How Ratios Can Strengthen This Year’s Finances

Key measurements, reported right, can uncover significant trends.

By Vonna Laue

This article offers guidance for tracking budgets through various key financial ratios—along with insights on why these measurements are important for building financial health. Start the year right by monitoring these ratios now and into the years to come. Then watch for an upcoming article focused on monitoring debt ratios.

For many of the ratios, the top number should be divided by the bottom number. This will produce a usable measurement for tracking trends and making comparisons.

Income and giving ratios

There are four ratios that can help you better understand your congregation’s giving patterns.

1. Net income ratio

   ![change in unrestricted net assets](unrestricted revenues)

   This ratio reveals the change in unrestricted net assets to unrestricted revenues. It shows whether your church’s general operations are positive or negative, and by how much. It answers the question of whether the church is making or losing money in its day-to-day ministry.

   Obviously a church is not a business that’s trying to generate a profit to stockpile cash. However, if a church continually loses money in its basic operations, it will eventually have to close.

   The benchmark for this ratio is a positive result for the year. A more important benchmark, however, is for the ratio to show an improving trend over the years, factoring in both years of surpluses and years of deficits.

2. Unrestricted contributions per average adult attendee and giving unit

   ![unrestricted contributions](average adult attendees and giving units)

   This measurement introduces the concept of a giving unit. A giving unit is a group of family members, or any recurring supporter, who contributes jointly to the church. This excludes individuals who make a smaller one-time gift supporting a specific event. To identify only the regular recurring giving units, set a minimum dollar threshold, such as giving units that contribute more than $250 annually.

   This calculation can be compared to other years to see trends and determine the effects on the church and budget. It is also useful to calculate what contributions would be if every giving unit made a certain amount (e.g., $40,000 a year) and tithed on that amount. Your church could use this measurement to make the congregation aware of the current giving per adult attendee and giving unit, and what the projected giving level would be if everyone participated.

3. Total contributions per average adult attendee and giving unit

   ![total contributions - the combination of accrual pledges and large one-time gifts]

   average adult attendees and giving units

   The key difference between this result and the measurement of unrestricted contributions to average adult attendees and giving units is that this one uses total (unrestricted and restricted) contributions and removes the effect of pledges (which are essentially a noncash accrual) and large one-time gifts.

   The power of this measurement comes through analyzing trends in congregational giving habits from year to year. During the period of a capital campaign this figure may be inflated due to an increase in smaller gifts, which are not removed from the calculation.
4. Median household income given to the church

**total contributions per average adult attendee and giving unit (Measurement 3)**

**local median household income**

This ratio determines total contributions per average adult attendee and giving unit to local median household income (from the US Census Bureau, *American Community Survey*). It shows what percentage of the local median county household income adult attendees and giving units are contributing. In essence, it reveals the additional giving capacity of your congregation.

The trends in this data from year to year are important because there are two indicators that affect the outcome of this ratio: congregational giving and local median household income. For example, if local median county income decreased from one year to the next, the measurement could appear to increase while overall giving actually remained the same.

This measurement will enable church leaders to see changes in giving habits from year to year in response to stewardship teaching and focus.

### Cash flow ratios

A church without necessary reserves will be scrambling to operate in the short term, no matter what the other balances are. Positive net income and net asset balances won’t make up for inadequate cash reserves or help in months when giving is down. Fortunately, there are five cash-flow measurements you can use to monitor reserves and identify any needed adjustments.

Numbers 1 through 3 offer different cash flow ratios you can use to calculate how many days of cash reserves your church has, using different perspectives from the financial statements. The result of each calculation is multiplied by 365 to determine a total number of days.

**1. Days of expendable net asset reserves**

- unrestricted, undesignated net assets + board-designated net assets for operations

- cash expenses (total expenses - depreciation) x 365

The first “days of cash” ratio tells how many days of operating expenses are available in net asset reserves. It takes into account the accrual of current assets and current liabilities. Expendable net assets represent the total resources available to spend on operations, excluding future gifts made or revenues generated by the church. It’s similar to a savings account.

