NSW Office of Sport

SSO Business Performance Metrics

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Opening Comments

Context

- Comments from our August 2022 webinar on financial reports:
  - *"Financial reports provide you with the information needed to establish your business strategy, make management decisions, and understand the challenges your business is facing and/or the opportunities available to it.*
  - *It is critical to your business for a number of important responsibilities, including responding to stakeholder expectations, reviewing performance, decision making, planning, and forecasting."*
- True – financial reports provide you with necessary information to run your business, but to adequately review performance, and to get the most out of them for decision making and planning, you need to be able to interpret the full message provided by the financial reports.

The financial reporting and analysis formula

QFR / RRA = EUDM

- In the last webinar we considered the following financial reporting formula:

Timely + **R**elevant + **A**ccurate + **C**omplete = **Q**uality **F**inancial **R**eporting

(T+R+A+C = QFR)

- This webinar we consider what can be done with QFR by using ratio analysis:

$$\frac{\textbf{Q}\text{uality } \textbf{F}\text{inancial } \textbf{R}\text{eporting}}{\textbf{R}\text{elevant } \textbf{R}\text{atio } \textbf{A}\text{nalysis}} = \textbf{E}\text{nhanced } \textbf{U}\text{nderstanding and } \textbf{D}\text{ecision } \textbf{M}\text{aking}$$

(QFR / RRA = EUDM)

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What are ratios and how do they add value?

What is a ratio?

- A ratio is the relationship between two amounts showing the number of times one value contains or is contained within the other.
- Financial/accounting ratios help directors and business managers understand the effectiveness of their decisions, identify areas of the business that require attention, and to make meaningful comparisons between similar organisations.
- A ratio may take any of the following forms:
  - A percentage (e.g., gross profit as a percentage of sales)
  - A fraction (e.g., working capital as a fraction of capital employed)
  - A number (e.g., rate of stock/inventory turnover)
  - A proportion (e.g., current assets to current liabilities)

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Why should SSOs use ratio analysis?

Understanding your business better

- The primary purpose of financial reporting is to communicate **relevant** and **reliable** information about the organisation to users and stakeholders.
- However, financial statements on their own provide directors and managers with limited ability to understand the underlying drivers of business performance.
- Ratio analysis:
  - provides the extra information needed to better understand how your business is performing and what to do to make it perform better.
  - is commonly used to assess the financial health of an organisation and identify any potential problems affecting ongoing viability.
  - enables you to perform trend analysis (e.g. identify and examine changes in performance over a specific period) and benchmark its performance and financial position against similar organisations in the same industry.

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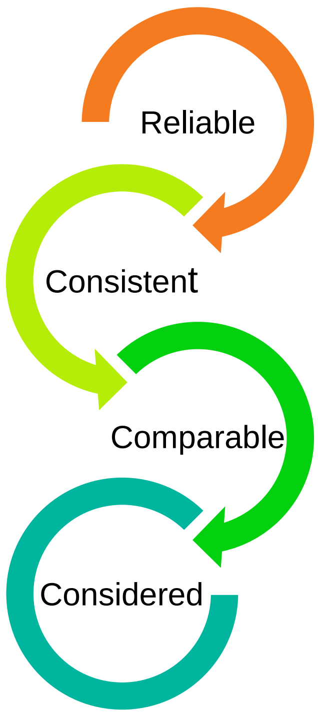
Financial ratios are useful if they are:



Based on timely, reliable accurate and complete financial reports (QFR)

Consistently calculated in the same way from period to period

Used in conjunction with pre-determined goals and available relevant benchmarks

Take both internal and external factors into consideration when being assessed.

Ratio analysis for SSOs

Specific challenges for NFPs

Measures commonly used by analysts in the commercial sector may not be as applicable to the NFP sector due largely to the “for purpose” or “not-for-profit” mission of that sector as opposed to the for profit distribution and equity models.

Whilst NFPs are largely represented as a single sector, the reality is that there is large variety of different types of organisations operating in the NFP sector with diverse operating characteristics, sources of revenue, objectives and stakeholder expectations.

Because of this variety, there are no standard NFP sector ratios to guide directors and managers.

Basic ratios for SSOs

Identified through NSW Office of Sport surveys

RATIO	CALCULATION	PURPOSE
Net income ratio	Operating surplus divided by total revenue	Measures the level of surplus generated from each dollar of revenue received. If the net income ratio is 30%, it means 30% of every dollar, or 30 cents is surplus. It also indicates the SSOs expenditure ratio for every dollar earned, which in this case is 70% or 70 cents.
Current ratio	Total current assets divided by total current liabilities	Allows an SSO to assess its ability to cover its liabilities as well as to grow and achieve strategic objectives. An important part of the budgeting process as it ensures there is sufficient working capital to fund operations. Aim for >1.5

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Basic ratios for SSOs

Identified through NSW Office of Sport surveys

RATIO	CALCULATION	PURPOSE
Debt to assets ratio	Total debt divided by total assets	A leverage ratio that indicates the percentage of assets that are being financed with debt. The higher the ratio, the greater the degree of leverage and financial risk. Ratio = 1 indicates the SSO is highly leveraged Ratio >1 indicates the SSO is extremely leveraged Ratio <1 indicates the SSO is able to sell assets to meet obligations if needed.
Revenue stream percentage ratio	Income from specific source divided by total revenue	Indicates how much a particular stream of revenue is contributing to total revenue. This is often beneficial in assessing the performance of a given strategic initiative, or in aiding discussions around where resources may need to be better focused.

