

Nonprofit Finance Committee – Financial Management



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As we noted in the first article of this series, a key role of the nonprofit finance committee is to assess the organization's financial health and performance. The finance committee should review various financial data and ratios to accomplish this responsibility.

Financial Reports & Ratios to Consider

- **Financial Statements:** Review the organization's financial statements, including the statement of financial position (balance sheet), statement of activities (income statement), and statement of cash flows. These statements provide a comprehensive overview of the organization's financial position, revenue, expenses, and cash flow.
- **Budget-to-Actual:** Compare the actual financial results with the budgeted amounts. Analyze the variances to identify any significant deviations and investigate the reasons behind them. This helps assess the organization's financial performance and ability to execute its plan.
- **Liquidity Ratios:** Evaluate the organization's ability to meet its short-term financial obligations. Key liquidity ratios include the current ratio (current assets divided by current liabilities) or the quick ratio (current assets excluding inventory divided by current liabilities). These ratios indicate the organization's liquidity and ability to cover its immediate financial obligations. A result greater than 1 is desirable. If the organization does not accrue for payroll from month to month, be sure to add an estimate to the liabilities total for payroll-related responsibilities that exist at the date applicable to the calculation.
- **Viability Ratio:** Measure the organization's ability to assume new debt and cover its current obligations. This ratio is calculated by dividing unrestricted net assets (excluding any funds restricted by the board for specific purpose) by long-term debt. The generally accepted healthy minimum for this ratio is 1.25.
- **Fundraising Efficiency:** Assess the organization's fundraising effectiveness by analyzing fundraising ratios. For example, the cost per dollar raised (fundraising expenses divided by total funds raised) helps evaluate the efficiency of fundraising efforts. Similarly, the return on investment (ROI) for fundraising campaigns can provide insights into the effectiveness of specific fundraising initiatives.
- **Program Efficiency:** Examine the ratio of program expenses to total expenses. This ratio indicates the percentage of funds allocated to program activities versus administrative and fundraising costs. A higher ratio suggests a more efficient allocation of resources toward the organization's mission.
- **Debt Management:** Evaluate the organization's debt management by analyzing debt ratios. For example, the debt-to-equity ratio (total debt divided by total equity) helps assess the organization's leverage and financial stability. A high debt ratio may indicate higher financial risk.

- **Revenue Composition:** Review the organization's revenue composition to assess its diversification and sustainability. Analyze the proportion of revenue from different sources, such as grants, donations, program fees, and investment income. A diversified revenue base reduces the organization's reliance on a single source and enhances financial stability.
- **Reserve Levels:** Assess the organization's reserves and unrestricted net assets. Review the level of unrestricted net assets in relation to annual expenses or the organization's operating budget. This helps evaluate the organization's financial sustainability and ability to withstand unexpected financial challenges. Having at least six months of average operating costs in an accessible reserve account is best practice.
- **Cash Flow Analysis:** Evaluate the organization's cash flow statements to assess its ability to generate and manage cash. Analyze the organization's cash flow from operations, investing activities, and financing activities. This provides insights into the organization's cash generation, capital investments, and financing activities. If cash availability has been an issue, consider preparing a cash flow projection for regular review and analysis by the committee as well.

It's important for the finance committee to review these financial elements and ratios regularly to monitor the organization's financial performance, identify areas for improvement, and make informed financial decisions. Presenting these items through a mix of numerical, narrative and chart formats can be effective in promoting understanding and attention to trends is critical to creating context.

For advisory assistance developing effective tools for your finance committee, please contact [Kaydee Ruppert](#).