First Nations FINANCIAL MANAGEMENT BOARD | CONSEIL DE GESTION FINANCIÈRE des Premières Nations

Proposed Standards and Performance Measures for Not-for-Profit Organizations – Invitation to Comment

June 16, 2020

Standards and Certification
First Nations Financial Management Board

Comments to the FMB must be received by September 30, 2020
standards@fnfmb.com

Executive Summary

In December 2018, the *First Nations Fiscal Management Act* ("the Act") was amended to include several new sections, including Section 50.1. As a result of this amendment, the First Nations Financial Management Board ("FMB") is now authorized under subsection 50.1 (3) of the Act to develop new standards for financial performance, laws or by-laws respecting financial administration, and financial management systems for five new types of organizations, including tribal councils and not-for-profit organizations.

The Not-for-profit Standards ("NPO Standards") introduced in this document have been developed specifically for tribal councils and other not-for-profit organizations established to provide public services, including social welfare, housing, recreational, cultural, health or educational services, to Aboriginal groups or Aboriginal persons (referred to collectively as "NPOs"). As the structure and operations of these organizations are vastly different from the First Nation governments that the FMB currently serves, brand new financial management practices and financial performance measures have been researched and developed by the FMB in order to best serve this new client segment.

> The NPO Standards have been published in a separate publication called ***Not-for-Profit Organization – Proposed Standards***. It is available for download on the FMB's website. This document is intended to act as a companion to the proposed NPO Standards and provides a background on the development of the Standards by the FMB. Readers will need to refer to the separate document to see the proposed Standards.

The proposed NPO Standards consist of two parts: financial management practices and financial performance measures.

Part 1 – Financial Management System Standards for NPOs. Part 1 will cover financial management practices, similar to the FMB's existing Financial Administration Law Standards and Financial Management System Standards for First Nation governments. The NPO will need to demonstrate that it has incorporated the financial management practices (as described in the NPO Standards) within its corporate by-laws and has implemented these practices.

For Part 1, the FMB has developed a series of financial management standards based on an internally developed control framework show in **Figure A** on the following page. The NPO Standards include detailed requirements within each of these five key areas of financial management. A background on the development of this part of the Standards is included in Part 1 of the NPO Standards section of this document.

Figure A - FMB's internal control framework for NPOs

Part 2 – Financial Performance Measures for NPOs. Part 2 will cover financial performance measures; similar to the FMB's existing Financial Performance Standards for First Nation governments. The NPO will need to demonstrate that it is in compliance with a set of financial performance ratios that measure the NPO's historical financial performance.

Part 2 is composed of five financial performance measures that will be used to measure a NPO's financial capacity, its ability to sustain and/or grow its fiscal balance, its investment in tangible capital assets, and its ability to manage its overall level of debt, shown in **Figure B** – Summary of proposed financial performance ratios on the following page

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A background on the development of this part of the Standards is included in Part 2 of the NPO Standards section of this document.

Figure B - Summary of proposed financial performance ratios

FISCAL GROWTH RATIO	OPERATING MARGIN RATIO	ASSET MAINTENANCE RATIO	NET DEBT RATIO	INTEREST EXPENSE RATIO
[(Total revenue in the CY less total revenue in the PY) / (Total revenue in the PY)]	[(Total revenue less total expenses) / (Total revenue)]	[(Total tangible capital asset expenditures) / (Total amortization expense)]	[(Total liabilities less total assets, TCA, prepaid expenses and inventory) / Total revenue)]	[(Total interest expense) / [Total revenue)]
This ratio measures the year-over-year revenue growth.	This ratio measures an organization's ability to generate revenue to satisfy expenses.	This ratio determines if the overall asset base is increasing or being replenished.	This ratio measures an organization's ability to manage debt, specifically, the net debt burden in relation to one year's annual revenue.	This ratio measures the total amount of interest incurred relative to total revenue. This measures an organization's ability to manage its overall level of debt.

The FMB is committed to being responsive and listening to the needs of NPOs and other First Nations Institutions. **The FMB is seeking comments and input prior to introducing these new Standards.** This input will be critical in developing standards that are relevant to the NPOs that will use them. This document and invitation to comment is intended to fulfill the commitments of transparency and responsiveness contained in the FMB's *Standard Setting Guidelines*.

The FMB welcomes all comments on the proposed NPO Standards, including any suggested changes. Given the disruptions caused by the current COVID-19 situation, the FMB wants to allow sufficient time for all interested stakeholders to provide comments and therefore the FMB is significantly extending the usual 45-day comment period. **The FMB requests that comments on the proposed NPO Standards be provided by September 30, 2020.**

Following the comment period and analysis of the feedback received, the FMB expects to issue the new NPO Standards in Q3 or Q4 2020-2021 depending on the volume and nature of comments received. The NPO Standards will become effective on the date determined by the FMB's Board of Directors. NPOs can then begin working with and applying these new NPO Standards.

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Why is the FMB developing new standards for NPOs?

In December 2018, the *First Nations Fiscal Management Act* ("the Act") was amended to include several new sections and changes. The purpose of the amendments was to clarify certain areas of the Act, address gaps, increase flexibility and expand access to the Act. A number of these amendments were based on recommendations advanced by the First Nations Financial Management Board ("FMB") and the other First Nations Institutions made over a period of several years.

With these amendments, the FMB is no longer limited to providing services and developing standards only for First Nation governments who are Scheduled to the Act. With the addition of the new section 50.1 of the Act, the FMB is now authorized to develop new standards and perform reviews for financial performance, laws or by-laws respecting financial administration, and financial management systems for five new types of organizations:

- *(a) a band that is not named in the schedule;*
- *(b) a tribal council;*
- *(c) an Aboriginal group that is a party to a treaty, land claims agreement or self-government agreement with Canada or with a province, or an entity established under, or as a result of, such a treaty or agreement;*
- *(d) an entity — owned or controlled by one or more First Nations or entities referred to in paragraphs (a), (b) or (c) — whose mandate is primarily to promote the well-being or advancement of Aboriginal people; or*
- *(e) a not-for-profit organization established to provide public services, including social welfare, housing, recreational, cultural, health or educational services, to Aboriginal groups or Aboriginal persons.*

The purpose of this new section is to respond to a need expressed to the FMB and the other First Nations Institutions by First Nations governments and other organizations to participate in the services offered under the Act, including FMB certification and access to borrowing with the First Nations Finance Authority ("FNFA"). Section 141.1 of the Act allows Canada to develop new regulations to adapt the Act in a way that would permit the FMB to certify these new entities and provide access to the lending services of the FNFA[1]. Although the FMB cannot provide certification services until these new regulations have been enacted, section 50.1 of the Act provides the FMB with the authority to develop the relevant standards and to evaluate and report on compliance upon request by these new types of entities.

