e.g., property, building, equipment, improvements) and cannot easily be converted to cash.

Health of Balance Sheet

The balance sheet reveals an organization's ability to manage risk and pursue growth or other opportunities. It is a summary of an organization's financial condition at a specific point in time – in the case of this report, each fiscal year end.

Included on the balance sheet are an organization's assets, liabilities and net assets. In the nonprofit sector there are restrictions on assets and net assets which can impact an organization's flexibility.

'Health of Balance Sheet' focuses on trends from Multicultural Institute's balance sheet, examining the magnitude, nature and distribution of each component.

How Does NFF Define Capital Structure?

Broadly speaking, capital structure is the distribution, nature and magnitude of your organization's assets, liabilities, and net assets

- Distribution (e.g., % assets in cash)
- Nature (e.g., restricted cash)
- Magnitude (e.g., $ amount of cash)

Where do you find this information?

- Your balance sheet

Every nonprofit – no matter what size – has a capital structure

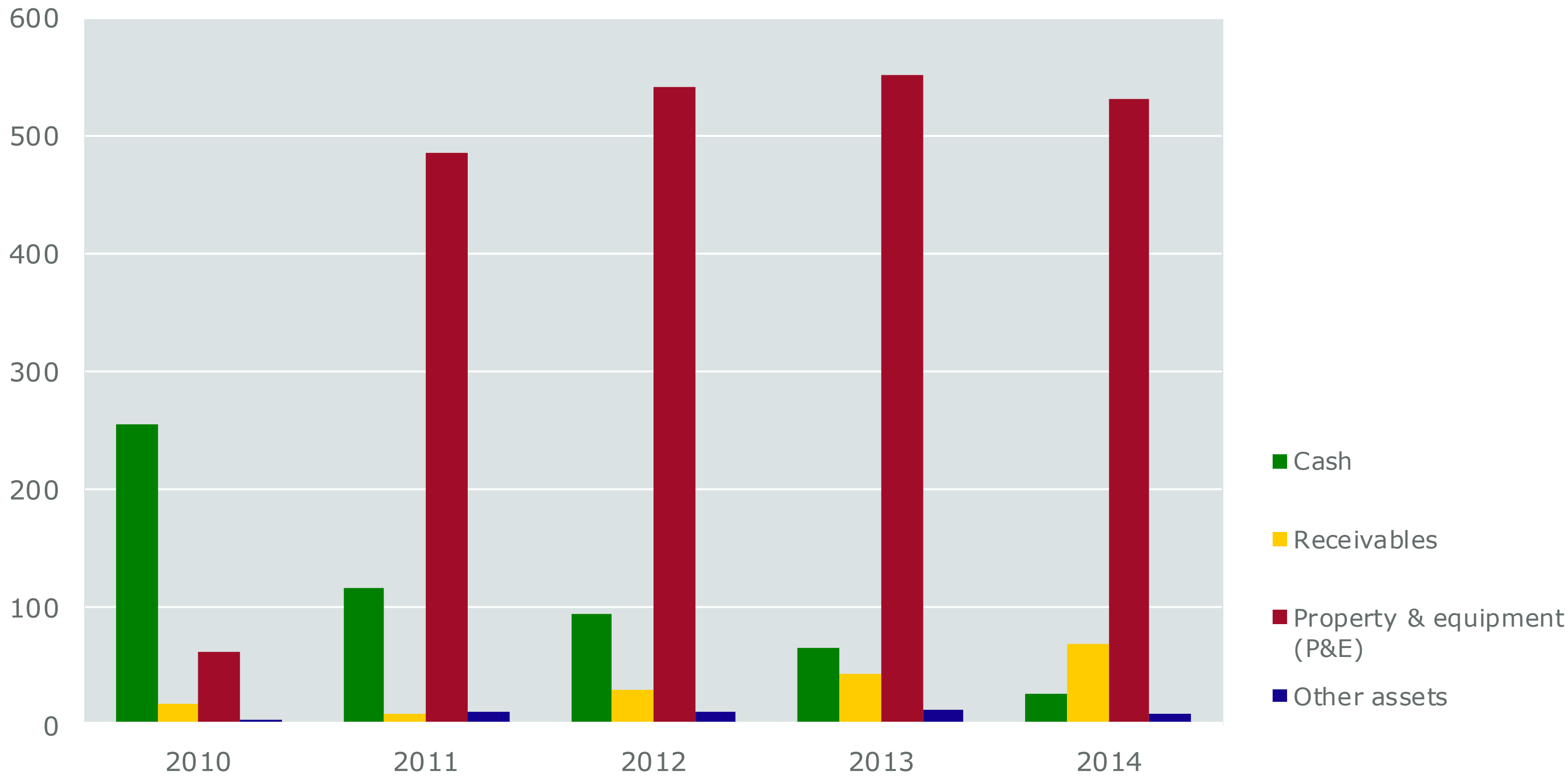
- No one "correct" type for an organization
  - Capital structure depends on business model, perceived environmental and operating risk, stage of growth, future strategic plan.
  - As these elements change significantly, so should capital structure

