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Nonprofit Funding Agencies' Review of Grant Recipients

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Honors Senior Thesis

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Abstract

Nonprofits need to be just as responsible as public corporations. Nonprofit funding agencies have the responsibility for evaluating the organizations they fund to make sure that they are operating with high integrity, maintaining strong internal controls, remaining financially stable, and overall being good stewards of the funds received. This paper will explain the criteria that a funding agency should follow in order to affect this process, as well as how a recipient nonprofit will benefit from following the criteria.

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Introduction

Nonprofit organizations make our communities better places. They exist primarily to pursue a mission that addresses the needs of society. These organizations serve a variety of sectors including religious, education, health, social services, commerce, amateur sports, clubs, and the arts ("Nonprofit (Not-for-profit) Accounting" 1). These organizations are intended to support good causes but when investing in a company, for-profit and non-profit alike, investors want to make sure their money is going toward honest and responsible applications. This responsibility is on the organization itself, as well as the funding recipients of the nonprofit. Nonprofit funding agencies should use financial/ratio analysis, nonprofit internal questionnaires, quantitative analysis based on financial documents, and economic empathy when determining initial funding or continued funding to nonprofits. This paper details the issues that nonprofit funding agencies must pay attention to and the qualitative and quantitative measures they should employ in determining whether it is wise to provide funding to other nonprofits.

Increase in Demand for Accountability of Nonprofits

Corporations and nonprofit organizations have different mandates for accountability purposes. Accountability became very important after fraud was becoming evident in major publicly traded companies such as Enron and WorldCom. As these frauds became evident in the corporate world and changes were made to the accounting standards and procedures, fraud within the nonprofit sector was also becoming an issue. As a result, changes to their mandates developed as well as donors and funding agencies wanted increased transparency of the organizations they were funding.

After the 1929 stock market crash and the Great Depression of the 1930's, the United States made many developments for the accounting field in the area of auditing. As a result of extensive misleading financial reporting that contributed to the stock market crash and world depression, the U.S. passed legislation in 1933 and 1934 that created the Securities and Exchange Commission (SEC). The SEC regulates major stock exchanges in the United States and companies wishing to trade shares on the New York Stock Exchange or the American Stock Exchange (publicly traded companies) are required to issue audited financial statements. The emphasis switched to fairness of presentation of the financial statements of these publicly traded companies, and the auditor's role was to verify the fairness of presentation (Louwers 23).

This dramatic shift in attitudes towards auditors and corporate governance in general can be assigned to a specific watershed event – the bankruptcy of the energy company called Enron on December 2, 2001. The changes were so substantial, that the term "post-Enron world" is used to signify the completely altered corporate landscape that has developed since then. Rather than an innovative energy company or new age hedge fund, Enron turned out to be more like a classic Ponzi scheme, relying, through deceptive promotions, on attracting more investors so the price of the company's shares would continue to be bid up. The losses to shareholders, including lower-level employees that were strongly encouraged, even forced, to invest their retirement savings in Enron stock while top management sold their shares based on insider knowledge of the disastrous real state of affairs, amounted to over $60 billion. More than 6,000 Enron employees lost their jobs along with much of their retirement savings (Louwers 25).

The accounting profession was put under the microscope due to the Enron Scandal. Arthur Anderson, one of the Big Five accounting firms at the time, audited the financial statements of Enron. Many top management officials at Anderson were being fired due to obstruction of justice, and the firm went through Supreme Court proceedings due to the lack of due care during the Enron audits. The firm eventually was destroyed due to clients leaving, concerned that they would be tainted by Arthur Andersen's shattered reputation. Now there are only the “Big Four” accounting firms and these “Final Four” are now struggling to redefine their roles in the post-Enron world (Louwers 25).

Nonprofits have also undergone many changes to their mandates due to fraud within the nonprofit arena. Today, they are required by the federal government to have an audit in accordance with OMB A-133 Compliance Supplement, a large and extensive United States federal government guide created by the Office of Management and Budget used in auditing federal assistance, if they receive more than $500,000 of federal funds. There are also state fundraising statutes that differentiate between states that require certain documentation for accountability. For example, a New Jersey nonprofit organization that must file a Charitable Registration Form CRI-300R, is required to attach a certified audit if its revenue exceeds $500, 000 (increased from $250,000 in February 2011). The Internal Revenue Service requires nonprofits to file an Internal Revenue Service Form 990, which includes information based on financial statements as well as compensation for the five highest paid employees of the nonprofits (Sorrells 2). An audit may also be required by a bank or other financing corporations, the lender may require an annual audit be performed. Lastly, an individual or government grantor may require in their grant agreement that an audit be done. Other than the federal government and state statute mandates, the additional reasons for grantors or banks to require audits are for their own personal accountability standards to grant money.

Demands from funding sources and constituents for accountability of nonprofit organizations have been increasing over the years. These funding sources have started to require nonprofits to develop systems to evaluate their service delivery and financial performance. The challenges and the development of technology have pressured nonprofits to adopt mechanisms to integrate and evaluate services and financial data (Schwartz 2). Reasons for this include fraud within the nonprofit industry as discussed below.

One major event that caused local funding agencies of nonprofits to put more emphasis on evaluating the nonprofit organizations that they fund, was fraud committed at the nonprofit Institute for the International Sport (IIS), which is affiliated with the University of Rhode Island. IIS was founded in 1986 at the University of Rhode Island (URI) and sought to promote peace through athletics and other activities. The IIS attracted the support of luminaries such as Archbishop Desmond Tutu and former President Bill Clinton. Danny Doyle, a former basketball coach, was and is clearly the visionary behind IIS, attracting support from prominent actors on the world stage, from the state of Rhode Island and from seven figure donors, both individual and institutional (Gregg 1).

The former President of the University, Robert Carothers, signed off on a tuition waiver for the Institute Director's top assistant, Lorna Wright. Wright was receiving the tuition as if she was an employee of the University of Rhode Island and was receiving their internal benefits, however, she was not entitled to these benefits. This was a mistake on the part of the University of Rhode Island, but was an addition to the current problems of the IIS nonprofit, including items such as questionable expenditures (Gregg 1).

This is not the first incident of malfeasance at the Institute for International Sport. The state of Rhode Island had the nonprofit under review for confusion regarding the expenditure of $575,000 for a new building on the URI campus. Conducting an audit in spring of 2012, the state auditors were only able to come up with receipts supporting the expenditure totaling $163,000, and even those were questionable. While the investigation was going on, the President of IIS, Daniel E. Doyle, took a mortgage out on his house to cover $380,000 owed to URI for unreimbursed payroll costs and other services provided to the Institute. Checks in the amounts of $100,000 and $280,846 were given to URI from Danny Doyle. The personal payment of organizational debt raised questions, as this is not a standard procedure (Gregg 1).

This event, which was highly publicized, brought much attention to the need of local funding agencies to review the nonprofit organizations they fund. Accountability is extremely important so that in situations like this one, the situation does not escalate to the extent that hundreds of thousands of dollars are being taken from the nonprofit. IRS Form 990 was what sparked the interest to audit the IIS much closer. If proper reviewing tools of internal controls and financial reporting were already in place, this situation could have been avoided.

Differences between Nonprofit Organizations and Corporations

When deciding what criteria nonprofit funding sources need to be attentive to when deciding how to allocate funds, an understanding of nonprofits in general must be mastered. Nonprofits are much different from for-profit corporations when it comes to accounting rules and regulations. These differences stem from the diverse missions of nonprofits and for-profit corporations, as well as the way each entity makes and uses revenue differs significantly. These two organizational bodies have such different missions and ways of functioning that there is a need for different approaches to financial reporting as well (Poirier).

The chart below itemizes the differences between nonprofits and for-profit corporations and further demonstrates why these rules and reporting standards must be different:

	Nonprofit	**Corporations**
Owner:	None	Stockholders
Primary Mission:	Provide services needed by society	Earn profits for stockholders
Secondary Mission:	Ensure that revenues are greater than expenses so that the services provided can be maintained or expanded	Provide services or sell goods
U.S. Tax Status:	Exempt from income taxes if approved by IRS	Corporations (or their owners) are subject to income taxes

	Nonprofit	Corporations
Financial Statements required by U.S. GAAP:	Statement of Financial Position Statement of Activities Statement of Functional Expenses Statement of Cash Flows Notes to Financial Statements	Balance Sheet Income Statement Statement of Cash Flows Statement of Stockholders' Equity Notes to Financial Statements
Total assets minus total liabilities is reported as: Subparts are recorded as:	Net Assets Unrestricted, temporarily restricted, and permanently restricted (based on donor's intended purpose for use of money)	Stockholders' Equity Pain-in capital, retained earnings, minus treasury stock
Examples of revenues:	Donor contributions, membership dues, program fees, fundraising events, grants, and investment income	Sales of merchandise, fees from services, investment income, gains on investments
Reported Expenses:	Program, management and general, fundraising	Cost of Goods Sold, depreciation, general and administrative, income taxes, allowances
Sources of money other than revenues and sale of assets:	Borrow from lenders	Borrow from lenders Issue shares of stock
Additional annual reporting for some larger agencies/companies:	IRS Federal Form 990 (churches are exempt)	SEC Form 10-K SEC Form 10-Q
Audit Requirements:	Yes, OMB Circular A-133	Yes, all publicly traded corporations

("Nonprofit (Not-for-profit) Accounting" 4)

Each type of business entity has its own distinct way of functioning. As shown in the preceding table, nonprofits exist to pursue missions that address the needs of society. They also do not have commercial owners and rely on funds from contributions, membership dues, program revenues, fundraising, grants, and investment income. Nonprofits and for-profit corporations all have different terminology for their accounting terms. Essentially net assets are equivalent to stockholder's equity, but as a not-for-profit, this is obviously not a direct parallel.