Expendable net assets consist of unrestricted, undesignated net assets, which are net assets that result from achieving positive net income from all sources of revenues (excluding restricted revenues). It also includes amounts designated by the board for operating purposes other than capital expenditures. You divide this total by the amount of cash expenses to find your net asset reserves. Since all of these ratios measure cash flow, I use the term “cash expenses.” These are total expenses less depreciation, the most significant noncash expense recorded.

**2. Days of operating cash and investments on hand to fund annual cash expenses**

- operating cash and investments x 365

This second “days of cash” ratio calculates the days of operating cash and investments on hand to fund annual cash expenses specifically related to liquid assets. That means it only considers operating cash and investments, not other current assets and liabilities. Again, you divide operating cash and investment by the sum of cash expenses plus capitalized interest (interest paid in cash but not expensed by the church) to find on-hand funds.

This measurement will calculate a result that is slightly different (typically higher) than the first ratio (net asset reserves) because it does not include the impact of other current assets and liabilities.

An appropriate benchmark for this ratio is to have 40 to 80 days of cash expenses on hand. Furthermore, a result of less than 20 days could indicate that your church should take action quickly to improve this measurement.

**3. Available days of cash flow coverage**

- operating cash and investments x 365

This final “days of cash” ratio represents the number of days of operations (including making scheduled debt payments) available when calculated from the sum of operating cash flow. This number comes from the statement of cash flows, operating cash and investments on hand at the beginning of the year, and the amount available from the operating line of credit.

Again, divide beginning cash, cash flows from operations, and available line of credit by the amount of total cash expenses and debt principal payments.

Here’s another way to state this: If your church used all of the cash generated from operations, all available cash and investments on hand at the beginning of the year, and your available line of credit, how many days would you be able to operate on these sources of cash? This number represents your maximum level of reserves, and should always be the highest of the three “days of cash” numbers.

**4. Liquidity ratio**

- operating cash and investments

 current liabilities – building fund current liabilities, deferred revenue, and short-term construction line of credit

The liquidity ratio measures how operating cash and investments are able to cover current operating liabilities, which exclude current building fund liabilities. (These typically have a separate source of cash from restricted revenues or budgets.) This ratio reveals how many times actual **operating** liabilities can be funded from **operating** reserves.

Divide operating cash and investments by current liabilities (excluding those items noted in the ratio).

A low result may indicate that the church is keeping fewer liquid reserves and is less likely to be able to handle unexpected operating expenses, events, or new opportunities that may come along.

**5. Net cash availability measurement**

- total cash and investments – adjusted current liabilities (current liabilities excluding amounts borrowed on a construction line of credit) and temporarily restricted net assets

The fifth and final cash flow item is not a ratio but a measurement of the sum of total cash and investments less certain amounts the church may owe or be required to spend for specific purposes due to donor restrictions. This measurement calculates the amount of cash available for other uses after the church has satisfied its adjusted current liabilities and set aside appropriate funds for temporarily restricted projects. Amounts borrowed on a construction line of credit are also excluded, as they will ultimately be refinanced with the debt and paid over time.

Your statement of financial position answers the question, “How much cash do we have?” but it doesn’t answer the question, “Whose cash is it and how much of it can we spend?” The answers to those questions are typically very different. Therefore, **this is one of the most important measurements you can provide church leadership**.

The minimum for this number is at least one month’s worth of cash expenses. Any positive amount less than this is in the warning range. Any negative amount indicates the church is borrowing from temporarily restricted funds—a warning that corrective action is needed.

### Expense ratios

Expense ratios can help identify trends in the outflow of resources over the years. They also allow you to compare your church with other churches and check the reasonableness of your expenses.
1. Personnel and mandatory debt service payments to total expenses (excluding depreciation expenses)

Personnel (salaries including benefits) + mandatory debt service payments (principal + interest expense) = total expenses - depreciation expense

The largest expense of most churches is salaries and benefits. Debt service payments—which are a reduction of a liability and not an expense—represent the second largest outlay. Together, these items represent a majority of resource outflows from the local church.