- Capital Structure can be simple, with small amounts of cash supplemented by "sweat" equity and enthusiasm, or highly complex, with multiple reserves, investments and a diversity of assets

How Has Asset Distribution Changed Over Time?

Total Assets

($ in thousands)



Receivables are funds owed to an organization, for goods and services it has provided or that have been committed as a grant or donation. The funds have been booked as revenue, but the cash has not yet been received.

Property & equipment (P&E), often called **fixed assets**, are physical items an organization owns (e.g., property, building, equipment, improvements), and cannot easily be converted to cash.

How Has the Distribution of Liabilities Changed Over Time?

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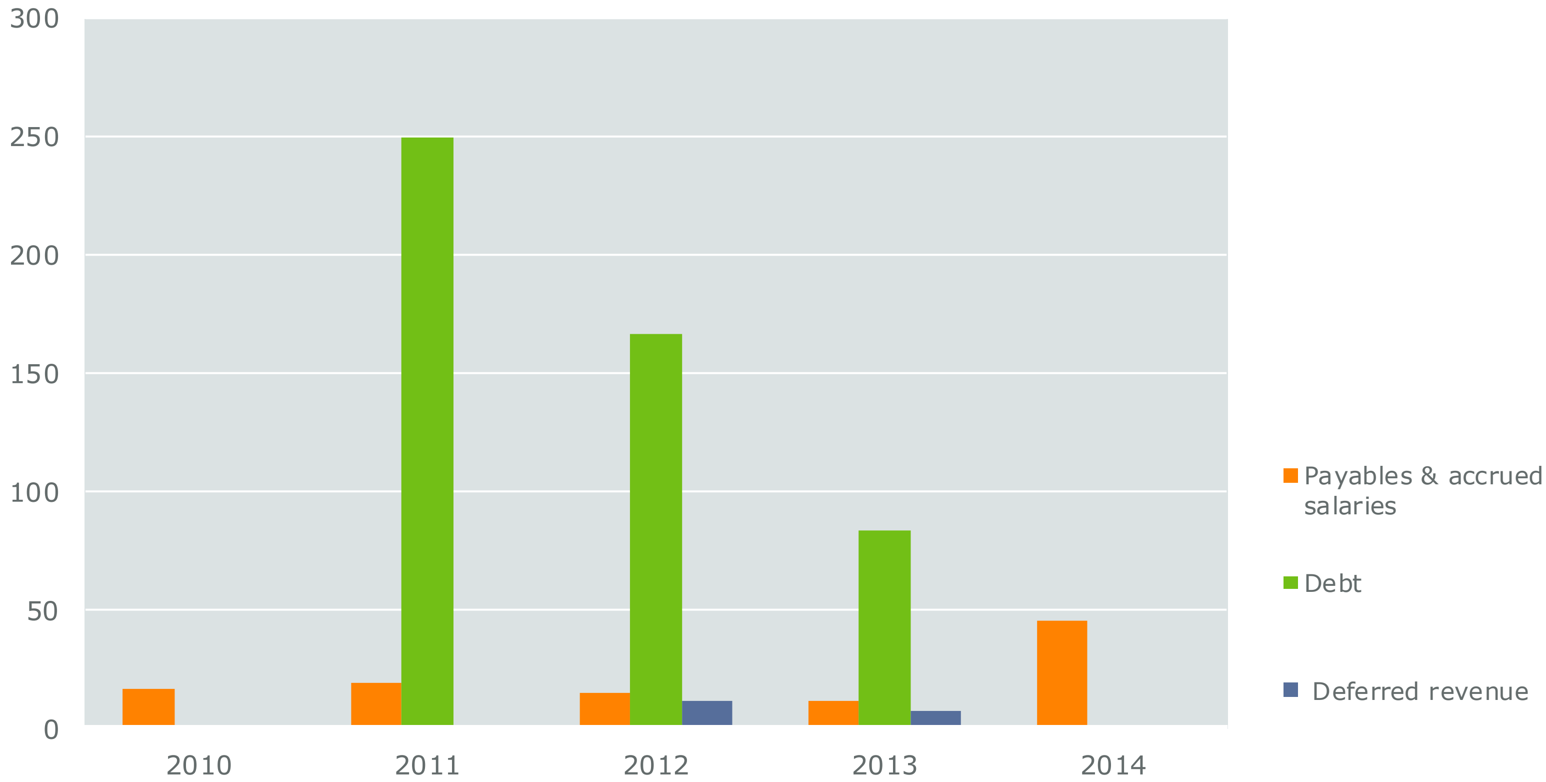
Total Liabilities