Nonprofits hold a tax-exempt status. Due to this, Internal Revenue Service Form 990 (a nonprofit tax return and public record) is very important allowing the IRS to keep track of the financial income of nonprofits and their expenditures. Even though exempted from taxes, this form allows the public to still see their financial information, including the amount of money coming in from specified sources and what the nonprofit is spending the money on, as well as ensure that they are not taking advantage of this status. Most nonprofits that are religious organizations are not required to file annual information returns, nor are organizations that take in less than $25,000 per year.

Due to different missions as well as different uses and sources of funding as noted in the chart above, corporations and nonprofits need affordable accounting policies and procedures that relate to their specific needs. Due to the differences, the policies and standards regarding these organizations need to be different. According to Poirier, since the rules and accounting reporting standards are different between nonprofits and corporations, the determination of financial stability is also different. Nonprofit organizations devote significant effort to measuring performance that is often focused on financial metrics related to dollars raised from donors and budget achievement. In addition to these measurements organizational success relative to achieving their mission must also be kept in mind (Epstein, McFarlan 28). Though, as with for-profit organizations, non-financial measures of success are often less precise and far more difficult to measure (Epstein, McFarlan 28).

This paper will rely primarily on financial measurement indicators and qualitative measures that a funding agency can measure from an external perspective, as well as analysis of internal source documents of a nonprofit. Funding agencies include organizations such as the

United Way and the Rhode Island Foundation, that donate hundreds of thousands of dollars to smaller organizations with a variety of missions within their area (Voccio). It is critical to understand that non-financial measures, such as quality of an Audit and internal controls, need to be evaluated for stability in order for the nonprofit to be successful. Non-financial and financial measures go hand-in-hand (Epstein, McFarlan 28).

Small nonprofits rely on funding agencies due to the funding agency being a larger organization, and in turn acquire more funds due to reputation. The nonprofit funding agency is a "middle man" between donors and the nonprofit receiving the funds. Funding agencies raise money by advertising the types of nonprofits they fund (housing, homeless, and food banks) and then distributing amounts of their discretion to the organizations. It enables the nonprofit to acquire larger amounts of funds for their organization while keeping expenditures low since the funding agencies takes care of the advertising, fundraising efforts, etc.

Evaluating a Nonprofit

The purpose of a nonprofit is to improve the lives of individuals, members, organizations, communities and society as a whole. When measuring a nonprofit, thought must also be given to the type of nonprofit that it is. Some organizations, such as charities, may be considered purely social-impact-focused, whereas others such as professional organizations may be viewed primarily as member-focused (Epstein, McFarlan 28). The vision of a "continuum" of not-for-profit organizations spanning from purely socially focused to purely member-focused should be envisioned with many nonprofits having dual roles in their mission of serving both their members and society. According to Marc J. Epstein and F. Warren McFarlan in "Measuring the Efficiency and Effectiveness of Nonprofit's Performance," performance measures internally within a nonprofit organization need to include five categories for evaluation. These categories include: inputs, activities, outputs, outcomes, and impacts. These categories should be part of the strategic plan by management and can be evaluated using the following table.

Inputs:	Key tangibles and intangibles that enable the nonprofit to perform its tasks. These include cash, personnel, equipment, and other material items as well as the mission statement and strategy. Inputs also include the current depth of your board and staff's understanding of the organization's mission and strategy.
Activities:	All of the specific programs and tasks that the organization undertakes, and they should be grouped into meaningful but flexible clusters for analysis. These groupings help trigger the debate about the appropriate balance within the group and can lead to a number of adjustments between the board and staff.
Outputs:	Tangible and intangible products and services that are the result of the organization's activities. The selection of these outputs for any institution would vary by mission, core competencies, and strategy inputs. When the world changes, these measured outputs may no longer be exactly the right ones to focus on and may need modifying.
Outcomes:	Specific changes in behaviors and individuals affected by the delivery of these services and products.
Impacts:	Include benefits to community and society, as a whole as a result of the nonprofit's outcome.

(Epstein 28-30)

Within these categories, measures can be divided into social-impact focused and member-focused. Below are the measures of which these researchers believe to be important to internal performance measures:

	Social-Impact-Focused	Member-Focused
Inputs	- Number (%) of strategic priorities aligned with the mission statement - Operational sustainability (operating revenue as a percentage of costs)	- Number (%) of strategic priorities aligned with the mission statement - Number (%) of activities documented and measured
Activities	- Dollars spent providing aid and support to the community - Employee productivity	- Realization of the planned activities (%) - Number (%) of members actively involved in activities
Outputs	- Number (%) of community members participating in the programs offered	- Increase in member participation on various activities/events (%) - Number (%) of members using networks provided
Outcomes	- Number (%) of participants reestablishing themselves in their communities	- Number (%) of members who advance their careers - Number (%) of members who claim to have acquired significantly new knowledge
Impacts	- Number (%) of beneficiaries reporting major improvement in quality of life	- Number (%) of members who applied new practices - Increase in the number of members of the association (%)

Nonprofits should abide by the measures above and see if results are appropriate for their industry. This can be relied on to check if performance is up to par and if the plan and actual implementation are consistent with others in the industry.

According to Marc J. Epstein and F. Warren McFarlan, the financial measures most appropriate to nonprofit organizations are often used to measure and evaluate financial performance. Though nonprofits cannot use many of them to compare across organizations due to industries and fundraising differentials, the numbers are still important for the Board of Directors and management of nonprofits to think about. Below are different efficiency measurements of performance. These measures are important due to being specific to where the nonprofit is spending most of their funds. These measures are also displayed in Exhibit C, the tool that the Directed Work Experience team of Johnson & Wales University constructed for the United Way of Rhode Island. These measures are effective to show if the nonprofit prioritizes supporting their mission, as well as if they can afford it.

Category	Performance Measures
Administrative efficiency	- Administrative expenses divided by total expenses of the organization - Percentage of revenues the organization spends on administrative expenses
Program efficiency	- Program support or charitable commitment (% of total expenses spent directly for charitable purpose) - Program expenses divided by total expenses - Program expenses growth - Current spending factor (total expenses divided by total revenues) - Program output index (number of units of actual physical output divided by total program expenses) - Productivity rate (outputs divided by inputs)
Fundraising efficiency	- Percentage of donations left after subtracting the cost of getting them - Percentage of revenues the organization spends on fundraising expenses - Fundraising expenses divided by total expenses - Donor dependency (operational surplus subtracted from donations, divided by donations)
Other financial performance measures	- Revenue growth - Working capital ratio (working capital divided by total expenses) - Day's cash on hand

The United Way of Rhode Island does ratio analysis of the nonprofits that they fund, and/or qualitative analysis of the agencies' audit reports (Voccio). The basis of analyses on nonprofit evaluation is not only financial but also within the transparency of the nonprofit to the funding agency. It is important whether or not internal controls are in place within the agency, as well as sufficient accounting knowledge known within the financial management department of the organization. Three issues encountered by auditors when auditing nonprofit organizations include; insufficient staffing of the accounting/finance department, weak internal communications, and deficient application of internal controls ("Auditing Nonprofits" 1). These issues are problematic due to, if not prioritized, having a high possibility of leading to fraud within the organization ("Auditing Nonprofits: Three Issues Encountered By Auditors" 1).

Nonprofits need to be wise in what they spend their money on, and financial accountability can be very expensive. Insufficient staffing, weak internal communications, and deficient application of internal controls are factors that the auditors are having trouble and very important for organization transparency. If these issues are not resolved within a nonprofit organization, more critical issues can arise including fraud and financial misstatement. Funding agencies want to know that their money is not only going to a good cause, but that it is being used appropriately as they work toward the mission of the organization. Recipients of funds need to be good stewards of the donors' money. This is the reason for the increased demand for disclosure of information by investors as well as the IRS. For these reasons, attention should be given to these areas when evaluating the financial stability of the nonprofits by the funding agencies.

Effects of the State of the Economy

The state of economy affects nonprofits just as it would affect corporations. The recession of 2008 caused disposable income of individuals and companies to decrease. Charities see revenues fall when this happens. With budget cuts in government spending, some programs were eliminated. For funding agencies, economic empathy needs to be taken into consideration to some extent. No funding agency wants a nonprofit to go under. In turn, nonprofits need to ensure that proper staffing and internal controls are met in order for the nonprofit to remain fiscally responsible (Foley 1).

Financial information prepared by a nonprofit can be unreliable when the accounting department is insufficiently staffed. With changes in the economy, some nonprofits choose to save money by decreasing their staff. Due to rising costs, nonprofit organizations usually employ one person to oversee many roles, which increases the potential for error. There may not be enough time to perform all duties asked, or the errors may be overlooked and/or be time-consuming corrections. Due to the sluggish economy, having one person playing so many roles leads to insufficient internal research and evaluation given to strategic planning and organizational growth. Lastly, insufficient staffing can lead to internal fraud. When one person is playing so many roles and taking on many duties, there is an improper segregation of duties. Segregation of duties should be separated as the following:

Segregation of Duties

This diagram exemplifies that in order to have an adequate segregation of duties these three areas need to be separated between at least three different people. As a system of checks in balances, it makes sure that one person does not hold too much responsibility that could essentially lead to fraud in the organization. Authorization of transactions includes a staff member that always signs checks to be written, or authorizes expenditures of the organization. Another staff member must do the record keeping of these expenditures written off by the staff member that authorizes transactions. A last staff member is responsible for holding the money of the organization, and as expenditures are authorized and recorded, they control the operations of the payment.

Internal Controls

Weak internal communications can hurt the reliability of a nonprofit's financial information, especially when the accounting department fails to receive or is unaware of the details surrounding financial transactions ("Auditing Nonprofits" 1). Adequate internal communication involves having proper disclosures within the annual report concerning the information within the financial statements, funding covenants, and internal functions of the organization. Communication breakdowns increase the potential for unrecorded transactions, non-compliance with regulations, and over expenditure of restricted funds. Information required for disclosure on financial statements, such as operating leases or related party transactions, may also be overlooked if not given enough attention to ("Auditing Nonprofits" 2).

