The Board's Financial Dashboard

We are always pleased to receive and respond to feedback from readers. One recent letter asked that we write more articles that spoke to board members of smaller organisations with few or no staff.

The following article is partly in response to that request. Although it is particularly relevant to directors of such organisations, especially those who do not consider themselves to be especially financially literate, it has relevance to a far wider range of organisations. We also know that there are many directors on boards of larger organisations, even commercial enterprises, who lack confidence in their grasp of financial affairs. We hope they too will find it helpful.

In previous issues of *Good Governance (*see *Good Governance #5* and *Good Governance #9)* we wrote about the board's financial responsibilities and its role in the budgeting process. In those articles we stressed that the board's role is financial governance, not financial management. In this article we will explore the concept of a board 'financial dashboard' as a means by which even the least financially skilled board members can confidently participate in *governing* the organisation's finances.

What is a dashboard?

Think of your car's dashboard. At a glance you can check the speed to see that you are within the law and the odometer to see how far you have travelled. The oil and water pressure gauges provide data about the state of the engine's lubrication and cooling systems and the tachometer indicates how fast the engine is running. All this without the driver needing to stop the car and look under the hood.

The financial dashboard serves the same purpose. A small number of carefully chosen financial indicators provide a snapshot of the finances so that, at a glance, directors can quickly satisfy themselves that 'all is as it should be'. Just as the car driver does not need to understand how the car's electronics produce the numbers on the dashboard, rather trusting that they are accurate, neither do directors need to be accountants to interpret the financial dials and lights. If an indicator tells us that everything is as it should be there is no need for further discussion. Time is then freed up so that the focus for the rest of the meeting can be forward, addressing strategic issues, rather than backwards, looking the rear vision mirror, so to speak. This is quite different from how many boards deal with their finances when, with no indicators, directors ponder over unanalysed or uninterpreted accounts trying to unravel them in order to find meaning. For many, meaning is never found. Others, with financial skills, place their own meaning on the pages of numbers but don't share this with the board. Rarely, in our experience, does the board as a whole have the equivalent of a dashboard - a set of agreed financial indicators providing a measure of financial health at a glance.

> ***The board then sets financial benchmarks or indicators that provide it with warning signals that alert to unacceptable performance or situations or circumstances that indicate potential harm to the organisation .***

Before describing the components of the financial dashboard it is important to take the car analogy a little further. While the dashboard provides a snapshot of the vehicle's performance while it is running, a car owner still has to periodically lift the hood to check that everything is working as it should. On a scheduled basis the car should be taken to a specialist for a thorough 'going over' with sophisticated diagnostic tools. So too should the board support its financial dashboard readings with regular specialist check-ups to provide assurance that the read-out from the various dials is accurate and can be relied on. Your external auditor and your audit committee provide these.

Developing the dashboard

How should a board develop its financial dashboard and what should be on it?

The development process sees directors agreeing the vital financial information they require for monitoring purposes and what results they want this information to confirm. The board then sets

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financial benchmarks or indicators that provide it with warning signals that alert to unacceptable performance or situations or circumstances that indicate potential harm to the organisation.

How much data and what data is on the dashboard will vary from organisation to organisation and from board to board. Larger organisations with investments and property will have more indicators than, say, a small organisation that breaks-even each year and whose only major cost is salaries. Regardless, we offer three key dashboard indicators that provide financial data that directors of even the smallest not-for-profit organisation need to know and understand.

1. The Current Ratio

There is a legal requirement that your organisation must not incur debts if it cannot meet these as and when they fall due. In other words the organisation must not trade while insolvent. Board members who knowingly or in ignorance allow their organisation to breach this provision expose themselves to breaching their duty of care and may face legal (and personal financial) liability.

One simple way for the board to be sure that the organisation is solvent and thus is able to meet its future debts is by ensuring that the organisation's **'current ratio'** remains in a healthy state. The current ratio is the ratio of current assets to current liabilities. Current assets are those that can be turned into cash or can be used within the operations of the business within one year. Note, this does not include so-called fixed assets such as buildings and vehicles. Current liabilities are those liabilities that must be met over the same timeframe. Examples of these are bills to be paid, staff wages, tax due, rent, hire purchase payments due and so on.

The current assets and current liabilities are usually itemised as separate lines on the balance sheet as shown in the sample balance sheet, *Figure 1*.

Traditionally a conservative measure has been 2:1 In other words the organisation should have at least $2.00 available for every $1 owed. Ideally the ratio should be at least 1.5:1.

The current ratio is best presented on a trend chart together with the numeric ratio (*Figure 2*), allowing directors to identify a trend and take action long before this gets to become a problem.

(Note - if your organisation is one that usually carries a large stock of goods it has produced a better measure might be the 'acid test' ratio which is similar to the Current Ratio.)