The Not-for-profit Standards ("NPO Standards") being introduced in this document have been developed specifically for the two types of entities listed in paragraphs 50.1 (1) (b) and (e) of the Act: **tribal councils** and **not-for-profit organizations**[2].

[1] Section 141.1 was also added in December 2018. These new regulations are under development as of the date of publication of this document.

[2] The FMB's existing standards for First Nation governments would apply to any First Nation that is not named in the schedule for the purposes of paragraph 50.1 (1) (a). It is expected that new standards and procedures will need to be developed by the FMB to accommodate the unique legal relationships that exist for modern treaty or self-governing Nations described in paragraph 50.1 (1) (c) and those entities described in paragraph 50.1 (1) (d).

As the structure and operations of these not-for-profit organizations are vastly different from the First Nation governments that the FMB currently serves, brand new financial management practices and financial performance measures have been researched and developed by the FMB in order to meet the needs of this new client segment. The results of this research are the NPO Standards presented in this document.

The FMB is excited to begin working with and providing support to tribal councils and not-for-profit organizations to put sound financial management practices in place.

Who are these new NPO Standards for?

As noted above, the new subsection 50.1 (1) of the Act extends the FMB's mandate for providing services based on new standards to five new types of entities. These NPO Standards are being designed specifically for **tribal councils** and **not-for-profit organizations**. For the purpose of this document, these entities will be collectively referred to as "NPOs"[3].

It is important to note that for not-for-profit organizations, the organization must meet the definition set out in paragraph 50.1 (1) (e) of the Act: "*a not-for-profit organization established to provide public services, including social welfare, housing, recreational, cultural, health or educational services, to Aboriginal groups or Aboriginal persons*". The FMB expects that a wide variety of organizations will meet this requirement and be eligible for FMB services.

What process does the FMB follow when setting new standards?


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STANDARD-SETTING

GUIDELINES

FIRST NATIONS FINANCIAL MANAGEMENT BOARD
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EFFECTIVE: DECEMBER 14, 2015
APPROVED BY BOARD OF DIRECTORS: DECEMBER 14, 2015

The FMB is committed to being responsive to the needs of the users of its standards and to the needs of its other stakeholders. In the context of setting and developing these new NPO Standards, this means listening to NPOs and understanding their first-hand experience.

To guide our efforts in this area, the FMB has published its own Standard Setting Guidelines. These Guidelines (available on our website) describe how the FMB will remain transparent in its standard setting activities and how NPOs and other stakeholders can participate in this process.

This document and invitation to comment is intended to fulfill the commitments of transparency and responsiveness contained in our Standard Setting Guidelines.

In developing new Standards, the FMB conducts analysis to assess the potential impacts of proposed standards on its prospective clients, other First Nations Institutions and other stakeholders, as necessary. Where a change would impact another First Nations Institution, such as the FNFA, the FMB staff will consult with the other Institutions and request their feedback on any proposed amendments. The FMB has also involved its legal and professional advisors, where appropriate.

[3] For the purpose of this document, the references to 'non-profit organization' and 'not-for-profit organization', including their acronyms, are considered to be equivalent.

The FMB is looking for feedback and comments on its proposed NPO Standards prior to introducing the new Standards. This input is critical in developing standards that are relevant to NPOs and responsive to their needs. The FMB welcomes comments on all aspects of these proposals, including any additional suggested changes.

Given potential disruptions caused by the current COVID-19 situation, the FMB wants to allow sufficient time for all interested stakeholders to provide comments and therefore the FMB is significantly extending the usual 45-day comment. **The FMB requests that comments on the proposed NPO Standards be provided by September 30, 2020.**

Following the comment period, the feedback collected from clients, stakeholders, staff and other First Nations Institutions will be analyzed by the FMB to determine whether any changes to the proposed NPO Standards are necessary. Depending on the volume and nature of the comments received during the comment period, the FMB plans to publish the final NPO Standards sometime during Q3 or Q4 2020-2021. The Standards will become effective on the date determined by the FMB's Board of Directors following their release. NPOs can then begin to work with and apply the new NPO Standards.

FMB Certification for NPOs

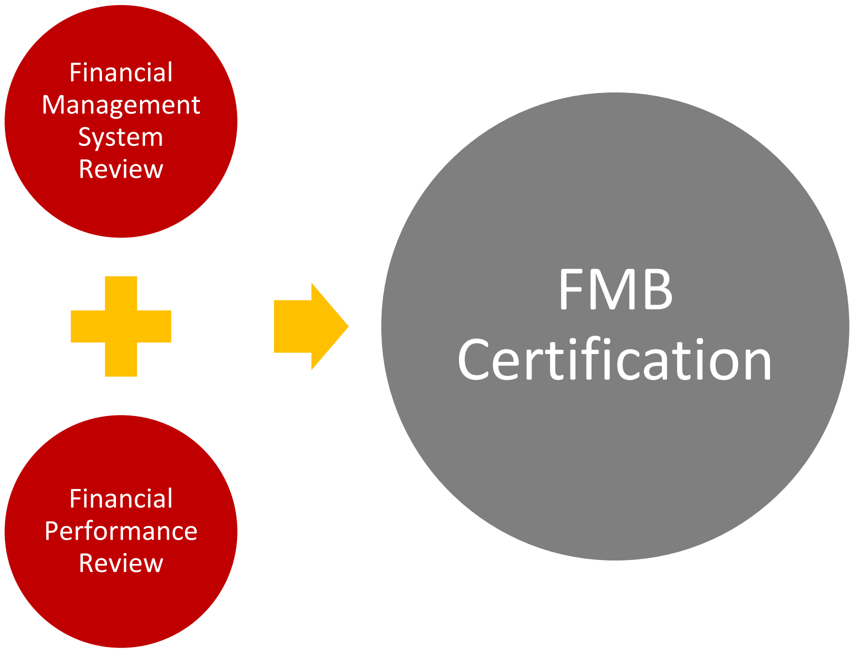
These NPO Standards are being developed to respond to the compliance evaluation and reporting needs of not-for-profit organisations under subsection 50.1 (1) of the Act. They have also been developed in anticipation of being used as a basis to issue a certificate to a NPO under yet-to-be developed regulations referred to in section 141.1 of the Act. It is anticipated that this new type of certification will allow eligible NPOs to become borrowing members of the FNFA.