Communication between the grant coordinators and the accounting department of nonprofit organizations must be clear so that certain restrictions on grants are complied with and the nonprofit can keep their revenue source. Future grants may be at risk if the organization is closely scrutinized by regulatory agencies and found to be seriously deficient in grant compliance. Potential and current donors may chose to donate elsewhere to ensure that there is better handling of funds that they give. If communication is not strong, fraudulent activity is another risk. Certain expenditures will not be questioned, inventory may be insufficiently recorded, and unusual transactions could go unnoticed ("Auditing Nonprofits" 2).

Lastly, insufficient application of internal controls is extremely important when it comes to the reliability of a nonprofit's financial information. If these policies or procedures are overridden or ignored, breaches occur within the organization when physical security of assets such as inventory or fixed assets is not maintained or when personnel outside of the accounting department are allowed access into the accounting system ("Auditing Nonprofits" 2). A lack of policies or procedures can adversely affect an organization's competitiveness. If reviews of the budgets and forecasts are not done, financial problems may not be identified until the annual audit, delaying corrective action. Internal control inadequacies can also increase fraud risk. If reviews related to financial performance and computer processing of information are not conducted on a regular basis, detecting unusual activities related to fraud is less effective ("Auditing Nonprofits" 2).

After understanding how a nonprofit differs in financial rules and reporting from corporations, we can see why a funding agency would have certain criteria to determine funding or continuing funding to other nonprofits. Just as stockholders want to have trust in their investment, donors would like the same trust in the nonprofit to which they give financial support. Funding agencies' criteria should include financial analysis, qualitative analysis, and empathy to the external environment of nonprofits they give funds to. Required documents by the funding agency should not only include Federal Form 990, the only form required by law that the nonprofit files.

Federal Form 990 is the tax document that tax-exempt nonprofit organizations file each year with the IRS. The Form 990 allows the IRS and the public to evaluate nonprofits and how they operate. It does not include potentially useful information for donors, creditors and regulators, such as cash provided by operating activities. This absence of cash operations information is due to not including selected information from the cash flow statement of a nonprofit organization on Federal Form 990 (Fischer 1).

The following quantitative analyses of nonprofit organizations by nonprofit funding agencies are determined using the financial sources such as Financial Statements, Form 990, the Audit or Review Report of the nonprofit, management letters and A-133 reports for agencies that receive federal funds. If the nonprofit is funded through a fiscal agent, the nonprofit should provide further internal source documentation of the nonprofit fiscal agent (Martello 2). The combination of these sources gives valid information that is useful in the funding agency's determination of financial stability.

Financial Analysis

Financial analysis is very different for a nonprofit compared to a corporation. This is due to differences in mission as well as rules and regulations of accounting processes. I was involved with Johnson & Wales University's Directed Work Experience with the United Way of Rhode Island (UWRI) to develop a new review tool for regulating the organization's funding to nonprofits and determine specific financial criteria for the UWRI to use to review nonprofits. Two fellow students and I worked side by side with a Certified Public Accountant (CPA) and met with the United Way of Rhode Island's CFO, Rich Voccio, and Grants Director, Carmen Ferguson. We were able to learn and develop ratio criteria that would be best for reviewing current and continuation of funding. The traditional ratios that may be good for a company selling goods and services were not similar to those of a nonprofit in order to determine financial stability. Ratios that are best capable of providing valid information on the stability of a nonprofit were determined to be: the current ratio, days cash on hand, debt service coverage ratio, and accounts payable aging indicator. Financial analysis needs to be cautious of where a nonprofit is getting most of its funds, as well as how it spends its money. The key ratios together with a revenue and expenditure analysis, should be used for financial analysis by a funding agency equate to the following:

Current Ratio: $\dfrac{\text{Current Assets}}{\text{Current Liabilities}}$

Days Cash on Hand: $\dfrac{\text{Total Liquid Assets}}{\text{Average Daily Expenses}}$

Debt Service Coverage Ratio: $\dfrac{\text{Adjusted Operated Income}}{\text{Annual Debt Service}}$

Accounts Payable Aging Indicator (in days): $\frac{\text{Accounts Payable and Accrued Expenses}}{\text{Average Daily Expenses}}$

Ratios

The Directed Work Experience team chose these ratios for the United Way of Rhode Island due to providing the most crucial information about nonprofits that is needed for financial stability evaluation coupled with the financial date described below. These ratios provide the following information on nonprofits:

Current Ratio: Measures the relative liquidity of the organization. By comparing assets to liabilities the granting agency can see if the organization can afford its debt due to external sources (liabilities) with their current assets (cash, grants, accounts receivable, inventory).

Days Cash on Hand Ratio: Measures how many days an organization can rely on its cash and liquid assets to fund operations.

Debt Service Ratio: Measures the burden of actual debt service payments relative to the overall operating budget. If this ratio has a high result, this could indicate difficulty in making future debt payments and continuing the mission.

Accounts Payable Aging Indicator: Measures how long in days the agency takes to settle its current debts.

Appendix A shows the sixteen ratios that the United Way of Rhode Island introduced to the Directed Work Experience team. These were what they had been using for financial analysis for their grantees. The team took these sixteen, and decreased them to four exemplified in Exhibit A, as well as an additional Excel review document that analyzes revenue and expenses. The reason for downsize of financial ratios used is due to most of the ratios being incorporated into a percentage analysis of revenues and expenditures. The additional tool allowed the United Way of Rhode Island to be able to see the differences of revenue sources and expenditure costs easier than before. This part of the tool is further explained in the next section.

Revenue Source and Expense Analysis

In addition to ratios, funding agencies need to have financial analysis of where funds are coming from, as well as where they are going. Looking at the financial statements of a nonprofit we can determine revenue growth or decline and concentration of revenue sources, expense composition and overhead rate, and change in net assets and composition thereof.

Since a nonprofit's primary purpose is to provide programs that meet certain societal needs, it issues a Statement of Activities (instead of the income statement that is issued by a for-profit business). Revenue growth and concentration of revenue sources is important in determining if the nonprofit is dependent on the funding agency or another funding source, as well as if the revenue for the nonprofit is growing or declining over time as expenditures grow or decline (Carroll 3). This information can be determined using the Statement of Activities as well as the footnotes to the financial statements. Some examples of revenue composition listed on the Statement of Activities includes the following:

- Contributions
- Membership dues
- Program fees
- Fundraising events
- Grants
- Investment income
- Gain on sale of investments
- Reclassifications when net assets are released from restrictions (a negative amount in the temporarily restricted column and a positive amount in the unrestricted column)

Expense composition is also crucial due to determining if enough money is going towards the mission of a nonprofit compared to employee compensation. This can be done with information from the Statement of Activities of the financial statements. The amount of money spent on a nonprofit's mission depends on the type of nonprofit that is being analyzed (Macleod 4). This is due to the categorization of expenses into two types:

1. Program expenses: (Or Program Services expenses) Are the amounts directly incurred by the nonprofit in carrying out its programs. For instance, if a nonprofit has three main programs, then each of the three programs will be listed along with each program's expenses.

2. Supporting Services expenses: Reported in two subgroups:

- Management and General
- Fundraising

In order to accurately report the amount in each of these subgroups, it may be necessary to allocate some management and general salaries to fundraising based on the time spent by employees performing fundraising activities. These two types of expenses can be in different composition depending on the type of nonprofit and whether or not they provide goods or services to society (such as a nonprofit solely for the purpose of awareness). The overhead rate is equally important in determining how much it costs to run the mission of the nonprofit (program expenses). The comparison between revenue and expenses is crucial to determine the ability of nonprofits' existence. Exhibit B and C show the review tool for revenue and expense analysis that the Directed Work Experience Team developed for the United Way of Rhode Island.

Lastly, the change in Net Assets and composition thereof can be determined using the financial statements of the nonprofit. The change in Net Assets is important due to its representation of how efficient a nonprofit controls its revenues (donations) and expenses (Calabrese 303-304). A nonprofit does not have owners but instead, grants and donations. A corporation's similar section of the balance statement would be Stockholder's Equity. These donations have certain restrictions based on the donors' discretions. We want to know the composition within the Net Assets to help determine how liquid the Net Assets are to the company. The Net Assets section of a nonprofit's statement of financial position reports totals for each of the following classifications:

- Unrestricted Net Assets: If a donor does not specify a restriction on his or her contribution, the amount received by the nonprofit is recorded as an asset and as unrestricted contribution revenues. Unrestricted contribution revenues (reported on the Statement of Activities) also cause the amount of unrestricted net assets to increase. If the nonprofit's board of directors designates some of the nonprofit's unrestricted assets for a specific purpose, those assets must continue to be reported as unrestricted net assets.
- Temporarily Restricted Net Assets: If a nonprofit receives a contribution that has a donor-imposed restriction (other than to be held in perpetuity), the amount is usually recorded as an asset and as temporarily restricted contribution revenues. Temporarily restricted contribution revenues (reported on the statement of activities) also cause the amount of temporarily restricted net assets to increase. Once the donated money is used for intended purposes, the amount is then transferred into unrestricted net assets.
- Permanently Restricted Net Assets: If a donor stipulates that their contribution must be held by the nonprofit in perpetuity (forever, not be used up), the amount is recorded as an asset and as permanently restricted contribution revenues. Permanently restricted contribution revenues (reported on the statement of activities) also cause the amount of permanently restricted net assets to increase.

These classifications are based on the restrictions made by the donors at the time of their contributions. These three classifications of net assets are reported as Net Assets or as Total Net Assets. Exhibit D shows the review tool for analysis of Net Assets that the Directed Work Experience team developed for the United Way of Rhode Island.