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Basic ratios for SSOs

Identified through NSW Office of Sport surveys

RATIO	CALCULATION	PURPOSE
Cash expenditure cover ratio	Total cash and cash equivalents divided by total expenses less non cash expenses such as depreciation	Measures the number of days of operating expenses that the SSO can cover from existing cash and cash equivalents. Higher values indicate a stronger liquidity position, and it is considered good practice to have the equivalent of at least 3 months of operating expenses available in cash and cash equivalents.

Some other useful ratios to consider

Ratio	Calculation	Purpose
Own source operating revenue ratio	Total revenue excluding any grants and contributions divided by total revenue	This ratio measures fiscal flexibility. It is the degree of reliance on external funding sources such as operating grants and contributions. An SSO that is not heavily reliant on grants to fund its operations has more flexibility when unforeseen events occur.
Debt service cover ratio	Net surplus before including interest, depreciation, amortisation and impairment divided by interest and loan principal payments.	This ratio measures the availability of operating cash to service debt including interest, principal and lease payments. The higher the ratio the better, with best practice considered to be >2x

Making ratio analysis useful

Some further thoughts on adding value through ratio analysis

It is important to understand the drivers of the ratios to be able to identify what action to take if relying on them for decision making

As no single set of ratios is suitable for all NFPs (which includes SSOs) it is important that directors and management of each organisation determine what is relevant to them and select ratios that are fit for purpose.

Ratios are good for analysing trends and identifying changes that may require management attention. Trend analysis is far more useful than individual results of calculating the ratio.

If relevant information is available, ratios can be used for benchmarking, providing organisations an opportunity to evaluate their performance and position against other similar organisations.

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What about non-financial ratios?

What and why…

Not all performance measurement ratios are financial. Some may be numerical but the result is not expressed in dollars. Some use a combination of financial and non-financial data inputs. Examples include:

Strategy	Metric	Outcome
Focus on growing participation rates	Participation program costs compared to participation numbers.	The lower the number, the greater the impact.
To improve participation retention strategies	Number of repeat members compared to total membership numbers	The greater the number, the better the retention.
Increase web traffic to support key events	Event revenues per unique web site visit.	The more revenue per visit, the greater the impact of the web campaign.

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Frequently asked questions about ratios

Frequently asked questions about ratios

1. **What is the most important ratio?**

   Normally there is not one single ratio that is most important. SSOs should have a number of different focus specific ratios that collectively provide guidance on their business performance.

   If you are analysing your SSO's profitability, you might look at the net profit ratio, return on equity ratio or even the own source operating revenue ratio.

   If concerned about the amount of cash you have available you would calculate the days cash on hand ratio.

2. **How many ratios are there?**

   The number of ratios that you can use to analyse your financial data is unlimited. The key though is to use ratios that provide information that is beneficial, easily calculated consistently and provides enough information without creating information just for the sake of creating information.

   As a guide, SSOs should consider between 5 and 10 ratios, and be prepared to make changes as operating circumstances change.

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Frequently asked questions about ratios

3. **Are ratios an accurate indication of how well an SSO is performing?**

   The key to remember is that ratios are indicators and need to be considered in conjunction with other data such as the financial statements and other ratios.

   It is also important to remember that ratios are better at highlighting trends over a period of time, be it from year to year or even quarter to quarter if the shorter time frame is relevant.

4. **How frequently should an SSO perform ratio analysis?**

   As often as the information provided by the calculation is needed. Whilst financial ratio analysis is normally based on a recently prepared (and usually audited) financial report, financial and non-financial ratios can be calculated as frequently as required. If an SSO is monitoring its ability to continue operating, analysis will be performed more frequently. In some cases during the COVID pandemic, SSOs were relying on information being prepared on a daily basis.

Key takeaways from today's session

- Ensure any financial ratio analysis is based on quality financial reports
- If relying on trend analysis, ensure the data source and calculation are consistent
- Choose ratios that are specific to your SSO
- Identify the key objective of the analysis and what you want to use the information for.
- Have an expectation of what the result of the ratio analysis should be before the calculation.
- Ratios are are only part of the picture and should not be the only information relied upon to manage your SSO.

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Appendices

Readily available information to support your SSO

1. Financial Management Toolkit – (NSW Office of Sport)
   - oos-sports-financial-management-toolkit.pdf (nsw.gov.au)
2. Financial Management for not-for-profit organisations – (CPA Australia)
   - financial-management-nfp-organisations.pdf (cpaaustralia.com.au)
3. Useful financial sustainability indicators for not-for-profits – (Institute of Community Directors Australia)
   - Institute of Community Directors Australia (ICDA) | Not-for-profit…
4. Financial Ratio Health Check Tool – (NSW Office of Sport)
   - Financial Ratio Health Check Tool | NSW Government

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Thank you

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