Analyzing Vendor Financial Data Part 1: The Annual Report

Transcript

Hello, I'm Katharine Macy, and I'm the founding project director of the ONEAL project. And today I'm going to walk you through an exercise of digging into both the annual reports and the 990 for a nonprofit publisher. Now, at times during this presentation, I might say what type of operating margin or profit that they're making. And yes, technically they don't make a profit. What they do is they have what you would call a net change in assets without donor restrictions. And what that is, is the amount of money that they have at the end of the day after paying for all their expenses and other obligations to reinvest into their organization. And so if I do say profit, that's what I'm talking about. It technically isn't a profit because they're not making a profit. They're reinvesting those funds in the organization. But what we're able to do is take a look at these numbers and then understand, is there room where, yes, they're able to reinvest and perhaps grow their organization, but is there room to try to think about creating a more sustainable relationship between us and them where we partnered together to basically promote our own longevity and continue to be able to have a fruitful partnership with providing information to our patrons. We're going to get started with this right now. Basically, we're going to look at American Chemical Society and their 2021 annual report and their 990. You will have downloaded a spreadsheet and you can use Google Sheets or you can use Excel. I've opened this up in Excel really doesn't matter which you use. You're not going to be dealing with a lot of different formulas. You're mostly filling out this template. In this template you'll notice yellow cells and those are where you're going to be inputting information, everything else is calculated. I'm going to try to take you through this so that you understand a bit more about how to put this information in and how to interpret it. If we look at ACS's annual statement, you'll open it up. The first thing you see is the management statement of responsibility. And basically saying that they did their best to prepare and present a fair presentation of their financial information. Then we get to page three and we see the start of their consolidated financial statements. The first thing you're going to notice in here is that there is a date you see December 31, 2021 and 2020. This is the 2021 annual Report. This December 31 tells you what the end period is, that is telling you that period of time for the most recent fiscal year is January 2021 through December 31, 2021. And then their prior year, of course, would be 2020. In this case, we're seeing the fact that the calendar year and their fiscal year aligned. I'm going to go over to the sheet right here and I see what period of time is the most recent fiscal year. I'm just going to put it in January 1, 2021 through December 31, 2021. Since I also happen to know that the current year is 2021, I'm going to go ahead and put this in here. And then prior years 2020, just so we can keep track of it, I'll keep going into this report. And I see their auditor's report, and then that is immediately followed with their actual financial statements. Now the first thing you see in their financial statements is that it is in thousands. And how you would read this is for their assets, their cash and equivalents, you see $89,008. What that really means is that they have $89,008,000 of cash and cash equivalents. Basically, a number in thousands means you add a comma and three zeros to get their actual number. I'm going to go ahead and add this into the report, just so that I have that as a reference. In that way, I know that if I'm looking at any of the numbers that I've put it in here for the actual annual report, that I need to add three zeros to really understand the scope of that number. All right, so we really want to start looking at what I would, can traditionally think of as an income statement in a for profit company. But in this case, this is a nonprofit. Instead, we're looking at the statement that shows the change in net assets without donor restrictions from operations. And that really is like the nonprofit equivalent to a traditional income statement that you would see for a for profit. This is going to have information on their revenues and their expenses and we're going to be able to approximate out what we would think that they're earning, so to speak, before interest and taxes, their EBIT or what their operating margin happens to be, of course, technically they don't make a profit. So this is all about increasing their assets. So it's a net change in assets. From this, I can go in here and start populating pieces of information and data about the organization. We've got total operating revenues, and if I look over at this table, I'm going to find two numbers. I'm going to see this 685,674 and this 632,100. Those are my operating total operating revenues. [Entering into the spreadsheet] 685,674. 632,100. All right. We have that information. Now what I want to find is their total operating expenses, not including support activities. Let's look at this report. I see they're operating expenses in here for programs. And then I see their supporting activities and then I see their total operating expenses. If I also look at this chart, I see I need to figure out the total support activities costs, which is like their human resources, their finance, their IT and their marketing. To make our lives a little bit easier, what I'm just going to do right now, I'm going to add up those total support activities. That would be =58,537 + 41,643 + 28,421 All right. Then I'm going to do that also for 2020 55,521 + 23,256 + 20,512 And I'm missing the equal, so I'm going to add that in there. I have that information from here. I can then look and go, okay, I've got my total operating expenses which includes support activities and I want to basically not include that. I'm going to go ahead and take my number for total operating expenses, which if we look at this table 605,144 then I see for 2020 it's 569,639. I'm going to go 605,144, and then I'm going to just subtract the total support activities. I do the same thing here, where I go 569,639, minus total support activities. Just making sure I got my numbers right -- actually, if I look at these percent changes, I see that I can see the percent difference between these numbers. Whenever you see things that look a little off, like I see like a significant percent change here, I just want to make sure I double check it and make sure the numbers are right. In this case, it looks In this case, it