2. The Financial Bottom Line

While the sector is commonly known as the not-for-*profit* sector, we like to characterise it as the not-

Figure 1 - Example Balance Sheet

ASSETS	
CURRENT ASSETS	
Cash at bank	33,971.11
Petty cash	117.00
Debtors	30,301.52
Investments	90,253.33
TOTAL CURRENT ASSETS	**$154,642.96**
NON CURRENT ASSETS	
Furniture & Equipment	177,481.20
less provision for depreciation	(119,545.26)
Motor vehicles	62,553.30
less provision for depreciation	(21,867.65)
TOTAL NON CURRENT ASSETS	**$98,621.59**
TOTAL ASSETS	**$253,264.55**
LIABILITIES	
CURRENT LIABILITIES	
Creditors	21,837.62
Grants in advance	29,373.00
Accrued expenses	13,596.66
Provision for ADOs	1,694.28
Provision for annual leave	39,545.90
Provision for long service leave	-
TOTAL CURRENT LIABILITIES	**106,047.46**
NON CURRENT LIABILITIES	
Provision for long service leave	14,165.00
TOTAL NON CURRENT LIABILITIES	**14,165.00**
TOTAL LIABILITIES	**120,212.46**
EQUITY	
Accumulated funds	133,052.09
TOTAL EQUITY	**133,052.09**
TOTAL LIABILITIES AND EQUITY	**$253,264.55**

In this example the current ratio is $\frac{154{,}642.96}{106{,}047.46} = 1.46{:}1$

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for-*loss* sector. The cold-hard reality is that every organisation in the sector must, over time, make an operating surplus, however small, in order to survive. In some years there will be such a surplus, other years may result in a deficit, other times the result may be a balanced budget.

We strongly advocate that the board, in consultation with the CEO and other financial officers, should determine the desired financial outcome for each year and do this ahead of the budgeting process. This is contrary to what actually happens in most not-for-profit organisations.

While the budget summary is a useful management tool, it is of relatively little use to the board unless accompanied by other financial data.

Three things are achieved by doing things in this order. Firstly the CEO knows what result to design the budget to achieve. Secondly, the CEO has a board-determined target to work towards thus a criterion for him or her to report against. The third benefit is that at each board meeting, or as often as the board requires, the CEO might be required to report that the organisation is, or is not, on target to achieve the board-determined end-of-year financial result. Adjustments can be made to the target if required, or the CEO might be required to find efficiencies or make operating changes so that the original target can be met.

This measure too can be presented on a trend chart (Figure 2) providing a clear picture of trends and movements towards the targets set.

3. Budget Variances

We must confess to some ambivalence about what is, for many boards, a mindless and long-winded scrutiny of the so called 'budget report'. Our ambivalence is because this is often the only financial performance report that the board gets but, in many instances, it offers the board very little meaningful governance data. While the budget summary is a useful management tool, it is of relatively little use to the board unless accompanied by other financial data. The budget does not necessarily provide evidence of overall financial health nor does it create a picture of the various key components that contribute to financial health. We accept, however, that, in conjunction with other more global data, a budget report can provide the board with some assurance that expenditures and revenues are generally 'on target'.

Our concern is that the typical budget variance report is not set against any performance criteria. Thus the board has no objective basis for making judgements about the content of the report. For example, has the board said that there must not be any variances against planned figures? Has the board said that the CEO cannot shift money from one 'pot' to another making balancing adjustments? Few not-for-profit boards adopt policies that might guide the CEO and provide a useful reference point for board-level monitoring. Directors, receiving a variance report in the absence of such policy criteria can only guess at the significance of the trends revealed in the report. The CEO in turn will often find him or herself having to justify often sound and sensible financial management decisions that, in the end, support the achievement of an appropriate financial outcome.