The new section 141.1 of the Act allows for new regulations to be developed by the federal government of Canada that will adapt the Act to allow NPOs[4] to be certified by the FMB and therefor eligible to become a borrowing member of the FNFA. These regulations under section 141.1 are still currently under co-development by Canada, the FMB and the FNFA. Until such time that these new regulations are published and come into force, the FMB will not have any authority to issue a certificate under the Act to an NPO; however, the FMB is presently able to provide services to NPOs, including compliance reviews against FMB's NPO Standards and the issuance of reports containing compliance opinions.

It is anticipated that the NPO certification process will involve two parts, as illustrated in **Figure C** – Proposed NPO Certification overview on the following page. The first part will consist of a Financial Management System ("FMS") review requiring evaluation of the NPO's corporate by-laws and implementation of those by-laws against the FMB's NPO Standards. The second part will consist of a Financial Performance ("FP") review, consisting of a review of the NPO's historical financial performance against the performance measures established in the FMB's Standards.

[4] Specifically, those referred to in paragraph 50.1 (1) (e) - a not-for-profit organization established to provide public services, including social welfare, housing, recreational, cultural, health or educational services, to Aboriginal groups or Aboriginal persons

Figure C - Proposed NPO Certification overview



NPO Standards

In developing new standards for NPOs, it was important to gain an understanding of the unique characteristics of NPOs and how these unique characteristics might influence the selection of standards and ratios used to evaluate financial management and financial performance. From this research, the FMB has observed a significant diversity of NPOs. Diversity in the types of services provided, the organization's size, its revenue sources, the financial reporting framework applied and its regulatory framework.

The FMB's NPO Standards will be different from the FMB's existing standards for First Nation governments to reflect the different structure and operations of NPOs. As a result, the FMB's new NPO Standards have a different look and feel, but do retain a similar underlying structure to the FMB's Standards for First Nation governments.

> The NPO Standards have been published in a separate publication called ***Not-for-Profit Organization – Proposed Standards.*** It is available for download on the FMB's website. Readers will need to refer to the separate document to see the proposed Standards.

As previously noted, there will be two parts to the NPO Standards

- **Part 1 – Financial Management System Standards for NPOs.** Part 1 will cover financial management practices; similar to the FMB's existing Financial Administration Law Standards and Financial Management System Standards for First Nation governments. The NPO will need to demonstrate that it has amended its own corporate by-laws, established any needed policies and implemented the financial management practices required by the NPO Standards.

- **Part 2 – Financial Performance Measures for NPOs.** Part 2 will cover financial performance measures; similar to the FMB's existing Financial Performance Standards for First Nation governments. The NPO will need to demonstrate that it is in compliance with a set of financial performance ratios that measure the NPO's historical financial performance.

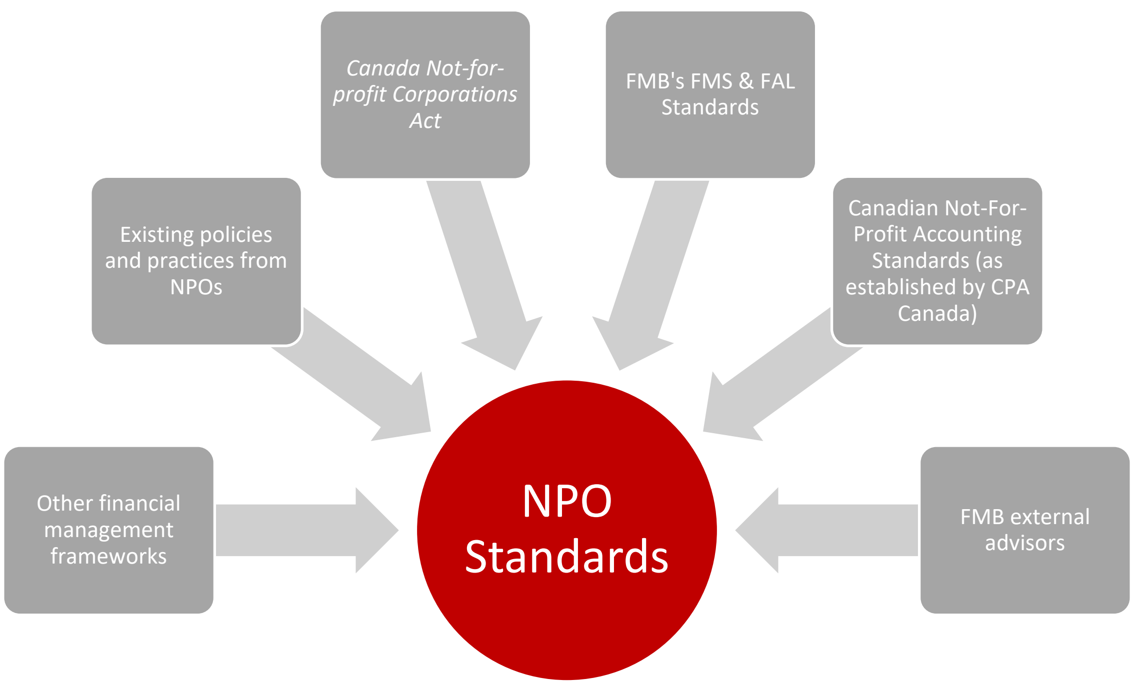
Each part of the proposed NPO Standards is explained in further detail in the sections that follow.

Part 1 - Financial Management System Standards for NPOs

Part 1 of the NPO Standards focuses on financial management practices designed specifically for NPOs. These new standards will be the framework used by the FMB to assess a NPO's internal control environment and will eventually be used to determine eligibility for Certification.

One of the primary objectives of the new NPO Standards is to establish standards for best practices in financial administration for NPOs. When considering which standards to include in the financial management section of the NPO Standards, the FMB considered the unique regulatory and operating environments of NPOs as well as other established frameworks for financial management and financial reporting. The FMB reviewed existing resources for NPO industry policies to identify best practices. This research included reviewing existing policies from a sample of NPOs and advice from external advisors with expertise in the not-for-profit sector. **Figure D** below illustrates the sources used by FMB in researching and developing the NPO Standards.