Continually monitor these levels as a percentage of cash expenses. Cash expenses are total expenses minus depreciation, the most significant noncash expense recorded. It is also important to promptly follow up on changes in trends or unusual variances from peers to ensure that your resources are continually maximized.

This ratio, which can be split into two separate pieces, allows you to look at two of your largest outflows and determine the portion of the operating budget that will be used. Often, a growth cycle results in an amount of debt the church anticipates being able to pay off as more people start attending. However, the church needs to be able to pay the bills and provide the services that will attract new people with the current budget. Reviewing this ratio in advance of any major debt decisions will help you analyze the feasibility of facility expansion goals.

Reasonable benchmarks for these ratios are:

- Personnel costs (salaries and benefits) should fall between 40 percent and 55 percent of expenses.
- Mandatory debt service payments, including interest, should be no more than 15 percent of total expenses.
- Total personnel and debt service costs should be no more than 40 percent to 70 percent of total church expenditures.

2. Expenses (excluding depreciation) per average adult attendee and giving unit

\[ \text{total expenses (excluding depreciation expense)} \]

\[ \text{average adult attendees and giving units} \]

This measurement tells you the cost to the church for each adult attendee or giving unit. It takes total cash expenses and divides that total by the average adult attendees or giving units.

The power of this measurement is in the peer group comparison. This allows your church to see if your cash expenses are high or low compared to your peers. Analyzing trends over the years is also important. Another benefit of this measurement is that it can be subtracted from total contributions per attendee and giving unit to show if contributions are high enough to cover the monetary cost per individual. In other words, are you taking in enough contributions to cover the costs of having people attend your church?

3. Total missions categories to total expenses

This ratio looks at the combined total of local and global outreach (missions and benevolence) expenses as a percentage of total expenditures. It can be separated into two pieces and calculated by local and global activities. Global activities include actual expenditures for cross-cultural missions activities in the United States and other countries. This includes direct support to missionaries; outside agencies, including national partners; and cross-cultural missions trips. It also includes internally allocated costs and salaries of employees included within missions for some church budgets. This is because internal allocations vary significantly among churches.

Local outreach includes expenditures for local missions activities not classified as "global." This includes direct support of community-based church ministries, local missionary agencies, and benevolence given to local individuals. It excludes internally allocated costs and salaries of church employees included within missions for the same reason as stated above.

This ratio can be useful in benchmarking your total outreach expenditures with other churches. More importantly, when a church experiences economic difficulties, the ministry and mission expenses are usually the first to be decreased as debt service payments are not discretionary and personnel costs are difficult to reduce. Declines in this ratio can allude to other issues. Monitoring these ratios over time will allow the church to identify any significant changes.

4. Facility cost per square foot (excluding interest expense)

\[ \text{total facility costs (excluding interest expense on the debt and depreciation)} \]

\[ \text{total facility square footage} \]

This measurement answers the question, "How much does it cost to operate the church building?" Total facility costs include building and grounds maintenance, personnel salaries and benefits, outside contract labor, utilities (excluding telephone), security, liability insurance, and rent or mortgage payments. It should also include the cost of general repairs to the facility and other facility-use expenses, but not equipment purchases or the cost of major renovations. This overall expense excludes both vehicle-related expenses and interest expense on debt and depreciation.

Facility expenses measurements can vary, depending on whether the church has new or older facilities and is in one or multiple locations. Facility expenses measurements can also vary by geographic area. The most accurate comparison would be against churches with buildings of a similar age as yours (e.g., built within a decade of your own).

Valuable insights, proactive tools

The ratios detailed above can provide valuable insights for leaders. They are tools that can be used proactively to minimize the need to respond to financial crises later.

Vanna Lane is a CPA, editorial advisor for Church Finance Today, and executive vice president of the Evangelical Council for Financial Accountability. This article is adapted from these three articles on ChurchLawAndTax.com: “4 Income and Giving Ratios Your Church Should Monitor,” “5 Cash Flow Ratios and Measures Your Church Must Monitor,” and “4 Expense Ratios and Measurements Your Church Should Monitor.”

Is Giving Outside of the Church Okay?

Many evangelical leaders give a thumbs up to tithes that include nonchurch ministries.