Questionnaires

Funding agencies should question the nonprofits they are funding through qualitative analysis as well as quantitative. This includes questionnaires and funding agency individual review tools. The reason for questionnaires is to give the recipients a chance to explain further the conditions of their financial statements, or conditions explained in their audit reviews. Questionnaires are a good source of primary information directly from the nonprofit and allow the nonprofits to provide internal information if they are funded through a fiscal agent. They also allow the nonprofit to provide the funding agency with documentation of what financial documentation they are providing. The questionnaires should include information such as dates of financial statement closing and audit completion, explanations for late audit reports, explanations for missing documentation, checklist of documentation provided, and subsequent events pertaining to specific issues in the management letter. Lastly, sending a questionnaire to a nonprofit grantee, it essentially tells the nonprofits what criteria the funding agency wants them to abide by. It also lets them know that the funding agency is holding them accountable.

Funding agencies require the presentation of Audit or Review reports of the nonprofit. The type of report is determined by mutual agreement between the client and the Certified Public Accountant (CPA). This determination usually depends on many factors including: the needs of the client, needs of creditors or investors, and the size and complexity of the business. The SEC laws require all publicly held enterprises to provide annual audited financial statements, while privately held companies often opt for reviewed or compiled statements. Credit agreements with lenders may require audited statements, even for private companies. In the case of nonprofit organizations, their requirement to have an Audit done is explained above.

There are significant differences between the objectives of an Audit of financial statements in accordance with Generally Accepted Auditing Standards (GAAS) and the objectives of a Review in accordance with Statements on Auditing Standards (SASs). The objective of an Audit is to provide a reasonable basis for expressing an opinion regarding the financial statements taken as a whole (Miller 1). A Review does not provide a basis for the expression of such an opinion. A Review does not "contemplate obtaining an understanding of the internal control structure or assess control risk, test accounting records or responses to inquiries by obtaining corroborating evidential matter through inspection, observation or confirmation, or include certain other procedures ordinarily performed during an audit" (Louwers 62). A Review may bring to the accountant's attention significant matters affecting the financial statements, but it does not provide assurance that the accountant will become aware of all significant matters that would be disclosed in an Audit. A Review offers limited assurance on the financial statements.

Dates are crucial in relation to Audit Reviews and Form 990s. The importance of dates are due to audits that take longer than nine months after year end have many possibilities as to why. They include internal issues within the organization or current affordability to have an auditor come in to conduct an audit. Issues internally could be insufficient staffing or an inefficient financial trail to follow causing an auditor's audit to take longer. The same reasons go for Form 990s. These two documents are used to prove the integrity of the nonprofit organizations' financial information. They provide the assurance to the donors that the nonprofits are not taking advantage of the system, and spending grants and donations appropriately. The average time for a nonprofit to complete an Audit or Review is nine months after year end. Form

990 is due five and a half months after year end. If neither of these filing dates are met, the questionnaire allows the nonprofits to explain their reasons for the deliquency.

Questionnaires should also include checklists for the nonprofits to fill out to let the funding agencies know what documents were received as well as reiterate to the nonprofit grantee what reports are required. This allows organization for the funding agency, as well as automatically disregard nonprofits that don't have needed sources such as financial statements and Audit or Review reports. If documentation is missing, the nonprofit can again, explain their reasoning for not providing. It allows the nonprofit to understand what the funding agency requires for continuation of funding.

Lastly, questionnaires allow the nonprofit to provide information on subsequent events. Audit and Reviews are done for a specific fiscal year. Audits average nine months after year end to be finalized for a nonprofit organization. A lot can happen between the finalization of an audit and year end date that could justify any negativity in the Audit Report or management concerns in the Management Letter. A Management Letter is a letter written by the auditors noting matters that can be made as recommendations to the client to improve the efficiency and effectiveness of their operations (Louwers 63). The questionnaires can help the funding agency to determine whether or not to continue funding with justification.

Exhibit E is an example of a questionnaire the Directed Work Experience team of Johnson & Wales University made for the review process of the United Way of Rhode Island. Appendix B is the questionnaire that the funding agency previously used for their nonprofits. The reasons for changing the questionnaire from the previous one used by the UWRI shown in Appendix B, is due to the team feeling that it did not include enough information on the qualitative side of reviewing nonprofits. Much information regarding reasons why a funded organization may have not met the required dates of an audit, such as change in management for instance, did not have a spot in the previous questionnaire. It also did not allow the organization management to explain their current position for the issues noted in the Management Letter, such as some of the auditors questionable situations within the annual report. By providing a questionnaire to their grantees, the funding agency is able to better understand the situations that the nonprofits are going through, and may cause empathy and understanding to the issues, instead of assuming it is indicative of a problem.

Grantee Agency Reviewers Report

The second part of qualitative analysis should include documentation to determine an evaluation of the information found in the financial statements, Audit or Review report, and Management Letter. This should be completed by the funding agency's reviewer of the grantee agency after quantitative analysis is conducted and the grantee agency's questionnare is recieved. The documentation can summarize all three of these sources; financial analysis, opinion of auditors', answers from nonprofit questionnaires, and the review of issues within the management letter. This will have an overall assessment of the funded nonprofit.

Exhibit F exemplifies the Grantee Agency Reviewer's Report that the Directed Work Experience team of Johnson & Wales University made for the review process of the United Way of Rhode Island.

How Nonprofits Benefit

Leaders of nonprofits are consistently reminded by regulators, donors, and auditors that they must be good stewards of the public trust by ensuring that the resources of the organization, funding agencies, are well protected and used efficiently to accomplish their missions for existence (Foley 1). Nonprofit funding recipients as well as nonprofit funding agencies both benefit from this review process. Nonprofit recipients can benefit from strict review tools of a funding agency in the sense that they know what the funding agency is looking for from them.

By following the criteria and keeping up with the funding agency's standards, the nonprofit can be successful as well. Funding agencies are essentially investors in the nonprofit, so to be protected themselves, they have to make sure they are investing in a safe environment.

An annual audit, filing form 990, and keeping up with strict internal controls will make the nonprofit knowledgeable of their current state, and should lead them to want to be more successful in their accounting standards and performance. The responsibility of these actions is that of the management of the nonprofit organization (Foley 2). These managers must make sure that all regulatory, legal, and reporting requirements imposed by federal, state, and local governments as well as meeting accounting guidelines and standards specific to the industry are fulfilled. At the same time, the nonprofit must comply with all restrictions of the donors on the use of their contributions (Foley 1).

In summary a nonprofit organization should set up a well integrated financial management system in order to accomplish all of its responsibilities. This integrated financial managament system includes:

- Accurate and dependable accounting
- Effective internal controls procedures
- Transparent reporting
- Informed analysis
- Responsible planning
- Appropriate responses to its financial data

Nonprofits do not have all of the funds that corporations have, though those responsible for the organization must adopt and follow good financial and risk management policies and engage staff or volunteer board members who have appropriate accounting and analytical skills to be financially accountable. Small organizations should put these systems into place in the beginning while still small – to position the organization to grow without disruptive overhaul to its financial operations while growing (Foley 2).

By following the criteria of a funding agency, as well as having a fully engaged and effective finance committee, the outcome is a sure indication that an organization is committed to good stewardship and it actively building and preserving its financial resources. Of course, all actions should be supporting the accomplishment of the nonprofit's mission, both short term and long term (Foley 2).

Conclusion

Due to increased fraud in all industries present day for-profit corporations and nonprofits must undergo procedures to ensure the accountability of financial operations. Accountability in nonprofits allows the investors, or grantors, to place their trust in the organizations that serve our less fortunate.

Nonprofit funding agencies have the responsibility for evaluating the organizations they fund to make sure that they are operating with high integrity, maintaining strong internal controls, remaining financially stable, and overall being good stewards of the funds. These areas combined create a transparent environment for the nonprofit recipient, as well as allowing the nonprofit funding agency to ensure that their funds are going to responsible use. The nonprofit funding agency creating standards such as requiring an annual audit, filing Federal Form 990, proper segregation of duties, and maintaining a healthy financial position, can accomplish qualified transparency.

By governmental mandates and grantors' regulations becoming more cumbersome for nonprofits to receive funds, controls will be in place for nonprofits to become more transparent and fiscally responsible internally. These internal controls will allow the organizations to be as responsible as possible within their missions. By becoming more transparent with their missions, those whom the nonprofits serve will benefit to their highest potential.

Exhibit A-1 *Populate within the yellow highlighted areas*

Ratio Analysis

LIQUIDITY	Current Year: $ Amount	Ratio		Prior Year: $ Amount	Ratio	Remarks:
A. Current Ratio						
Current Assets	-	#DIV/0!		-	#DIV/0!	
Current Liabilities	-			-		
B. Days Cash on Hand						
Total Liquid Assets	$ -	#DIV/0!		$ -	#DIV/0!	
Average Daily Expenses	-			-		
DEBT-MANAGEMENT						
C. Debt Service Coverage Ratio						
Adjusted Operating Income	$ -	#DIV/0!		$ -	#DIV/0!	
Annual Debt Service	$ -			$ -		
D. Accounts Payable Aging Indicator (in days)						
Accounts Payable & Accrued Expenses	-	#DIV/0!		-	#DIV/0!	
Average Daily Expenses	-			-		

Support & Explanations for Ratios

A. Current Ratio: Measures the relative liquidity of the Organization.

Items to Include:	Current Year $ Amount	Prior Year $ Amount
Current Assets:		
Cash		
Contributions & Grants Receivable		
Accounts Receivable		
Inventory		
Other Current Assets		
Total Current Assets	$ -	$ -
Current Liabilities:		
Accounts Payable		
Accrued Expenses		
Deferred Revenue		
Current portion of Long-term debt		
Other Current Liabilities		
Total Current Liabilities	$ -	$ -

B. Days Cash on Hand: Measures how many days an organization can rely on its cash and liquid assets to assets to fund operations.