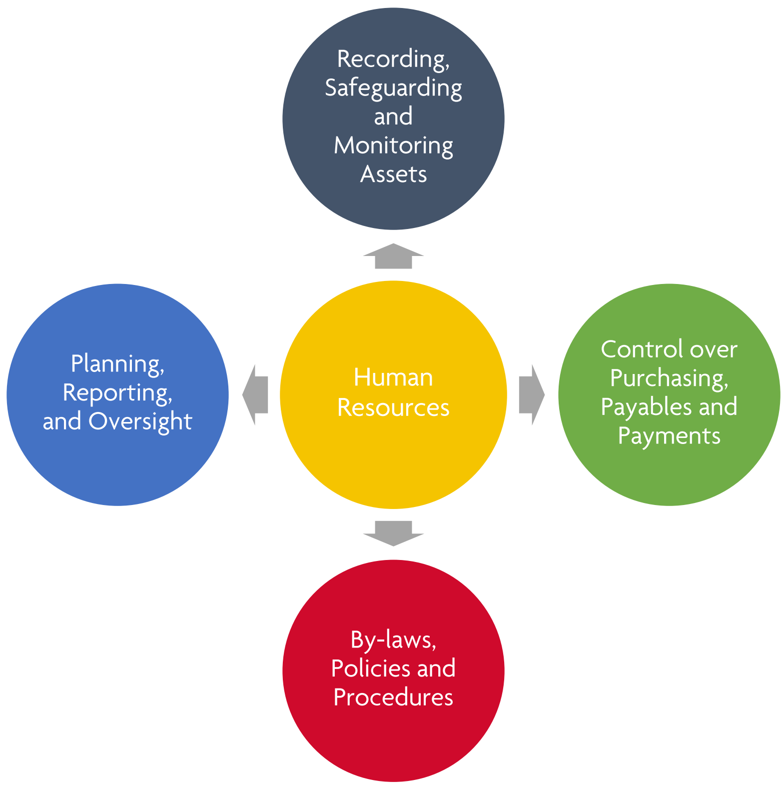
Figure D - Sources used during the development of the NPO Standards



FMB relied heavily on the existing FMB Financial Management System Standards and Financial Administration Law Standards for First Nation governments, which have set the standard for strong financial management practices to date. These standards were assessed for applicability and modified to meet the unique differences of NPOs.

Based the research performed, the FMB developed an internal control framework for NPOs, shown in **Figure E** below, around which the proposed NPO Standards have been tailored. The NPO Standards include detailed requirements within each of these five key areas of financial management.

Figure E - FMB's Internal Control Framework for NPOs



- **Human Resources** – This section contains standards specific to human resources management, including hiring, dismissals, performance management, records management and key roles in financial administration.
- **By-laws, Policies and Procedures** – This section contains standards related to establishing policies and procedures in certain areas of financial management and conduct expectations, including conflicts of interest.
- **Planning, Reporting and Oversight** – This section contains standards specific to financial planning and budgeting, financial reporting, risk management and also governance, including the requirement for an audit committee.
- **Recording, Safeguarding and Monitoring Assets** – This section contains standards related to cash management, account reconciliations, investments, and tangible capital asset management.

- **Controls of Purchasing, Payables and Payments** – This section contains standards related to expenditure management, account reconciliations, and borrowing.

A complete listing of the proposed financial management practices contained in the NPO Standards is found in the separate publication called **Not-for-Profit Organization – Proposed Standards**, which can be downloaded from the FMB's website.

As previously noted, Part 1 of the new NPO Standards will contain standards for financial management, similar to FMB's existing Financial Administration Law Standards and Financial Management System Standards for First Nation governments, however NPOs are different in that they cannot enact a Financial Administration Law under the Act. NPOs are subject to their own articles of incorporation and corporate by-laws (established under provincial or federal legislation) that set the rules for governing and operating the organization. The NPO Standards will require that the NPO's corporate by-laws contain some minimum provisions related to financial administration.

NPOs will already have existing corporate by-laws in place, as required by the legislation under which the NPO was incorporated, and it is anticipated that many of the requirements contained in the NPO Standards may already be reflected in the NPO's corporate by-laws. The financial management section of the NPO Standards will require the NPO to amend its corporate by-laws to include the required financial management practices, as necessary, or will require that the by-law contain a requirement to establish policies and procedures where these practices can be documented instead.

The NPO Standards include requirements for both the content of the corporate by-laws, policies and procedures and the implementation of those by-laws, policies and procedures. Each section of the NPO Standards will be comprised of two components. The first component requires a NPO to include certain provisions in the corporate by-law. The second component requires the implementation of the provision. **Figure F** below illustrates this structure for a sample standard – PRO.18 *Annual Financial Statements Audit*.

Figure F - Structure of new NPO Standards - Sample

PRO.18 Annual Financial Statements Audit	
	The governing body of the NPO demonstrates that the NPO has a corporate by-law that includes provisions respecting, or requires the governing body to establish policies and procedures respecting, the annual appointment of a licensed and qualified public accountant to conduct an audit of the NPO's annual general purpose financial statements in accordance with Canadian generally accepted auditing standards.
	The governing body of the NPO demonstrates that it has appointed a licensed and qualified public accountant to conduct an audit of the NPO's annual general purpose financial statements in accordance with Canadian generally accepted auditing standards.

The first component of PRO.18 describes the by-law requirement for the annual appointment of a licensed and qualified public accountant to conduct the audit of the NPO's annual financial statements. The second component requires the implementation of the by-law, where the NPO must demonstrate that they have appointed a public accountant to conduct the annual audit.

Part 2 - Financial Performance Measures for NPOs

Part 2 of the NPO Standards focuses on financial performance measures for NPOs. These new financial performance measures will be the framework used by the FMB to assess a NPO's historical financial performance and will eventually be used to determine eligibility for Certification.

The existing Financial Performance Standards for First Nation Governments were used as the starting point for the development of the new NPO financial performance ratios. Since the primary purpose of the financial performance evaluation will ultimately be the same – assessing eligibility to become a borrowing member of the FNFA – many of the assumptions used in the existing Financial Performance Standards remained applicable to the evaluation of financial performance of NPOs. The FMB was able to leverage the extensive research that was performed during the development and periodic updating of FMB's original financial performance standards.

Certain underlying assumptions for the evaluation of financial performance of NPOs were borrowed from the Financial Performance Standards:

- The NPO financial performance ratios will be based on historical financial performance covering the five most recent years.
- A weighted average or average will be used to measure whether the NPO is within the required threshold for each ratio.
- The financial information used to calculate NPO financial performance ratios must be available from the organization's annual financial statements.

The FMB extended the research into which financial performance measures would be applicable for use in the assessment of financial performance of NPOs to a wide variety of accounting and not-for-profit literature and resources including:

- Review of the various financial reporting frameworks available to NPOs for any material differences that may impact the proposed financial performance measures. For example, Accounting Standards for Not-for-Profit Organizations and Public Sector Accounting Standards (with and without the 4200 series);
- Review of common financial performance measures used within the not-for-profit sector; and,
- Review of common financial performance measures used within the private sector.