looks like they had a significant drop in their IT - I mean a significant increase in their IT in their current year expenses. But whenever you see like double digit percent change, that's a good indicator that you want to double check your work. All right, now I want the change in assets without donor restrictions from operations. And I can find that line on this right below. Here is those numbers, 80,530 and 62,641. I can see that the current year they're "operating margin" [air quotes with fingers], so to speak, even though technically they don't have a margin because they're nonprofit, is 11.74% and then in 2020 is 9.88 So fairly healthy difference between their revenues subtracting out their expenses, they are bringing in a decent amount of money. The next thing we want to do is figure out the name of the publishing division of ACS. And if you can't immediately tell what that division is from the report itself, you can take a look at the notes to the Consolidated Financial Statements in this report and look at the information under revenue recognition to figure out what that is. I can tell you that if you look at that information, you're going to find that it's electronic and other information services and that's where it's showing up under operating revenues and then under expenses, they just have shortened it further to information services. So I'm going to go ahead and type that in there for my reference. All right. And now what I want is the operating revenues from this division. And I see it's 614,468 and 577,927. All right. That tells me, if I look at the next line, I'm calculating out percent of the operating revenues that this division is contributing to the entire operating revenues, which is a significant amount. You see that 89% and 91% of the total revenues is coming from this division. That's that tells you that they are relying on the revenue they're generating from their publishing division. Now, I want to put in operating expenses not including support activities. This is where I can find that under program activities, I see 390,510 and 394,920. Now, I can see here I'm like, sometimes in the formatting gets messed up when you are downloading spreadsheets. So I'm just going to go back here and just fix this number so that is a cleaner number. I see that we've estimated the support activities for this division based off of what it is overall. Using that, I have calculated out what I think the division contribution to change in net assets happens to be. I have calculations about how we got at these numbers. From there we can calculate out the division operating margin. And I'm seeing 17.69% and 15.96% for 2020. That is significantly more than their overall operating margin. Which is not surprising when you realize suddenly that From this division, they're making 135% of the total operating margin for the company, of the amount of growth in their assets, the internal assets, it's coming from this division. In fact, they're making up for shortfalls in other divisions. So if you see this over 100% you know that they're actually very much supporting divisions that are operating at a loss. And you can see the difference. Other information that can be really useful to look in here is you can get a breakdown of their expenses for a particular division. This can be informative and help inform you along the way, like does it look like they're spending an appropriate amount on compensation and benefits versus materials versus professional services, etc. Like, does it seem out of line with what you see in other publishers? And once you have enough experience being able to do this type of analysis, you might start seeing something that seems a little out of line that you can ask them about. Especially sometimes I wonder, and I look at numbers of financials as somebody and I go, why is your sales and marketing expense so high compared to maybe somebody else and when you think that they're sending seven people sometimes to present in person, you go, is that the most efficient way to do this? Can we figure out how to operate in a more sustainable way? This is just like the type of color that you can get out of digging into understanding like the breakdown expenses. You don't always need to do this. I just want to show you how you can do it to get this information. You're going to find it in the back part of the report. I want to say it's around page 34 of the PDF, but we will guess I am seeing All right. Oh, there we are. It's technically page 34, but it's 37 of of the total PDF. In here, you can see that there is a breakdown across categories for the different programs and we can gather this information and put this in here. I'm going to go ahead and add this to the report right now. I see 203287, 103324, 37635 24643, 517, 21104 for a total of 390,510 So that's really 390 million. I'm going to do the same thing for 2020. 199078, 104233 -- Again, I'm looking at these numbers down here. I'm going to scroll that up a little bit so you guys can see-- 37274, 26218, 397, 27720. That is correct. My totals equal out, but yeah, this just provides additional color. I'm going to go ahead and just clean this up a little bit more. That's the biggest thing that sometimes when you get in templates is just making the numbers look good so that they're easy for you to read. You can always find that formatting on the ribbon. There we go. So that is basically how I would dig into and understand the annual report. And again, like the big A-HAs! that I have from this is that the fact that they're making 11-12%, they're able to reinvest of the revenues they're making, they're able to reinvest around ten to 12% a year back into the organization. Then from that actually, if you really dig into the division itself, it looks like those margins are much closer to 16 to 18%. So they are very much supporting other divisions including membership and grants, you know, other programs, education, scientific advancement, that type of thing. So there is other things that they're supporting that don't bring in revenues or actually operate at a loss. That is true. But I would also say that at 12% of change in net assets, so to speak, after expenses, if you see this, I'm like, I'm just thinking that they there's probably a little bit of room where we should be having a better conversation about how do we make sure we're sustainable. We don't mind supporting them, but if we're supporting them at the cost of actually being able to keep our programs and personnel, that's a problem and it's a mismatch. I would just say this is a healthy margin for a nonprofit. And I just think there's room-- that's my own personal viewpoint and interpretation from that.