($ in thousands)



Payables are funds owed by an organization to its vendors for goods or services purchased.

Accrued salaries are wages due to employees for work to-date.

Deferred revenue refers to payment received from a client for a transaction that has not yet occurred (e.g., subscription purchase for performances held on future dates). This situation creates an obligation, and thus a liability, for the organization to provide goods or services in the future.

What Is the Composition of Your Net Assets? How Much Is Unrestricted?

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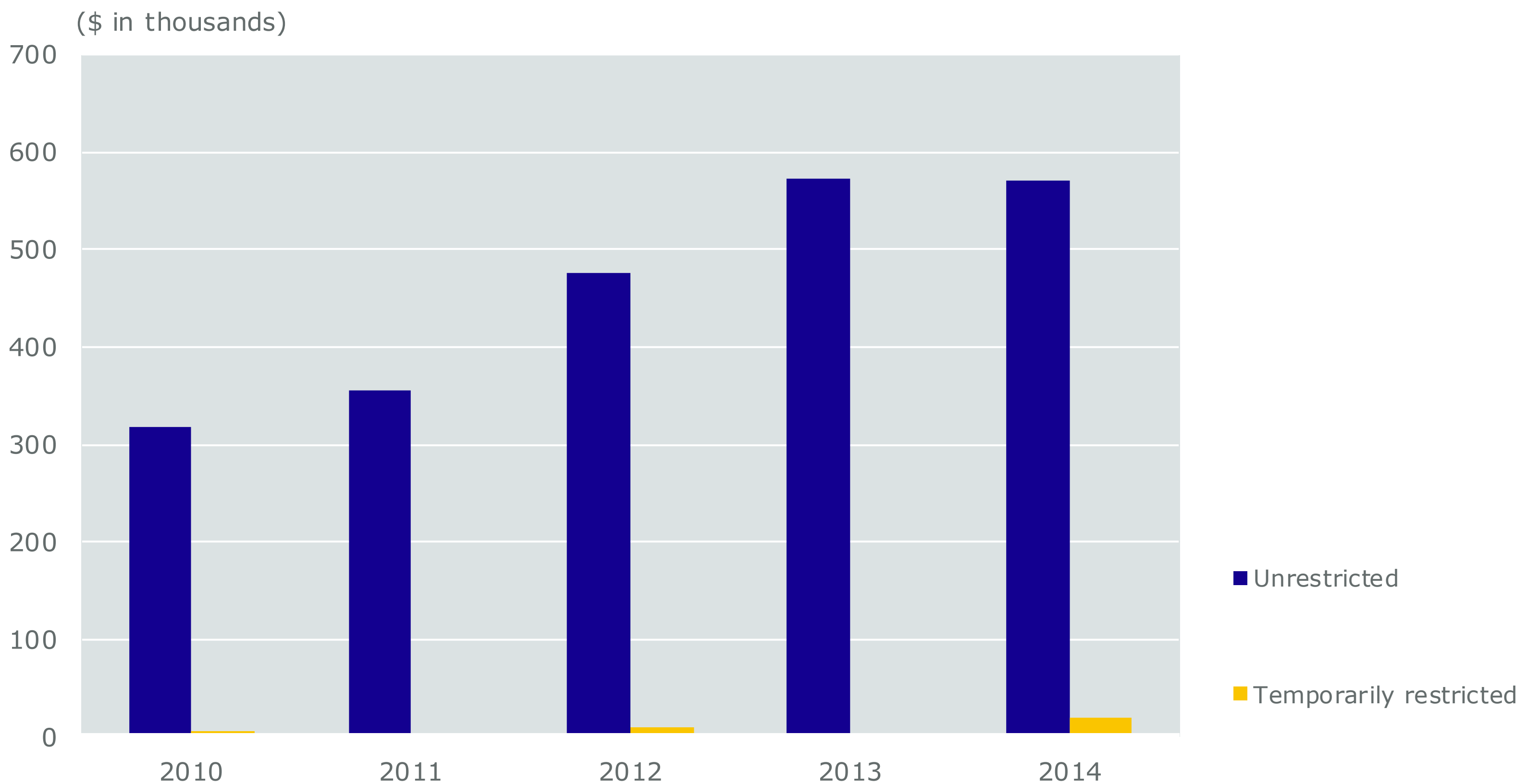
Total Net Assets