	Current Year $ Amount	Prior Year $ Amount
Liquid Current Assets:		
Cash		
Contributions & Grants Receivable		
Accounts Receivable		
Other Liquid Current Assets		
Total Liquid Current Assets	$ -	$ -

C. Debt Service Ratio: Measures the burden of actual debt service payments relative to the overall operating budget.
High could indicate difficulty in making future debt payments and continuing the mission.

	Current Year $ Amount	Prior Year $ Amount
Operating Income (Increase in Net Assets)	$ -	$ -
Plus:		
Interest Expense		
Depreciation & Amortization		
Operating Lease Payments		
Adjusted Operating Income	$ -	$ -
Annual Debt Service:		
Principal Payments		
Line of Credit		
Capital Lease Payments		
Interest Payments		
Operating Lease Payments		
Annual Debt Service	$ -	$ -

D. Accounts Payable Aging Indicator: Measures how long in days the agency takes to settle its current debts.

	Current Year $ Amount	Prior Year $ Amount
Accounts Payable		
Accrued Expenses		
Total Accounts Payable & Accrued Expenses	$ -	$ -

Exhibit A-2 Populated for Purposes of Review

Agency Name: Nonprofit ABC

Ratio Analysis

LIQUIDITY	Current Year: $ Amount	Ratio	Prior Year: $ Amount	Ratio	Remarks:
A. Current Ratio					
Current Assets	1,800	1.80	1,400	2.15	
Current Liabilities	1,000		650		
Standard:					
<.75 = Low, .75-1.5 = Medium, >1.5 = High					
B. Days Cash on Hand					
Total Liquid Assets	$ 1,500	378	$ 1,200	398	
Average Daily Expenses	4		3		
Standard:					
<70 days= Low,70-120 days = Medium, >120 days = High					
DEBT-MANAGEMENT					
C. Debt Service Coverage Ratio					
Adjusted Operating Income	$ 17,400	11.60	$ 12,675	10.14	
Annual Debt Service	$ 1,500		$ 1,250		
D. Accounts Payable Aging Indicator (in days)					
Accounts Payable & Accrued Expenses	700	176	500	166	
Average Daily Expenses	4		3		

Support & Explanations for Ratios

A. Current Ratio: Measures the relative liquidity of the Organization.

Items to Include:	Current Year $ Amount	Prior Year $ Amount
Current Assets:		
Cash	$ 600	$ 500
Contributions & Grants Receivable	500	400
Accounts Receivable	400	300
Inventory	300	200
Other Current Assets		
Total Current Assets	$ 1,800	$ 1,400
Current Liabilities:		
Accounts Payable	$ 400	$ 300
Accrued Expenses	300	200
Deferred Revenue	200	100
Current portion of Long-term debt	100	50
Other Current Liabilities		
Total Current Liabilities	$ 1,000	$ 650

B. Days Cash on Hand: Measures how many days an organization can rely on its cash and liquid assets to assets to fund operations.

Liquid Current Assets:	Current Year $ Amount	Prior Year $ Amount
Cash	$ 600	$ 500
Contributions & Grants Receivable	500	400
Accounts Receivable	400	300
Other Liquid Current Assets		
Total Liquid Current Assets	$ 1,500	$ 1,200

C. Debt Service Ratio: Measures the burden of actual debt service payments relative to the overall operating budget.
High could indicate difficulty in making future debt payments and continuing the mission.

	Current Year $ Amount	Prior Year $ Amount
Operating Income (Increase in Net Assets)	$ 17,050	$ 12,500
Plus:		
Interest Expense	$ 200	$ 100
Depreciation & Amortization	100	50
Operating Lease Payments	50	25
Adjusted Operating Income	$ 17,400	$ 12,675
Annual Debt Service:		
Principal Payments	$ 400	$ 350
Line of Credit	350	300
Capital Lease Payments	300	250
Interest Payments	250	200
Operating Lease Payments	200	150
Annual Debt Service	$ 1,500	$ 1,250

D. Accounts Payable Aging Indicator: Measures how long in days the agency takes to settle its current debts.

	Current Year $ Amount	Prior Year $ Amount
Accounts Payable	$ 400	$ 300
Accrued Expenses	300	200
Total Accounts Payable & Accrued Expenses	$ 700	$ 500

Exhibit B-1 *Populate within the yellow highlighted areas*

Analysis of Revenue

UNRESTRICTED	Current Year:	% of total	Prior Year:	% of total	$ Change	% Change
List Major Sources of Revenue:						
Grants, Pledges & Contributions		#DIV/0!		#DIV/0!	$ -	#DIV/0!
Sales Revenue		#DIV/0!		#DIV/0!	0	#DIV/0!
Interest Income		#DIV/0!		#DIV/0!	0	#DIV/0!
Donated Services		#DIV/0!		#DIV/0!	0	#DIV/0!
Program & Registration Fees		#DIV/0!		#DIV/0!	0	#DIV/0!
		#DIV/0!		#DIV/0!	0	#DIV/0!
Total UNRESTRICTED Revenue	$ -	#DIV/0!	$ -	#DIV/0!	$ -	#DIV/0!

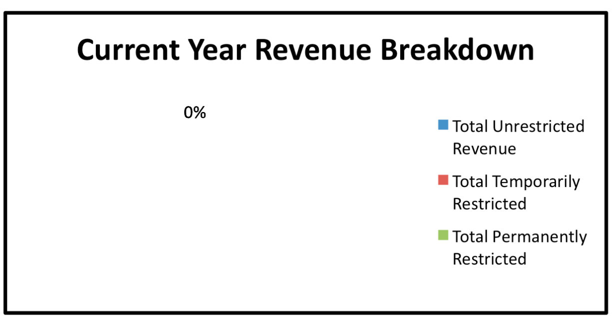
TEMPORARILY RESTRICTED	Current Year	% of total	Prior Year	% of total	$ Change	% Change
List Major Sources of Revenue:						
Grants, Pledges & Contributions		#DIV/0!		#DIV/0!	$ -	#DIV/0!
		#DIV/0!		#DIV/0!	0	#DIV/0!
		#DIV/0!		#DIV/0!	0	#DIV/0!
		#DIV/0!		#DIV/0!	0	#DIV/0!
		#DIV/0!		#DIV/0!	0	#DIV/0!
		#DIV/0!		#DIV/0!	0	#DIV/0!
Total TEMPORARILY RESTRICTED Revenue	$ -	#DIV/0!	$ -	#DIV/0!	$ -	#DIV/0!

PERMANENTLY RESTRICTED	Current Year	% of total	Prior Year	% of total	$ Change	% Change
List Major Sources of Revenue:						
		#DIV/0!		#DIV/0!	$ -	#DIV/0!
		#DIV/0!		#DIV/0!	0	#DIV/0!
		#DIV/0!		#DIV/0!	0	#DIV/0!
Total PERMANENTLY RESTRICTED Revenue	$ -	#DIV/0!	$ -	#DIV/0!	$ -	#DIV/0!

TOTAL REVENUE	$ -	#DIV/0!	$ -	#DIV/0!	$ -	#DIV/0!
Grant from United Way Rhode Island		#DIV/0!		#DIV/0!	$ -	#DIV/0!

Revenue Summary:

	Current Year	Prior Year
Total Unrestricted Revenue	$ -	$ -
Total Temporarily Restricted	$ -	$ -
Total Permanently Restricted	$ -	$ -



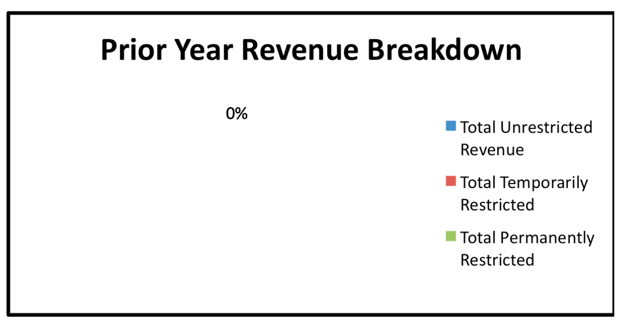


Exhibit B-2 Populated for Purposes of Review

Agency Name: Nonprofit ABC

Analysis of Revenue

UNRESTRICTED	Current Year:	% of total	Prior Year:	% of total	$ Change	% Change
List Major Sources of Revenue:						
Grants, Pledges & Contributions	$ 5,000	27.03%	$ 4,000	29.41%	$ 1,000	25.00%
Sales Revenue	4,000	21.62%	3,000	22.06%	1,000	33.33%
Interest Income	3,000	16.22%	2,000	14.71%	1,000	50.00%
Donated Services	2,000	10.81%	1,000	7.35%	1,000	100.00%
Program & Registration Fees	1,000	5.41%	500	3.68%	500	100.00%
		0.00%		0.00%	0	#DIV/0!
Total UNRESTRICTED Revenue	$ 15,000	81.08%	$ 10,500	77.21%	$ 4,500	42.86%