The FMB identified numerous financial performance measures during the research phase, which were further evaluated for suitability. The FMB evaluated these potential measures using a framework based on the Canadian Accounting Standards Board ("AcSB") *Framework for Reporting Performance Measures, First Edition* (Accounting Standard Board, 2018)[5]. The AcSB Framework was developed for the purpose of setting out best practice guidance for selecting, development and reporting performance measures, which made it directly applicable to the FMB's research and analysis. The FMB took each of the seven characteristics under the AcSB framework as a starting point and reinterpreted them in the context the FMB's financial performance evaluations and the unique characteristics of NPOs. According to the modified framework adopted by the FMB, seven key characteristics, shown in **Figure G** below, were considered when selecting

[5] Accounting Standard Board, *Framework for Reporting Performance Measures, Voluntary guidance to enhance the relevance of financial reporting, First Edition, December 2018.*

the NPO performance measures. As part of the analysis, the seven criteria were applied to each of the performance measures considered. A greater emphasis was placed on the relevance characteristic in assessing these financial performance measures. This was necessary as many of the measures noted may be applicable to NPOs on a general basis but were not as relevant for the FMB's purposes.

Figure G - Seven characteristics for selecting a financial performance measure

Relevance	Faithful Depiction	Consistency	Comparability
Verifiability	Timeliness	Understandability	

From the analysis described above, five financial performance measures, presented in **Figure H** – Proposed Financial Performance ratios below, were chosen by the FMB for the assessment of financial health of NPOs. **APPENDIX A – Other financial performance measures considered** presents a summary of the other financial performance considered by the FMB.

The proposed financial performance standards comprise a collection of five ratios that will be used to measure a NPO's financial capacity, its ability to sustain and/or grow its fiscal balance, its investment in tangible capital assets (other than land), and its ability to manage its overall level of debt.

Figure H – Proposed financial performance ratios

FISCAL GROWTH RATIO	OPERATING MARGIN RATIO	ASSET MAINTENANCE RATIO	NET DEBT RATIO	INTEREST EXPENSE RATIO
[(Total revenue in the CY less total revenue in the PY) / (Total revenue in the PY)]	[(Total revenue less total expenses) / (Total revenue)]	[(Total tangible capital asset expenditures) / (Total amortization expense)]	[(Total liabilities less total assets, TCA, prepaid expenses and inventory) / Total revenue)]	[(Total interest expense) / [Total revenue)]
This ratio measures the year-over-year revenue growth.	This ratio measures an organization's ability to generate revenue to satisfy expenses.	This ratio determines if the overall asset base is increasing or being replenished.	This ratio measures an organization's ability to manage debt, specifically, the net debt burden in relation to one year's annual revenue.	This ratio measures the total amount of interest incurred relative to total revenue. This measures an organization's ability to manage its overall level of debt.

The five proposed financial performance ratios were applied to a sample population used to test the results under the proposed ratios as well as benchmark the thresholds for achieving compliance with the ratios.

The formulas and thresholds presented in the sections that follow are the results derived from FMB's research and quantitative analysis.

The proposed Financial Performance Measures are also contained in the separate publication called **Not-for-Profit Organization – Proposed Standards**, which can be downloaded from the FMB's website.

1. **Fiscal Growth Ratio**

$$(TR_x - TR_{(x-1)}) / TR_{(x-1)}$$

TR_x: Total revenue in year "X"
$TR_{(x-1)}$: Total revenue from the fiscal year one prior to year "X"

The Fiscal Growth Ratio ("FGR") will measure the NPO's ability to sustain and grow its financial and/or service capacity. A growth rate greater than 0 indicates that revenue is growing. A ratio of 0 would indicate no revenue growth when compared to the prior year. A growth rate of less than 0 indicates that revenue is decreasing which could indicate an unsustainable trend.

Limitations considered – The FMB considered potential limitations of this ratio, including the lack of consideration given to the year-over-year change in expenditures. If the annual expenditure growth rate is larger than the annual revenue growth rate, then this would be another indicator of an unsustainable operation. However, this potential limitation was mitigated when combined with other measures such as the Operating Margin Ratio noted below.

Threshold – The FGR is also a ratio used in the FMB's evaluation of financial performance of First Nation governments. The current FGR threshold for a First Nation government must not be lower than -5.0%, which allows for some decrease in revenue over the period being evaluated.

Based on the quantitative analysis performed by the FMB, the threshold being proposed is that the average FGR for the five-year period under review **must not be less than -5.0%**. This remains consistent with the FGR for First Nation governments.

2. **Operating Margin Ratio**

$$(TR - TE) / TR$$

TR: Total revenue for the period under review
TE: Total expense for the period under review

The Operating Margin Ratio ("OMR") will measure the NPO's ability to sustain fiscal balance. A ratio greater than 0 indicates that sufficient revenue is generated to meet expenses. A ratio less than 0 would indicate that the NPO is spending beyond its revenue base and thus, exerting stress on its financial capacity. A ratio of exactly 0 would imply a NPO's earnings are equal to its expenditures.

Limitations considered – The FMB considered potential limitations of this ratio including the lack of consideration given to debt repayment. A NPO may have an OMR of 0.0 or higher but fail to generate sufficient net income to service debt repayments. However, this limitation was mitigated by the combined assessment of the OMR and Net Debt Ratio noted below.

Another potential limitation is declining services (i.e. volume of services) offered by an NPO over a period of time. For example, the NPO could be receiving less funding year-after-year due to declining services offered/phasing out a program, however we would expect to see a corresponding reduction of expenses and the operating margin would remain unchanged. This limitation is also mitigated with the combined analysis of the FGR above.

Threshold – The OMR is also a ratio used in the FMB's evaluation of financial performance of First Nation governments. The current OMR threshold for a First Nation government is not lower than -5.0%. Since both a First Nation government and a NPO share a similar objective (i.e. to operate at or near a break-even point), the threshold for an NPO would be similar. Some allowance for a negative ratio is reasonable to accommodate a situation where an NPO may choose to operate for a period of time with a deficit by drawing down on previously accumulated surpluses derived from earlier periods. This situation could occur, for example, when an NPO accumulates a reserve for some specific purpose over time (while reporting a surplus) and then in a future period, the cash reserves could then be drawn down and used to finance a corresponding operating deficit until a fiscal balance is restored.