Net assets represent the difference between total assets and total liabilities, effectively net worth. Net assets are categorized as unrestricted, temporarily restricted, or permanently restricted.

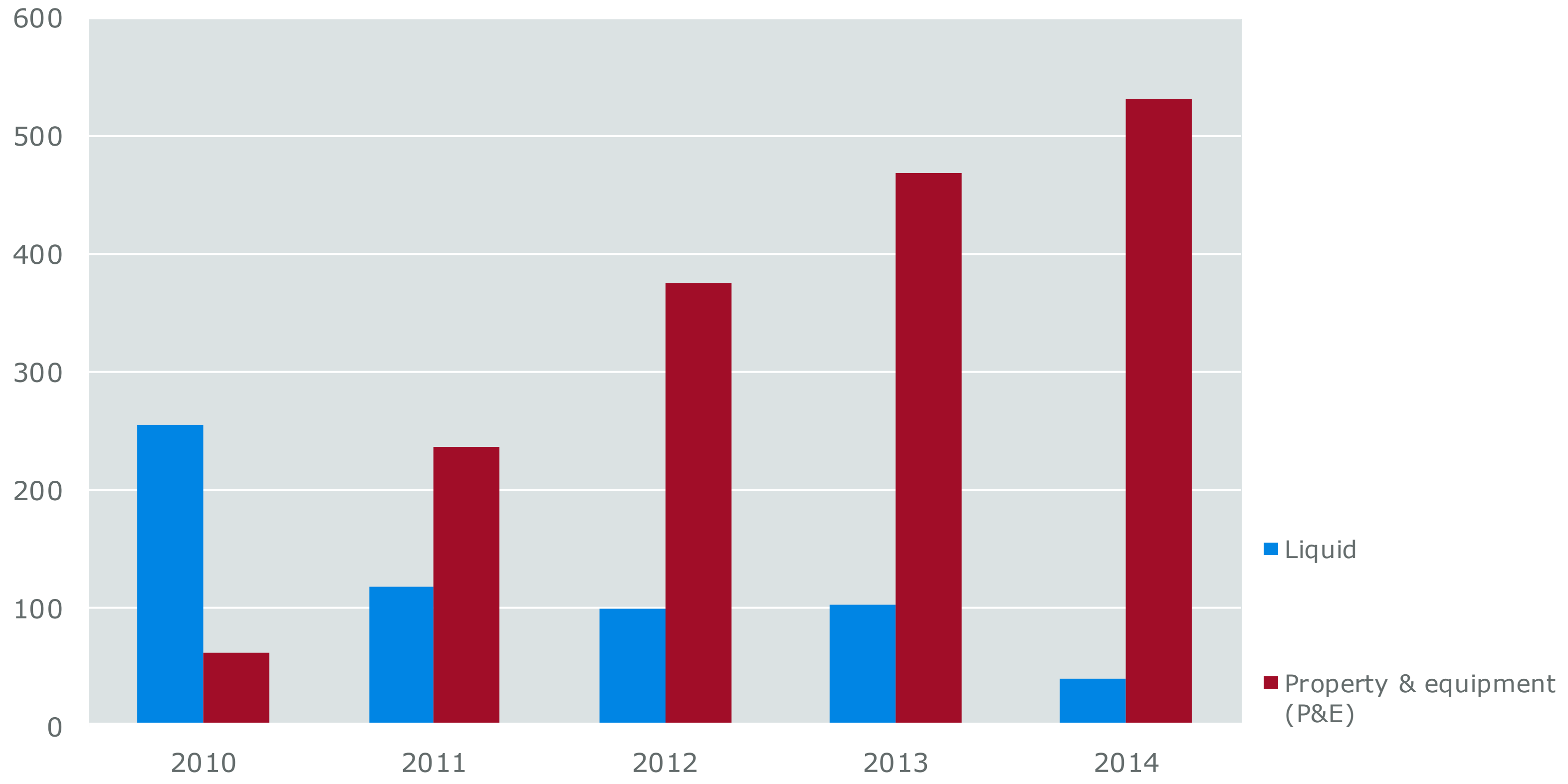
Unrestricted net assets have no external restriction as to use or purpose.