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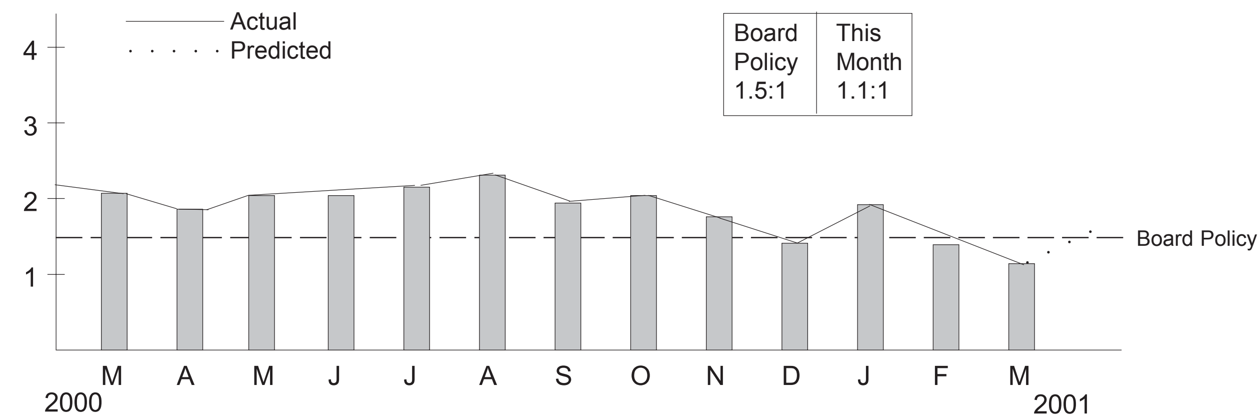
We recognise that few not-for-profit boards will be persuaded to dispense with the monthly budget summary, despite its inherent shortcomings. To assist to make the best use of such reports we recommend that a written description of the performance of the organisation against the budget should precede the figures. By presenting the report in this order the board looks at the meaning of the report before looking at the numbers. Secondly, we strongly recommend that the board should determine the performance variables it wants to control via the budget and make these clear to the CEO so that he or she has a focus for budget reporting and directors have benchmarks against which to monitor. Thirdly, budget reports should always be presented on a 13-month basis. In other words the last month's figures (budget and actual) should be compared with the equivalent month of the previous year. This assists in deciding whether variances are significant or simply 'seasonal'.

The budget report should be seen as the least important of the three financial reports presented by the CEO, the data relating to the overall financial position taking priority. ➢

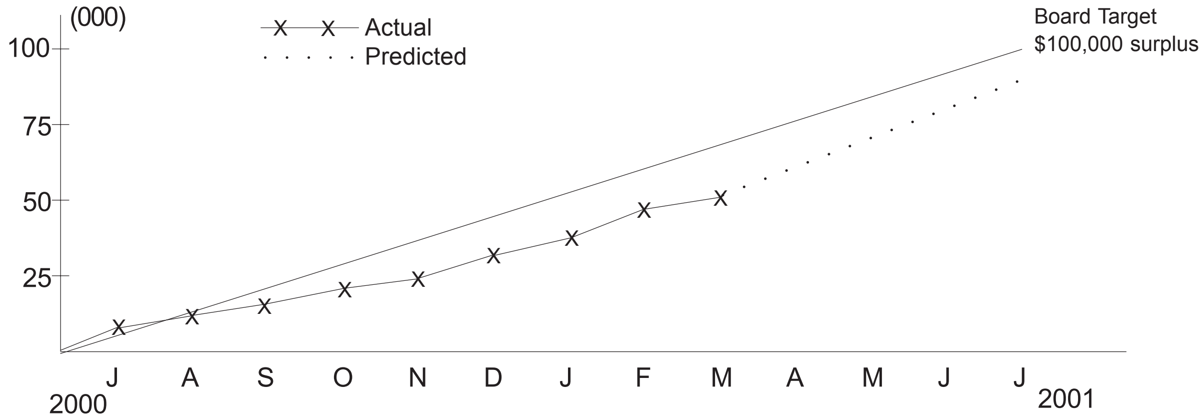
Figure 2 - Sample Financial Dashboard - 3 Key Indicators

Financial Report (Summary) for March 2001

1. Current Ratio



2. End of Year Result



3. Budget Management

I report that my management of the revenues and expenditures is consistent with sound financial management. I am on track to meet my budget estimates. I draw your attention to one breach of the board's Financial Planning policy and to one issue that may, at first glance, appear to create the impression of an unusual situation.

a. The Department is slow paying the quarterly grant. This has resulted in a negative cash flow for the last two months. Note the dip in the current ratio trend chart, the last two months points falling below the board's policy that I manage the cash flows such that the current ratio remains above 1.5:1. We can sustain the current cash flow situation for another month without creating any real threat to our operating requirements. I am in discussion with the Department regard their payment schedule and am confident that the matter will be remedied quickly. I thus predict that the ratio will fall in line with the board's policy within a month.
b. We are now paying all our insurance premiums as an annual lump sum payment to our broker. Thus the huge variation in the monthly budget assessment for insurance premiums. This will continue to read this way until the end of the year.

4. Attached Reports

a. Balance sheet for 3 months to March 2001
b. Consolidated Profit and Loss to March 31
c. Consolidated budget summary
d. Statement of investments.

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Other dashboard items

Some boards of larger not-for-profit companies may desire further summary information to be included on their financial dashboard. This data, which should have associated board-determined performance criteria could include:

- Debt ratio, or the debt to equity ratio
- Return on sales ratio (or profit margin)
- A report of the state of the companies investments
- A report of the state of reserves
- A report on debtors.

A sample 3 item financial dashboard is on page 11. ◆

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