Survey question: Is it acceptable for a Christian who tithes 10 percent to give part of that 10 percent to ministries outside of the local church?

- 24% No
- 76% Yes

Source: The Evangelicals Leaders Survey, a monthly poll of around 100 board members of the National Association of Evangelicals. Those participating in this survey include the CEOs of denominations and representatives of a broad array of evangelical organizations, including missions, universities, publishers, and churches.
Notes & Numbers

Saving on Health Care

Whether or not you offer employees health insurance, you can still help them save on medical expenses. Here's a saving tip worth passing along to them—from Kiplinger Financial Adviser:

Shop [around] for the best price on X-rays, tests, and even some types of surgery. At HealthcareBluebook.com, you can see a cost estimate for thousands of procedures in your area. To save on prescriptions, always ask about generic drugs, which can cost up to 85 percent less than brand-name drugs. If your drug doesn't have a generic equivalent, ask your doctor if there is a "therapeutic alternative" that treats the same condition but costs less under your plan. If you have a high-deductible health insurance policy, you can take advantage of a triple tax break: Contribute pretax (or tax-deductible) money to a health savings account, which in turn grows tax-deferred and can be used tax-free in any year for medical expenses.

Key Tax Deadline

February 10, 2018

 Churches having nonminister employees (or one or more ministers who report their federal income taxes as employees and who have elected voluntary withholding) may file their employer's quarterly federal tax return (Form 941) by this date instead of January 31 if all taxes for the fourth calendar quarter of 2017 have been deposited in full and on time.

The free Tax Calendar—available on ChurchLawAndTax.com/tc—provides reminders about regular, semiweekly, and monthly withholding requirements, plus other upcoming dates and deadlines related to church taxes.

Q: What is—and isn't—tax deductible for donors who attend a church spaghetti dinner fundraiser?

Our church group hosted a spaghetti dinner to raise money for hurricane disaster relief. How do we determine what is a donation and what is payment for the spaghetti dinner, or can a donor's entire check for the dinner work as a tax-deductible donation?

A: If the understanding with the participants was that the "price" of the dinner was a donation of any amount, the Internal Revenue Service considers this to be a quid pro quo arrangement. Under such an arrangement, the value of the dinner (not the dinner's actual cost) is what you use to determine the nondeductible amount. In making that determination, the law allows you to make a "good faith estimate." For instance, you could say that the value of the dinner is worth what a comparable meal would cost at Fazoli's.

However, if the understanding was that it was a free dinner and an "ask" was made for contributions at the dinner, it is not a quid pro quo arrangement, and the entire amount donated by each participant is tax deductible.

The requirement to issue a proper receipt for the quid pro quo arrangement applies only to payments by donors of more than $75. Further, the law allows you to ignore the quid pro quo arrangement if the value of items received in exchange is 2 percent or less of the gift amount—up to $107 for the value of items received in exchange, for items received in 2017. The amount is inflation-adjusted each year. The amount is up to $109 for 2018.

For IRS guidelines on issuing a proper receipt for a quid pro quo arrangement, go to IRS.gov and search "quid pro quo contributions." You'll also find guidelines for issuing receipts for quid pro quo arrangements, along with guidelines for issuing receipts for donations over $250 that aren't quid pro quo, in chapter 8 of the 2018 Church & Clergy Tax Guide (ChurchLawAndTaxStore.com).

—Michael Batts, CPA and editorial advisor for Church Finance Today

To submit a question for consideration in a future Q&A, email editor@churchlawandtax.com.

Money Talks That Help Congregants

Your church can talk about money without being awkward and actually help people:

• Free your pastor to preach about money. And not just tithing or "give us your money," but how we're supposed to think about money as kingdom people.

• Offer classes on money management. Help people understand the danger of debt and the value of savings.

• Talk about generosity. We should be generous people, with our money, with our time, with our lives (and not just to the church).

—ChurchMarketingStinks.com

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Download the SkillBuilders on "6 Benevolence Fund Best Practices." Visit CLTstore.com/SkillBuilders by February 28 and enter the code GBF8P7 at checkout.

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