Temporarily restricted net assets have a donor-imposed time or purpose restriction that, once satisfied, are released.

What Is the Composition of Unrestricted Net Assets? How Much Is Available to Support Operations?

Unrestricted Net Assets

($ in thousands)

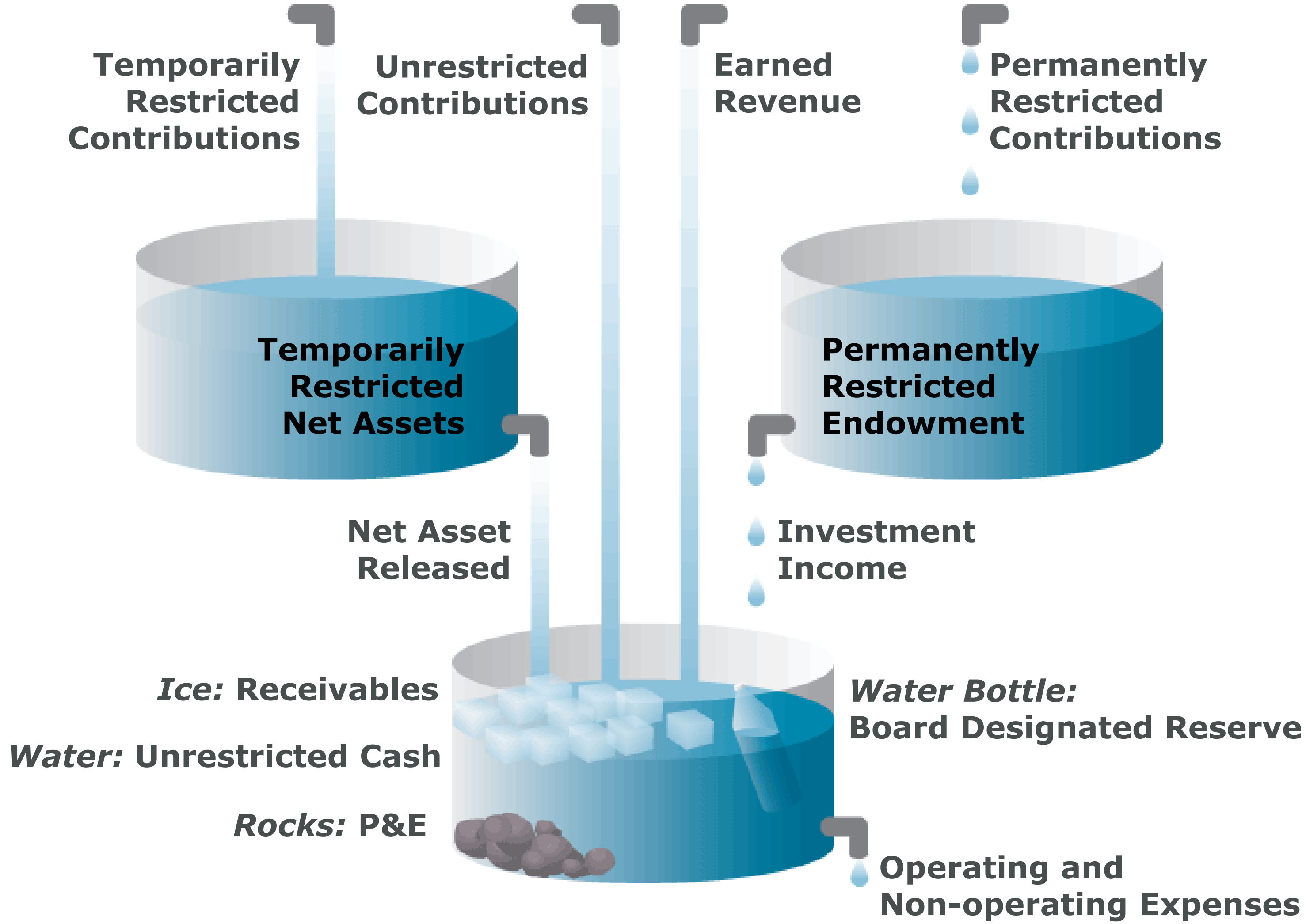


Note: *P&E is assumed unrestricted; it is net of depreciation and related debt.*

Liquid net assets, also called **unrestricted undesignated net assets,** represent the estimated amount of unrestricted net assets NOT invested in P&E or board-designated reserves. Essentially this is the liquid amount of unrestricted net assets available to support operations.

Property & equipment (P&E), often called **fixed assets**, are physical items an organization owns (e.g., property, building, equipment, improvements), and cannot easily be converted to cash.

Examine Net Asset Composition



How Much Cash and Liquid Net Assets Does Multicultural Institute Have Available to Support Operations?