Based on the quantitative analysis performed by the FMB, the threshold being proposed is that the average OMR for the five-year period under review **must not be less than -5.0%**. This remains consistent with the OMR for First Nation governments.

3. Asset Maintenance Ratio

TTCE / TAE

TTCE: Total tangible capital asset expenditures during the period under review (other than land)
TAE: Total amortization expense during the period under review

The Asset Maintenance Ratio ("AMR") will measure a NPO's ability to sustain its investment in tangible capital assets. This ratio will assess whether the overall asset base is increasing, or being replenished, at a rate equal to, or higher than, the consumption of assets (i.e. ratio greater than or equal to 1.0). Additionally, this ratio will be an indicator of the willingness of the NPO to maintain the current level of investment in capital assets and provide a measure of the NPO's ability to execute a tangible capital assets maintenance plan. A ratio less than 1 indicates that assets are being consumed at a rate faster than it is being replenished.

Limitations considered – The FMB considered potential limitations of this ratio including that it does not identify a specific/major class of assets that may require immediate replenishment or replacement. Deteriorated assets can create fiscal stress in the future. Delayed maintenance or replacement of capital assets may result in outdated assets which affect the NPO's ability to provide programs and services. A mitigating factor will be the potential for the NPO to access the FNFA borrowing pool for tangible capital assets projects pending future certification.

Also, the FMB recognized that not all NPOs are dependent upon infrastructure and tangible capital assets for the provision of their services. Some NPOs may not have any material tangible capital assets, making this ratio not relevant to the FMB's financial performance assessment. As such, the FMB is proposing that this ratio would not be applicable if an NPO's total original cost of tangible capital assets is below $500,000. This threshold of $500,000 is consistent with a similar threshold applied within the CPA Canada Handbook to small not-for-profit organizations, to exempt them from the tangible capital asset accounting provisions contained in the NPO section of the CPA Handbook[6].

Threshold – The AMR is also a ratio used in the FMB's evaluation of financial performance of First Nation governments. The current AMR threshold for a First Nation government is not lower than 100.0%. The rationale for this threshold is to ensure the overall asset base is increasing, or being replenished, at a rate equal to, or higher than, the consumption of assets. As this rationale holds true for a NPO as well, it is reasonable to establish an AMR threshold similar to the one established for a First Nation government.

Based on the quantitative analysis performed by the FMB, the threshold being proposed is that the average AMR for the five-year period under review **must not be less than 100.0%**. This remains consistent with the AMR for First Nation governments.

4. Net Debt Ratio

[TL – (TA - TCA - PPD - INV)]
/ TR

TL:	Total liabilities
TA:	Total assets
TCA:	Tangible capital assets
PPD:	Prepaid expenses
INV:	Inventory
TR:	Total Revenue

[6] Threshold of $500,000 is consistent with the annual revenue threshold applicable for small not-for-profit organisations described in Part III of the CPA Handbook paragraph 4433.03.

The Net Debt Ratio ("NDR") will measure a NPO's ability to manage its overall level of debt. Specifically, this ratio will measure the size of the net debt burden in relation to one year's annual revenue available to service the debt. This ratio will indicate whether a NPO's debt load is sustainable or potentially restricting its financial flexibility to incur more debt. An increasing ratio will indicate total debt is becoming more onerous on the NPO, which could lead to long-term sustainability concerns. A decreasing ratio will indicate that the NPO's capacity to incur more debt is strengthening.

The FMB anticipates that many NPOs looking for certification are service-based entities with minimal, if any, debt. For NPOs providing public service, long-term debt may be used for the construction or acquisition of tangible capital assets.

Threshold – A similar NDR is used in the FMB's evaluation of financial performance of First Nation governments. The current NDR threshold for a First Nation government is not greater than 50.0%. Based on the quantitative analysis performed by the FMB, the weighted average NDR for the five-year period under review **must not be greater than 50.0%** <u>or</u> the current year NDR **must not be greater than 50.0%**. This remains consistent with the NDR for First Nation governments.

5. Interest Expense Ratio

TIE / TR

TIE: Total interest expense
TR: Total revenue

The Interest Expense Ratio ("IER") will measure a NPO's ability to manage its overall level of debt. Specifically, the IER measures the size of the NPO's interest expense burden in relation to annual revenue.

Threshold – The IER is also a ratio used in the FMB's evaluation of financial performance of First Nation governments. The current IER threshold for a First Nation government for the period under review must not exceed 5.0%.

Based on the quantitative analysis performed by the FMB, the threshold being recommended is that the average IER for the five-year period under review **must not be greater than 5.0%.** This remains consistent with the IER for First Nation governments.

Comments and feedback requested

The FMB is looking for feedback and comments on its proposed NPO Standards prior to introducing the new Standards. This input is critical in developing standards that are relevant to NPOs and responsive to their needs. Feedback sent to the FMB can lead to changes to a final standard. The FMB also welcomes comments on all aspects of the proposed NPO Standards, including additions and suggested changes.

To help the FMB develop a comprehensive set of financial management standards and financial performance measures we need feedback from the organizations who will use these NPO Standards. Please see **Appendix B – Survey questions** for a series of questions that will help the FMB in this development process. The first set of questions are intended for NPOs and will help us establish a benchmark and understand the practices currently in place at NPOs. The responses to these will help us assess the relevance and achievability of the proposed Standards. The second set of questions are for providing feedback specific to the proposed Standards.

For convenience, these questions can be answered using an online feedback form. Alternatively, written comments may be sent by email to the FMB's Standards and Certification team: standards@fnfmb.com

Given the disruptions caused by the current COVID-19 situation, the FMB wants to allow sufficient time for all interested stakeholders to provide comments and any feedback on these proposed standards. Therefore the FMB is significantly extending the usual 45-day comment period. **The FMB requests that comments on the proposed NPO Standards be provided by September 30, 2020.**

Next steps

The FMB will compile a listing of the feedback and recommendations received during the comment period. The FMB will review the feedback and recommendation received and will consider it in the drafting of final NPO Standards. The timing of such steps are as follows:

- ➔ **Comment period –** Feedback to be received on or before **September 30, 2020**
- ➔ **Release of final NPO Standards –** Depending on the volume and nature of the comments received during the comment period, the FMB plans to publish the final NPO Standards sometime during Q3 or Q4 2020-2021.
- ➔ **Effective date of new NPO Standards** – The Standards will become effective on the date determined by the FMB's Board of Directors following their release. NPOs can then begin to work with and apply the new NPO Standards.