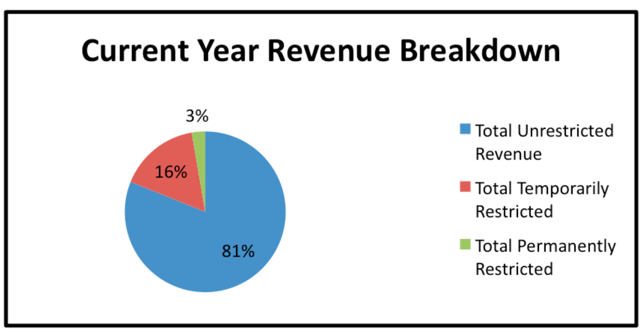
TEMPORARILY RESTRICTED	Current Year	% of total	Prior Year	% of total	$ Change	% Change
List Major Sources of Revenue:						
Grants, Pledges & Contributions	$ 3,000	16.22%	$ 2,500	18.38%	$ 500	20.00%
		0.00%		0.00%	0	#DIV/0!
		0.00%		0.00%	0	#DIV/0!
		0.00%		0.00%	0	#DIV/0!
		0.00%		0.00%	0	#DIV/0!
		0.00%		0.00%	0	#DIV/0!
Total TEMPORARILY RESTRICTED Revenue	$ 3,000	16.22%	$ 2,500	18.38%	$ 500	20.00%

PERMANENTLY RESTRICTED	Current Year	% of total	Prior Year	% of total	$ Change	% Change
List Major Sources of Revenue:						
"PNC Bank"	500	2.70%	$ 600	4.41%	$ (100)	-16.67%
		0.00%		0.00%	0	#DIV/0!
		0.00%		0.00%	0	#DIV/0!
Total PERMANENTLY RESTRICTED Revenue	$ 500	2.70%	$ 600	4.41%	$ (100)	-16.67%

TOTAL REVENUE	$ 18,500	100.00%	$ 13,600	100.00%	$ 4,900	36.03%
Grant from United Way Rhode Island	$ 200	1.08%	$ 100	0.74%	$ 100	100%

Revenue Summary:

	Current Year	Prior Year
Total Unrestricted Revenue	$ 15,000	$ 10,500
Total Temporarily Restricted	$ 3,000	$ 2,500
Total Permanently Restricted	$ 500	$ 600



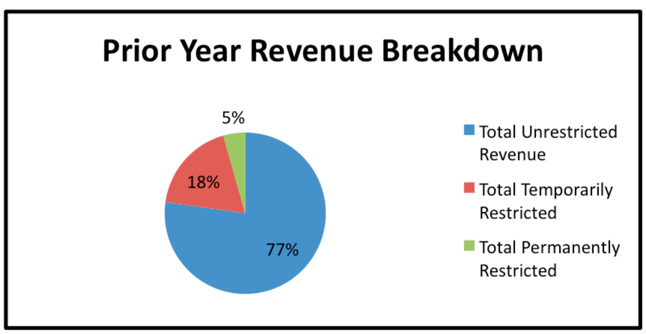
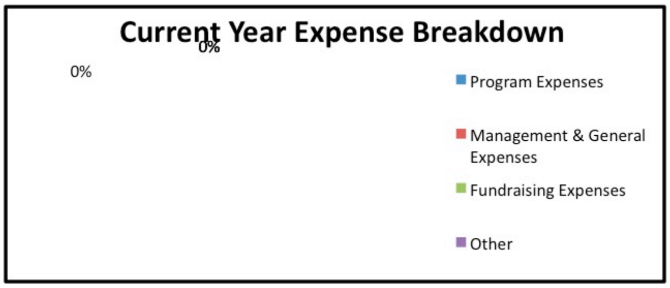
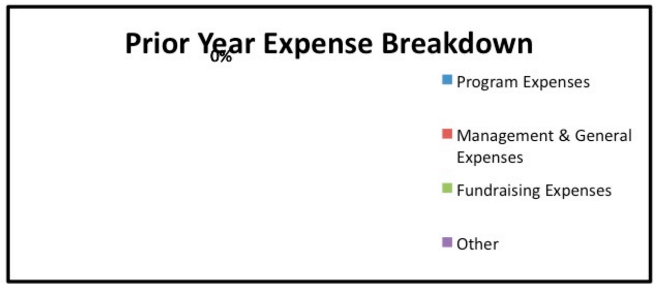


Exhibit C-1 *Populate within yellow highlighted areas*

Analysis of Expenses

	Current Year:	% of total	Prior Year:	% of total	$ Change	% Change
Program Expenses		#DIV/0!		#DIV/0!	$ -	#DIV/0!
Management & General Expenses		#DIV/0!		#DIV/0!	0	#DIV/0!
Fundraising Expenses		#DIV/0!		#DIV/0!	0	#DIV/0!
Other		#DIV/0!		#DIV/0!	0	#DIV/0!
					0	#DIV/0!
					0	#DIV/0!
Total Expenses	$ -	#DIV/0!	$ -	#DIV/0!	$ -	#DIV/0!
Total Revenue	$ -	#DIV/0!	$ -	#DIV/0!	$ -	#DIV/0!
Increase (Decrease) in Net Assets	$ -		$ -		$ -	#DIV/0!



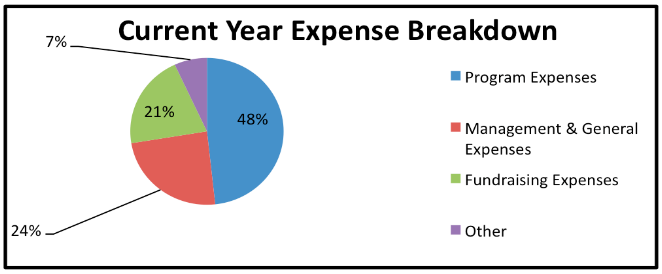


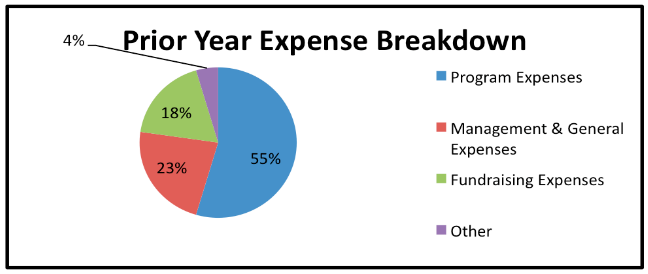
Overhead Rate:	Current Year	Ratio	Prior Year	Ratio
Management & General + Fundraising	0	#DIV/0!	0	#DIV/0!
Total Expenses	$ -		$ -	

Agency Name: Nonprofit ABC

Analysis of Expenses

	Current Year:	% of total	Prior Year:	% of total	$ Change	% Change
Program Expenses	$ 700	48.28%	$ 600	4.41%	$ 100	16.67%
Management & General Expenses	350	24.14%	250	1.84%	100	40.00%
Fundraising Expenses	300	20.69%	200	1.47%	100	50.00%
Other	100	6.90%	50	0.37%	50	100.00%
					0	#DIV/0!
					0	#DIV/0!
Total Expenses	$ 1,450	100.00%	$ 1,100	8.09%	$ 350	31.82%
Total Revenue	$ 18,500	100.00%	$ 13,600	100.00%	$ 4,900	36.03%
Increase (Decrease) in Net Assets	$ 17,050		$ 12,500		$ 4,550	36.40%





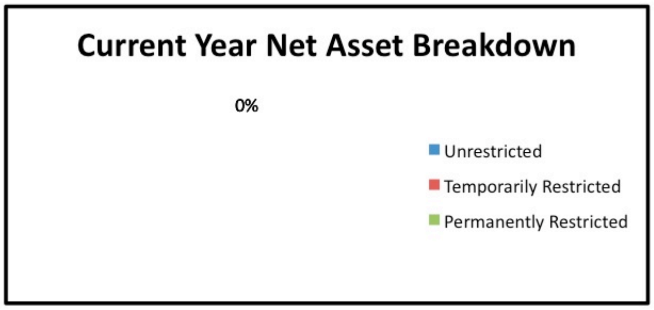
Overhead Rate:	Current Year	Ratio	Prior Year	Ratio
Management & General + Fundraising	650	44.83%	450	40.91%
Total Expenses	$ 1,450		$ 1,100	

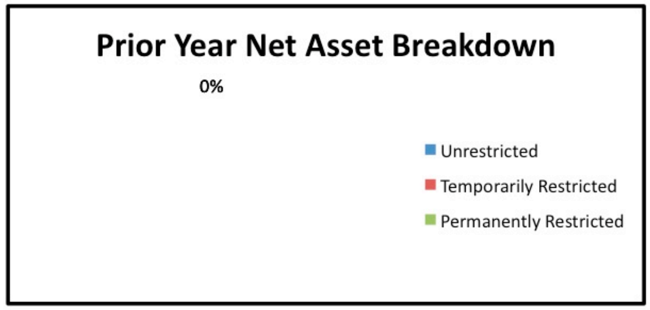
Standard: <10% = High, 10-15% = Medium, >15% = Low

Exhibit D-1 *Populate within the yellow highlighted areas*

Analysis of Net Assets

	Current Year:	% of total	Prior Year:	% of total	$ Change	% Change
Unrestricted		#DIV/0!		#DIV/0!	$ -	#DIV/0!
Temporarily Restricted		#DIV/0!		#DIV/0!	0	#DIV/0!
Permanently Restricted		#DIV/0!		#DIV/0!	0	#DIV/0!
Total Net Assets	$ -	#DIV/0!	$ -	#DIV/0!	$ -	#DIV/0!