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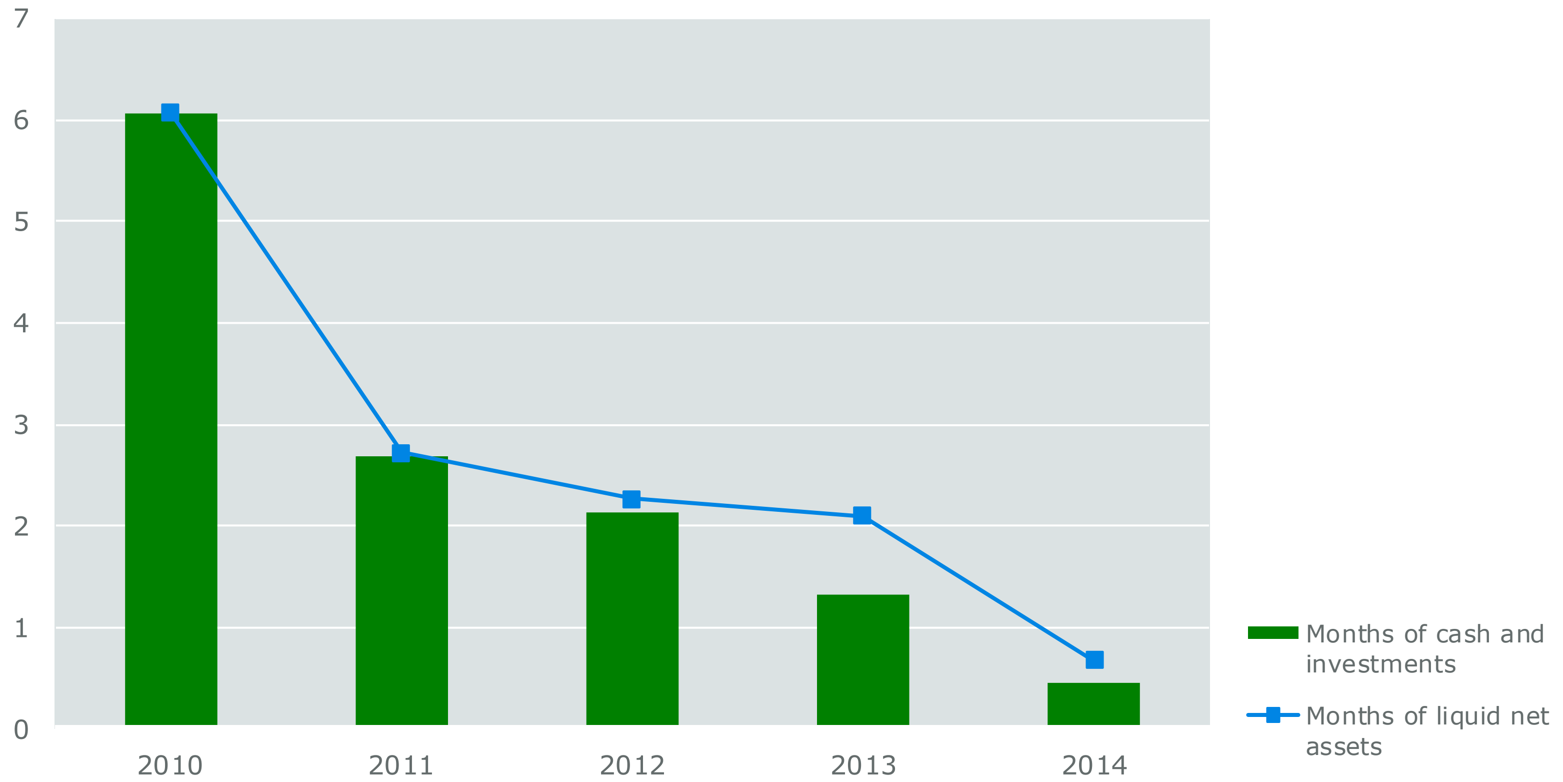
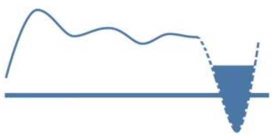
Months of Cash and Investments vs. Liquid Net Assets



Months of expenses covered by cash and investments is a measurement of how long the organization could operate at current expense levels using current cash reserves or investments.

Months of liquid net assets refers to the number of months the organization could operate at current expense levels using liquid net assets.

Different Kinds of Capital Address Different Needs

	Capital Types	Function of each	Addresses:
	Working	Allows the organization to bridge revenue timing gaps	Liquidity
	Risk & Opportunity	Absorbs unforeseen funding losses or unexpected, extraordinary expenses	Adaptability
	Change	Funds investments in infrastructure and capacity associated with changes in business model, may cover deficits until programs and operations can support themselves	Adaptability, Durability
	Recovery	Allows an organization to address a historical mistake or chronically undercapitalized operations	Durability
	Facilities & Equipment	Supports acquisitions or upgrades, or can be used to accumulate reserves to meet future facility and equipment needs	Durability
	Endowment	Provides ongoing operating funds through investment income	Durability

What Ranges of Reserves Might Be Appropriate for Multicultural Institute Over the Longer Term?