APPENDIX A – Other financial performance measures considered

Appendix A presents other financial performance measures considered and analyzed by the FMB during the research phase. Based on this analysis, these measures were not selected for use in the evaluation of NPO financial performance. The FMB's qualitative assessment of each potential ratio is presented below.

The analysis also included an evaluation of each potential ratio against the seven characteristics for evaluating performance measures adopted by the FMB (refer to **Figure G - Seven characteristics for selecting a financial performance measure** in Part 2 above). A greater emphasis was placed on the relevance characteristic in assessing these financial performance measures. This was necessary as many of the measures noted may be applicable to NPOs on a general basis but were not as relevant for the FMB's purposes.

Legend – Ratio Source	
A	Historical financial performance ratios used by the FMB
B	From FMB research - accounting and not-for-profit literature and resources

Ratio Name	Formula	Source	Qualitative assessment
Budget Performance Ratio	[Total Actual Revenue - Total budgeted revenue]/Total budgeted revenue; [Total Actual expenditures - Total budgeted expenditures]/Total budgeted expenditures	A	This ratio assesses an organization's ability to manage its operations within its budget. The FMB noted that a potential challenge with using this measure is that the budget figures may not be verifiable. A similar issue was noted when this measure was included with the previous Financial Performance Standards for First Nations governments. Under accounting frameworks other than PSAS, it is not a requirement to present budgeted figures on the statement of operations. This ratio was excluded from further consideration.
Viability Ratio	[Net assets / Long-term debt]	B	This ratio indicates a not-for-profit's relative liquidity or its ability to cover its debt. Similar to the Current Ratio below, the FMB noted a limitation to this ratio is that it does not take into consideration availability of short-term borrowing. Additionally, some expendable assets may not be easily converted into cash in order to meet/fulfill the current obligations. As such, this ratio was excluded from further consideration.

Ratio Name	Formula	Source	Qualitative assessment
Current Ratio / Quick Ratio	[Current assets / Current liabilities]	A, B	This ratio measures the availability of cash and other liquid assets to meet the organization's obligations. The FMB noted a limitation to this ratio is that it does not take into consideration availability of short-term borrowing. Additionally, some expendable assets (i.e. accounts receivables) may not be easily converted into cash in order to meet/fulfill the current obligations. This ratio potentially includes some non-GAAP figures (classification of current assets and liabilities) and this issue was noted when this measure was included with the previous Financial Performance Standards for First Nations governments. As such, this ratio was excluded from further consideration.
Operating Reserve Ratio	[Expendable net assets** / (Total expenses less depreciation)] **Net assets without restrictions or unrestricted net assets less (fixed assets less debt related to fix asset)	B	This ratio measures unrestricted funds set aside to stabilize an entity's finances for unexpected cash flow shortages. The FMB noted that a potential limitation of this ratio is that, a high operating reserve ratio may indicate that the organization is losing out on other opportunities to further their mission. In addition, the ratio potentially includes some non-GAAP figures (e.g. expendable net assets) that will not be possible to derive from annual financial statements. Therefore, this ratio was excluded from further consideration.
Program Efficiency	[Total program expenses / Total expenses]	B	This ratio measures how efficient each program is operated. This ratio was excluded from further consideration as it was not considered relevant to the FMB's evaluation of financial performance for the purposes contained in the Act.
Operating Reliance	[Program revenues / Total expenses]	B	This ratio measures an organization's ability to pay for expenses solely from program activities. This ratio was excluded from further consideration as it was not considered relevant to the FMB's evaluation of financial performance for the purposes contained in the Act.
Fundraising Efficiency	[Total amount of contributions / Fundraising Expense]	B	This ratio measures the amount of contributions generated per dollar spent. This ratio was excluded from further consideration as it was not considered relevant to the FMB's evaluation of financial performance for the purposes contained in the Act.
Reliance Ratio	[Type of income / Total income]	B	For many NPOs it is anticipated that the largest type of income will be government funding. This ratio was excluded from further consideration as it was not considered relevant to the FMB's evaluation of financial performance for the purposes contained in the Act.
Contributions and Grants	[(Revenue from Contributions plus Grants) / Total Revenue]	B	This ratio measures the amount of contributions and grants received relative to total income. This ratio is not relevant to the FMB's purposes since many contribution / grant agreements will contain stipulations on how the funding is to be used (therefore making them non-securable revenue streams for purposes under the Act). This ratio was excluded from further consideration.
Government Grants	[Revenue from Government grants / Total Revenue]	B	Refer to analysis noted above for contributions and grants. This ratio was excluded from further consideration.

Ratio Name	Formula	Source	Qualitative assessment
Self-Sufficiency Ratio	[Total earned income / Total expense]	B	This ratio measures the proportion of operating expenses that are covered by an organization's earned income. The primary users of the FMB's report under the Act are likely concerned about the organization's ability to cover its expenses in aggregate, as such, the Operating Margin Ratio selected by the FMB is considered a more relevant measure. This ratio was excluded from further consideration.
Personnel Cost Ratio	[(Total wages plus taxes plus employee benefits) / Total expenses]	B	This ratio is narrow in scope and does not likely provide significant value to the potential users of the FMB's report. This ratio was excluded from further consideration.
Administration Cost Ratio	[(Total fundraising plus general and admin expenses) / Total expenses]	B	This ratio measures the total cost spent on administrative expenses relative to total expenses. This is an indicator of how efficient an organization is with managing its administrative costs. This ratio is narrow in scope and does not likely provide significant value to the potential users of the FMB's report. This ratio was excluded from further consideration.
Cost per "Unit" of Service	[Program expense / Units of service]	B	This ratio measures the cost of producing one "unit" of service. This ratio would be difficult to calculate and apply consistently and comparably. Additionally, this ratio is narrow in scope and likely does not provide significant value to the potential users of the FMB's report. This ratio was excluded from further consideration.
Accounts Receivable Aging	[(Accounts receivable > 90 days overdue) / Total accounts receivable]	B	This ratio measures the amount of outstanding accounts that are old/potentially uncollectible relative to the total accounts receivable. The larger the balance, the more risk of uncollectable accounts and potential cash flow issues. This ratio would be difficult to verify as the aged accounts receivables listing is not normally disclosed in the organization's annual financial statements. Also, it is expected that the NPOs being reviewed would be receiving the majority of their funding through federal government grant or contribution agreements and would not have a material amount of accounts receivable outstanding. This ratio is narrow in scope and does not likely provide significant value to the potential users of the FMB's report. This ratio was excluded from further consideration.
Accounts Payable aging	[(Accounts payable > 90 days overdue) / Total accounts payable]	B	This ratio measures the amount of outstanding payables greater than 90 days relative to total the total amount of accounts payable. A large ratio may indicate cash flow problems as trade payables are usually due within 30 days. Similar to the accounts receivable aging ratio noted above, this ratio will be difficult to verify. In addition, this ratio on its own does not provide enough information (i.e. reason for late payment, ability to access short term borrowing, amount of free cash flow, etc.). This ratio is narrow in scope and does not likely provide significant value to the potential users of the FMB's report. This ratio was excluded from further consideration.