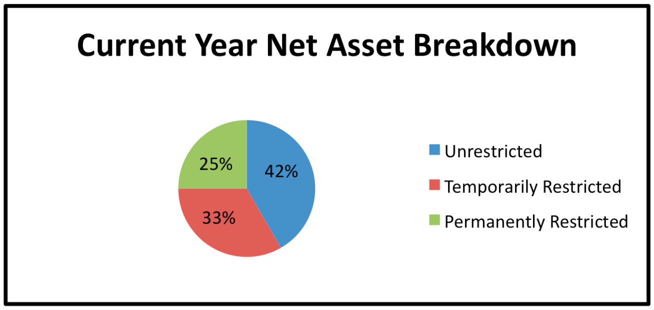




Agency Name: Nonprofit ABC

Analysis of Net Assets

	Current Year:	% of total	Prior Year:	% of total	$ Change	% Change
Unrestricted	$ 500	41.67%	$ 400	44.44%	$ 100	25.00%
Temporarily Restricted	400	33.33%	300	33.33%	100	33.33%
Permanently Restricted	300	25.00%	200	22.22%	100	50.00%
Total Net Assets	$ 1,200	100.00%	$ 900	100.00%	$ 300	33.33%



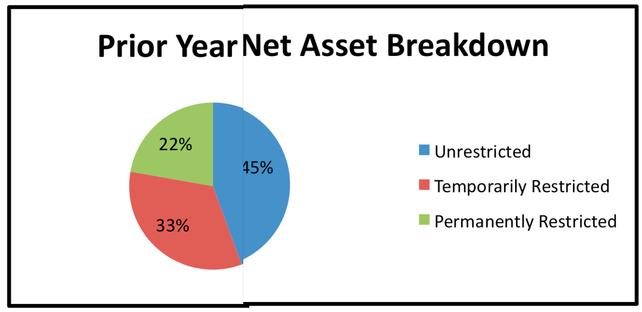


Exhibit E-1

Grantee Agency Annual Questionnaire

United Way of Rhode Island

Section I – General Information

Name of Agency:	
501(c)3:	☐ Yes ☐ No
United Way Grant Amount per year:	
Contract period:	
Name of Fiscal Agent, if applicable:	

Section II – Financial Reporting Package Required

Reports required to be provided to United Way for the most recent year end are as follows:

Check here if reports are for Fiscal Agent rather than the Agency:

	Check below			
	Yes	No	N/A	If no, please explain below:
Audited Financial Statements if Revenue greater than $300,000	☐	☐	☐	
Reviewed Financial Statements if revenue less than $300,000	☐	☐	☐	
A-133 Report	☐	☐	☐	
Management Letter	☐	☐	☐	
Auditor's Report on Internal Control Over Financial	☐	☐	☐	
Form 990	☐	☐	☐	

Other reports prepared by auditor's list below:

If Agency has Fiscal Agent, please provide the following internal reports for the Agency:				
	Check below			
	Yes	No	N/A	If no, please explain below
Internally generated financial statements	☐	☐	☐	
Budget to Actual Revenue and Expense comparisons	☐	☐	☐	

Year end date of reports provided:	

Section III – Additional Information

Please answer the following additional questions pertaining to the Agency:	
Date of Audit/Review Report:	
If greater than 9 months after year end, please provide explanation:	
List all significant subsequent events since the date of financial statements provided:	
If not provided in reporting package, please comment below on management's resolution to management letter comments:	
Was form 990 filed on time?	☐ Yes ☐ No
If no, please explain:	
Is the Agency registered with the Better Business Bureau?	☐ Yes ☐ No

Exhibit F-1

Grantee Agency Reviewer's Report

United Way of Rhode Island

Name of Agency:	
Fiscal Agent, if applicable:	
Name of Reviewer:	

Information received from Agency:	Check below		
	Yes	No	N/A
Audited Financial Statements if Revenue greater than $300,000	☐	☐	☐
Reviewed Financial Statements if revenue less than $300,000	☐	☐	☐
A-133 Report	☐	☐	☐
Management Letter	☐	☐	☐
Auditor's Report on Internal Control Over Financial Reporting	☐	☐	☐
Form 990	☐	☐	☐
Other reports prepared by auditor's list below:			

Based on financial analysis (Excel File), comment on the following:
Revenue growth (decline) and concentrations of revenue sources:
Expense composition and overhead rate:
Change in Net Assets and composition thereof:
Liquidity and Cash Flow:
Debt-Management:

Based on Auditor's Report, comment on the following:
Timing:
Type of Opinion:
Items worthy of mention found in the footnote disclosures (Ex. Debt covenant violations, commitments and contingencies and concentrations of risk, etc.):

Based on Management letter and internal control report, list areas of concern and management's resolution:	
Areas of Concern:	Management's Resolution:
Reportable Conditions:	
Material Weaknesses:	
Other:	

Conclusion:	
Was Form 990 filed on time?	☐ Yes ☐ No
Overall assessment:	
Are there any concerns the United Way should be aware of that might impact the Grantee Agency's ability to continue its mission over the next 12-24 months?	

United Way of Rhode Island
Audit Review Committee - Analysis of Grantee Financial Statements

AGENCY:

YEAR ENDING:

RATIO ANALYSIS

	Ratio Description	12/31/10 Current Year	12/31/09 Prior Year
1	**DAYS CASH ON HAND (# of Days)**		
2	**LIQUID FUNDS RATIO (# Months)**		
3	**LIQUIDITY RATIO (# Months)**		
4	**NET TEMPORARILY RESTRICTED ASSET RATIO**		
5	**ACCOUNTS PAYABLE AGING INDICATOR (# Months)**		
6	**SAVINGS INDICATOR**		
7	**CONTRIBUTIONS AND GRANTS RATIO**		
8	**FUNDRAISING EFFICIENCY RATIO**		
9	**FUNDRAISING EXPENSE RATIO**		
10	**PROGRAM SERVICE EXPENSE RATIO**		
11	**MANAGEMENT EXPENSE RATIO**		
12	**PROGRAM SERVICE DEMAND RATIO**		
13	**ENTERPRISE LIQUIDITY RATIO**		
14	**DEBT SERVICE TO OPERATIONS RATIO**		
15	**DEBT SERVICE COVERAGE RATIO**		
16	**EXPENDABLE FINANCIAL RESOURCES**		

United Way of Rhode Island

Audit Review Committee – Analysis of Grantee Financial Statements

Agency:

Reviewer:

List below information received on Grantee from UWRI:

Review of Financial Statements and Financial Footnotes:

Ratio Analysis: Using the Ratio Computations, summarize the key indicators of financial health for the grantee agency. Indicators of financial distress are:

- Negative working capital (current liabilities > current assets)
- Significant, recurring annual deficits
- Decrease in revenue
- Access to cash from lenders, funders or donors is declining
- Debt covenant violations
- Decline in mission critical expenditures

Liquidity:

Cash Flow:

Operating Surpluses/Deficits:

Restrictions on Resources and Net Assets:

Debt Covenants:

United Way of Rhode Island

<u>Other Observations</u>: In your review of the financial statements and footnotes are there any concerns that United Way should be aware of that might impact the grantee agency ability to continue its mission over the next 12-24 months.

<u>Review of Management Letters, A-133 Reports and Other Audit Correspondence:</u>

In your review of the above documents, please summarize any concerns that might preclude the grantee agency to continue its mission over the next 12-24 months. Indicators that could suggest that an agency is having financial issues are:

- Audit adjustments not recorded by management.
- Internal control issues reported in the management letter.
- Control deficiencies relative to the administration of federal funds.

Annotated Bibliography

"Auditing Nonprofits: Three Issues Encountered By Auditors." Auditing Nonprofits: Three Issues Encountered By Auditors. July 2004. Web. 06 Apr. 2012. <http://www.pro2net.com/x44326.xml>.

Contributing to external factors research on what funding sources should pay attention to determining whether or not to donate to nonprofits, involves analysis of the audit of the nonprofit. To understand the audit, further understanding of what is difficult for the auditor is extremely helpful in determining funding. This article explains three issues encountered by auditors, insufficient staffing of the accounting/finance department, weak internal communications, and deficient application of internal control. If these are difficult to the auditor, funding sources should understand that these issues are very important when determining funding.

Bryson, John M. Strategic Planning for Public and Nonprofit Organizations: A Guide to Strengthening and Sustaining Organizational Achievement. San Francisco: Jossey-Bass, 1995. Print.

This book is focused on the strategic management and planning internally by public and nonprofit agencies. This would contribute to internal factors that can help with the success of financial stability of the agency. John Bryson recognizes that strategic management is what is called for today, meaning strategic planning must be linked to leadership, stakeholder involvement, the budget process, system redesign, and performance management.

Calabrese, Thad D. "The Accumulation of Nonprofit Profits: A Dynamic Analysis." Nonprofit and Voluntary Sector Quarterly (2011). Sage Publications. SAGE, 15 Apr. 2011. Web. 6 Apr. 2012. <http://nvs.sagepub.com/content/41/2/300>.

This article contributes to internal factors of financial stability for a nonprofit for my thesis paper. This report is an analysis examining why nonprofits choose to retain unrestricted net assets. This article explains that unrestricted net assets are a more accurate definition of available internal resources than total net assets. This article tests several theories that might motivate nonprofit accumulation of unrestricted net assets. Results show that nonprofits target profits and seek accumulation over time, and targets may be set at low levels for the purpose of reducing organizational financial vulnerability.

Carroll, Deborah A., and Keely J. Stater. "Revenue Diversification in Nonprofit Organizations: Does It Lead to Financial Stability?" Journal of Public Administration Research and Theory 19 (2008): 947-66. Print.

This article is research on nonprofits based on whether revenue diversification leads to greater stability in the revenue structures of nonprofit organizations. The findings suggest that nonprofits can indeed reduce their revenue volatility through diversification, particularly by equalizing their reliance on earned income, investments, and contributions. This article contributes to internal factors that Agency management can use to become more financially stable and marketable to funding sources. A diversified portfolio encourages more stable revenues and consequently could promote greater organizational longevity. The nonprofit should not rely on one revenue source to fund their program. The analysis also reveals several other important factors that contribute to nonprofit revenue stability.

Epstein, Marc J., and F. Warren McFarlan. "Measuring the Efficiency and Effectiveness of a Nonprofit's Performance." Institute of Management Accountants. Institute of Management Accountants, Inc., 2011. Web. 6 Apr. 2012. <http://www.imanet.org/PDFs/Public/SF/2011_10/10_2011_epstein.pdf>.