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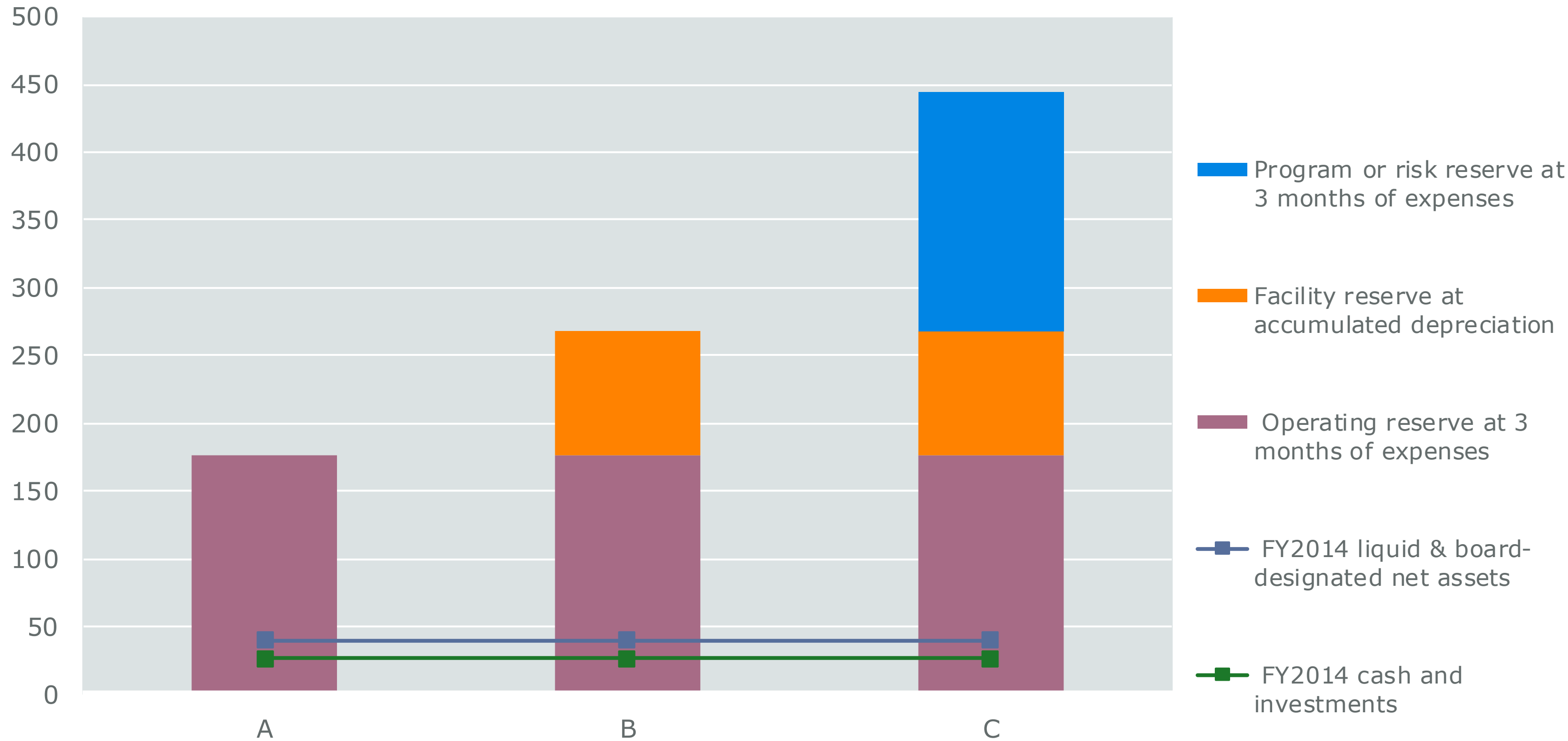
Reserve Options vs. Actual

($ in thousands)



Note: *For discussion purposes only. Ideal value may be higher or lower.*

Liquid and board-designated net assets represent the estimated amount of unrestricted net assets NOT invested in P&E, including unrestricted net assets that have a defined use or purpose, as determined by an organization's board of directors.

Reserves Can Be Built in Two Ways

Nonprofit Finance Fund™

Accumulated Surpluses

Reserves

Special Campaign or One-Time Gift

Operations

Targeted Fundraising

Wrap up: The Knowing-Doing Gap: Where are You?

Information Gap: Do you develop transparent, accurate and timely financial planning and management reports that give you the information you need?

Interpretation Gap: Do management and board collectively have the ability to understand, interpret and discuss the implications of financial information?

Decision-making Gap: Do you have a culture of making and following through on tough decisions?

Thank You!
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