Ratio Name	Formula	Source	Qualitative assessment
Daily Cash on Hand	[Cash and current investments / Daily cash requirement***] ***Daily Cash requirement: [(Annual expense budget less depreciation less in-kind expense less pass-through funds less unusual expenses) / 365]	B	This ratio measures the amount of cash, relative to cash requirements, available on a daily basis. The primary users of the FMB's report under the Act may not be as concerned about the daily operations of the organization compared to the organization's ability to service debt. Similar to ratios discussed above, the FMB noted that a potential limitation to this ratio is the availability of short-term financing. Another limitation is the need to rely on budgeted figures, which may not be available in the NPO's financial statements. This ratio is narrow in scope and does not likely provide significant value to the potential users of the FMB's report. This ratio was excluded from further consideration.
Profit Margin Ratio	[(Change in net assets without donor restrictions) or (change in unrestricted net assets) / (Total revenue and support without donor restrictions) or (total unrestricted revenue and support)]	B	This ratio indicates whether the organization is earning or receiving more than it is spending on operations. The information provided by the Operating Margin Ratio selected by the FMB would provide sufficient information regarding an organization's profitability. Therefore, this ratio has been excluded from consideration.
Cash Expenses per Day	[(Operating expenses less depreciation or amortization less in-kind expenses less unusual one-time expenses) / (Cash expenses) / 365]	B	The purpose and results of this ratio is similar to the Daily Cash on Hand ratio noted above. This ratio is narrow in scope and does not likely provide significant value to the potential users of the FMB's report. This ratio was excluded from further consideration.
Net Assets	[(Temporarily restricted net assets) / (Cash + Investments + pledges receivable)]	B	This ratio is used in determining if an organization is spending restricted cash for purposes other than its intended purpose. Although this is a good investigative measure, it is not relevant for the FMB's purposes. This ratio was excluded from further consideration.
Saving Indicator	[(Income less expenses)/ Total expenses]	B	This ratio measures the amount of savings an organization can generate on a yearly basis. This ratio was excluded from further consideration as it was not considered relevant to the FMB's evaluation of financial performance for the purposes contained in the Act.
Debt Ratio	[Total debt / Total unrestricted net assets]	B	This ratio measures how much the organization is relying on funding from others in the form of debt. The Net Debt Ratio selected by the FMB would provide more relevant data because typically debts are secured by some sort of revenue (funded and other source); hence incorporating revenue to the ratio. This ratio was excluded from further consideration.

Ratio Name	Formula	Source	Qualitative assessment
Defensive Interval	[(Cash plus marketable securities plus receivables) / (Average monthly expenses)]	B	This ratio measures how many months an organization could operate if no additional funds were received. The Net Debt Ratio selected by the FMB would provide more relevant information as this ratio does not consider items such as short-term financing, cyclical expenditures and the ability for an organization to reduce/eliminate variable cost on a short-term basis. This ratio was excluded from further consideration.
Liquid Funds Indicator	[(Total net assets less restricted net assets less fixed assets) / (Average monthly expenses)]	B	This ratio is similar to the Defensive Interval noted above. Refer above for detail analysis regarding the justifications as to why this ratio was excluded from further consideration.
Liquid Funds Amount	Dollar value of unrestricted net assets - Net fixed assets + Mortgages and Other notes payable	B	The ratio quantifies the liquid unrestricted dollar amount that an organization has available to meet current obligation. This balance is dependent on the size of the operation and thus, not comparable to other organizations. This ratio was excluded from further consideration.

APPENDIX B – Survey questions

The FMB is seeking feedback on the proposed NPO Standards. For convenience, these questions can be answered using an online feedback form. Alternatively, written comments may be sent by email to the FMB's Standards and Certification team: standards@fnfmb.com

Benchmarking questions

1. Please tell us about your organization.
   - ☐ Not-for-profit organization
   - ☐ Tribal Council
   - ☐ First Nation government
   - ☐ Advisor to First Nations governments or NPOs
   - ☐ Other (please specify)

2. Organization Name:

3. Is your organization federally or provincially incorporated?
   - ☐ Federal
   - ☐ Provincial
   - ☐ Not incorporated
   - ☐ Incorporated, but not sure of jurisdiction

4. Please tell us a bit more about yourself and your role at your organization.
   - ☐ Finance or administration
   - ☐ Board member
   - ☐ Advisor
   - ☐ Other (please specify)

5. Is there a need within the next 12 months by your organization to access funding for capital project purposes?
   - ☐ Yes (please provide an example(s) of proposed capital project your NPO is planning on undertaking)
   - ☐ No

6. What type of financial planning and reporting is your organization currently producing? (Select all applicable responses).
   - ☐ Annual budgets
   - ☐ Annual financial statements
   - ☐ Annual reports
   - ☐ Documented strategic plan

7. What level of assurance (auditor involvement), if any, does your organization obtain for its annual financial statements?
   - ☐ Audit opinion
   - ☐ Review engagement
   - ☐ Compilation or notice to reader
   - ☐ None of the above

8. Would your organization be interested in providing its annual financial statements to the FMB for use by the FMB in its extended benchmarking analysis of the proposed financial performance ratios?
   - ☐ Yes (please provide your email below)
   - ☐ No

NPO Standards questions

9. Are there any standards you would like to see changed, added or removed from the proposed financial management system standards?
   - ☐ Yes (please provide as many details as possible with your reasoning or rationale)
   - ☐ No

10. Are there any financial performance measures you like to see changed, added or removed from the assessment of financial performance of a NPO? Should any of the ratios that have been excluded (refer to Appendix A) be re-considered? If so, please provide details regarding the suggested measure and rationale.
    - ☐ Yes
    - ☐ No

11. Are there any foreseeable challenges regarding the implementation the proposed NPO Standards by not-for-profit organizations? If so, please provide a brief explanation.
    - ☐ Yes
    - ☐ No

12. Do you have any other feedback, comments or suggestions to share with the FMB about the proposed NPO Standards?