This article by the Institute of Management Accountants will be useful in evaluating internal factors that contribute to nonprofit stability. Nonprofit organizations devote significant effort to measuring performance that’s often focused on financial metrics related to dollars raised from donor and budget achievement, as well as organizational success focused primarily on achieving their mission. This article describes the critical importance of including both financial and nonfinancial measures to evaluate nonprofit organizations. Current practice in performance measurement against an organization’s mission has often been weak, this article tries to point out ways to strengthen performance measurement for the benefit of the nonprofit itself.

Fischer, Mary. "Tax-Exempt Organizations and Nonarticulation: Estimates Are No Substitute for Disclosure of Cash Provided by Operations." Accounting Horizons 22.2 (2008): 133-58. Sage Publications. SAGE, June 2008. Web. 6 Apr. 2012. <http://link.aip.org/links/rre_nosuchart.jsp>.

As an external factor contributor to my honors thesis, this article by Mary Fischer explains the difficulty of using only a Form 990 when examining a nonprofit organization. Form 990 does not include potentially useful information for donors, creditors, and regulators such as cash provided by operational activities. Theoretically it is possible to derive operating cash flows from revenue, expenses, and balance sheet accounts included in the return, but this study determined whether cash from operations can be accurately calculated from Form 990 data. Results appear to show that an accurate estimate of cash flow from operating activities cannot be derived from the other financial statements; therefore those involved with this study suggest that Form 990 be revised to include selected information from the cash flow statement. Due to this study, financial measurement and evaluation cannot be solely based on Form 990, more information from the Agency must be given to the funding source.

Foley, Elizabeth H. "Stewardship & Accountability." Featured Articles. 2008. Web. 02 Apr. 2012. <http://www.nonprofitaccountingbasics.org/reporting-operations/stewardship-accountability>.

The “Stewardship & Accountability” article by Elizabeth Foley, pertains to the importance of the trust that the financial statements enable investors (contributors) to have in the agency. The article pertains to certain government specifications and what should be included within your financial records. The article also explains the goal of financial accountability of agencies. This trust is also placed in the fiscal agencies of the nonprofits, if your statements are not accountable, they will not see fit to keep contributing. This article is important for both sides of my thesis, what fiscal agencies should look for as far as accountability as well as how an agency themselves can be more accountable against their competitors.

Gregg, Katherine. "Sport Institute Donor Says Doyle 'mischaracterized' His Relationship with the Charity." *The Providence Journal*. N.p., 7 Mar. 2012. Web. 30 Oct. 2012. <http://news.providencejournal.com/breaking-news/2012/03/sport-institute-3.html>.

This article explains the scandal at the Institute of International Sport a part of the University of Rhode Island. This article is one of many scandals that exemplify why the review of nonprofit of organizations is crucial to the assurance and transparency of accounting regulations. This scandal is one of many for the Institute of International Sport.

Hatry, Harry P. Performance Measurement: Getting Results. Washington, D.C.: Urban Institute, 2006. Print.

This book will be helpful with my thesis in providing insight to financial measures on nonprofit accounting and reporting. The Urban Institute pioneered methods for government and human services agencies to measure the performance of their programs. This book synthesizes more than two decades of Harry Hatry's pioneering work on performance measurement into a comprehensive guide. The author explains every component of the process, from identifying the program's mission, objectives, customers, and trackable outcomes to finding the best indicators for each outcome, the sources of data, and how to collect them. He covers the selection of indicator breakouts and benchmarks for comparisons to actual values and suggests a number of uses for performance information.

Louwers, Timothy J. *Auditing & Assurance Services*. New York: McGraw-Hill Irwin, 2011. Print.

This textbook by Timothy Louwers is a prominent resource for auditing procedures and history, which is very important due to the reasons why auditors review corporations as well as nonprofits. Auditors stand to be the source of validity for organizations with financial standing, and due to this investors and grantors can give money with assurance that the company is using it for responsible use. This textbook explains the differences between audits and reviews, exemplifying why the assurance standards are viewed differently between each.

Macleod, Roderick K. "Program Budgeting Works In Nonprofit Institutions." Harvard Business Review EBSCOhost (2000): 46-56. Print.

This article contributes to internal as well as external factors of nonprofit accounting and reporting efficiency. This article explains the increased demands for better controls over expenditures of the money materials, and manpower that nonprofits contribute. This article emphasizes that program budgeting is beneficial to the nonprofit itself in keeping it financially stable and efficient. This draws attention to funding sources having attention on Agency budgets and whether or not the Agency properly stays within restraints of the budgets.

Martello, Michael, John G. Watson, and Michael J. Fischer. "Implementing A Balanced Scorecard In A Not-For-Profit Organization." Journal of Business & Economics Research 6.9 (2008). Print.

This paper examines the use of the Balanced Scorecard in a nonprofit organization. They used this scorecard on The Rehabilitation Center nonprofit and they started using the tool within their nonprofit. The Balanced Scorecard uses the basic concepts of the financial perspective, customer perspective, internal process perspective, and learning and growth perspective when developing what should be evaluated as well as paid attention to within the Agency. This report can contribute external as well as internal factors of what should be evaluated by funding sources as well as paid attention to internally by Agencies.

Miller, Shawn H. "Post-Fieldwork Considerations for Audits." Featured Articles. 2012. Web. 01 Apr. 2012. <http://www.nonprofitaccountingbasics.org/audit-process/post-fieldwork-considerations-audits>.

This article is a description of post-fieldwork for auditors of nonprofit organizations. A part of the article that is critical, is the explanation of how crucial it is to complete the post-fieldwork of your audit in efficient time before the audit is finished. Post-fieldwork is after the audit is complete but ties up some odds and ends with discussions with management about discovered issues. Nonprofits have a habit of not having efficient timing between their year-end and audit date. The closer the dates are the more efficient the financial information will be. This information is important for the agency's perspective; how the agency can become more financially stable by knowing what the auditors may be looking for and making sure their process has efficient timing.

"Nonprofit (Not-for-Profit) Accounting." Accounting Coach. Accounting Coach, LLC, 2012. Web. 06 Apr. 2012. <http://www.accountingcoach.com/nonprofit-accounting/>.

The "Nonprofit (Not-for-profit) Accounting" article presents some of the basic concepts that are unique to nonprofit accounting and reporting. This article would be useful in this thesis paper in helping develop an introduction and background on nonprofit accounting and how its financial measurement and stability would be different to that of for-profit accounting. Nonprofits do not have commercial owners and must rely on funds from contributions, membership dues, program revenues, fundraising events, public and private grants, and investment income. Due to this, it's accounting and reporting is unique and measurement can be done many different ways.

Poirier, Kevin W. "Nonprofit and Governmental Accounting." Senior Seminar. Johnson & Wales University, Providence. 18 Apr. 2012. Lecture.

Kevin Poirier's lecture gave a base of information for the differences between nonprofits and public accounting in a detailed scope. This provides background information on nonprofits for my thesis paper. It is important to understand why different industries such as public, for profit, and nonprofits, have different accounting standards as well as financial measurement capabilities. This lecture gave a basis for public accounting as well as nonprofit reporting standards within financial reporting and tax-basis.

Poister, Theodore H. Measuring Performance in Public and Nonprofit Organizations. San Francisco: Jossey-Bass, 2003. Print.

Measuring Performance in Public and Nonprofit Organizations shows the development of a commitment to increased accountability and improved performance essential in both governmental agencies and nonprofit organizations. To help managers and executives in their ongoing quest for greater accountability and improved performance Theodore H. Poister, offers a comprehensive resource for designing and implementing effective performance measurement systems at the agency level. The ideas, tools, and processes in this vital resource help organizations develop measurement systems to support such results-oriented management approaches as strategic management, results-based budgeting, performance management, process improvement, performance contracting, and employee incentive systems. Using this book as a guide, public and nonprofit organizations accurately measure outputs, efficiency, productivity, effectiveness, service quality, and customer satisfaction, and use the resulting data to strengthen decision-making and improve agency and program performance. These ideas and data will contribute to the external factors that funding agencies should look at, as well as internal factors that Agencies can use to be more efficient in financial stability.

Schwartz, Sara L., and Michael J. Austin. "Financing and Evaluating Nonprofits: Mapping the Knowledge Base of Nonprofit Management in the Human Services." Financing and Evaluating Nonprofits. Print.

This article shows the development of demands from funding sources and constituents for accountability to nonprofits. These groups have required nonprofits to develop systems to evaluate their service delivery and financial performance. This is important for external evaluation as well as the internal factors that need to be considered when making your nonprofit financially stable. The dual challenges and the rapid development of technology have pressured nonprofits to adopt mechanisms to integrate and evaluate service and financial data.

Sorrells, R. Michael. "IRS Exempt Organizations Annual Report and Workplan: What the IRS Is Up To!" Featured Articles. 2012. Web. 02 Apr. 2012. <http://www.nonprofitaccountingbasics.org/form-990-core-form/irs-exempt-organizations-annual-report-workplan-what-irs>.

This article is important for nonprofit organizations' accounting due to understanding what the IRS is now going to be focusing on in terms of nonprofit organizations, activities, and issues. This article discusses aspects of nonprofits' annual reports as well as their work plans.

Some nonprofit organizations only provide a Form 990, this is due to the organization having an annual report only for their parent fiscal agent. The form 990 is crucial to each company to see where donations are coming from and costs of the actual program are. This can be crucial to both sides of my research, from the aspect of the agency as well as the fiscal agent.

Voccio, Rich. "United Way Service Agency Evaluation." Personal interview. 11 May 2012.

Rich Voccio is the CFO of the United Way of Rhode Island. They United Way is a nonprofit organization which serves as a funding source to agencies of all different missions. The United Way provides grants to these agencies and conducts evaluation based on financial performance as well as internal controls to determine whether or not to continue funding. This source pertains to external factors that funding sources, such as the United Way, should use when determining funding or the continuation of funding.