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Financial Due Diligence

Welcome Everyone!

To participate in today's webinar, you must:

1. LOG-IN to SEE the web portion; and
2. DIAL-IN to HEAR the audio portion.

Call: 866-740-1260.

Use the following access code: 7853891

You will hear hold music until 2:00PM

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June 6, 2012

Financial Due Diligence:
It's More Than Checking Boxes

***Presented By*: Thomas A. McLaughlin**

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McLaughlin & Associates

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Moody's "Core Dimensions of Governance"

- Development of Organization's Mission
- Selection and Evaluation of Senior Management
- Board Composition and Performance
- Understanding and Interpreting of Financial Reporting
- Use of Performance Metrics to Regularly Review Institutional Performance
- Maintaining and Building the Organization's Financial Resources
- Avoiding Conflicts of Interest

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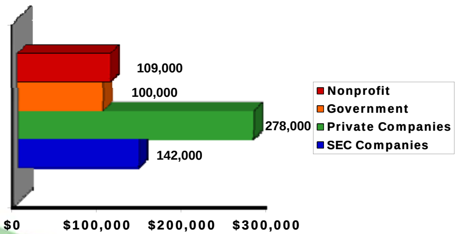
Median Losses by Type of Organization (2012)



Source: Association of Certified Fraud Examiners

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‘Risk’ of Check-the-Box Due Diligence

- Snapshot in time
- May be descriptive, not analytical
- Implicitly relies on adequate systems
- Little historical perspective
- Narrow definition of risk

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Risk: Governance Structure

	Organization A
Required # of Board Members (by-laws)	Minimum of 6
Officers	Minimum of 3
Committees	2
Board meeting frequency	2-3 times/yr
Current # of Board Members	5
Average Board Attendance	51%
Average Staff Attendance	1

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Risk: Board Composition

	Organization A
Nonprofit	0
For-Profit – Public	3
For-Profit – Private	13
Government	0
Other/non-affiliated	6
President/CEO or equivalent (also included in above numbers)	9

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Risk: Executive Compensation Imbalance

Problem: CEO compensation is more than ~25% higher than next highest paid executive

If CEO compensation is fair:
1. No 'bench strength' for succession planning or emergencies
2. Executive talent pool may not be up to leadership caliber
3. 'It's The CEO's Show'

If CEO compensation is not fair (i.e., too high):
1. Other executives may be rewarded for loyalty, not outcomes
2. Other salaries may be skewed upward as well
3. Staff alienation can percolate

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☐ Check this box if the organization did not compensate any current officer, director, or trustee

(A) Name and Title	(B) Average hours per week	(C) Position (check all that apply): Individual trustee or director	Institutional trustee	Officer	Key employee	Highest compensated employee	Former	(D) Reportable compensation from the organization (W-2/1099-MISC)	(E) Reportable compensation from related organizations (W-2/1099-MISC)	(F) Estimated amount of other compensation from the organization and related organizations
[redacted]				X				134,487.		26,011.
				X				104,859.		24,348.

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Risk: Parochial Executive Experience

- In-bred executive culture
- Stability prized over innovation and growth
- Distorted sense of diversity
- Not Invented Here
- Exceptionalism
- Slow strategic response time
- Overly cautious management style

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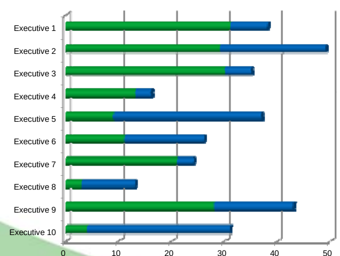
Risk: Parochcial Executive Experience



Green = Organizational experience

Blue = Experience elsewhere

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Risk: Donor Over-Concentration

Problem: One or a small number of donors contribute a high percentage of total revenue .

- Organization at risk in event of donor fatigue
- Donors exert undue influence
- Donors taken for granted
- Organizational complacence
- Other donors stay away due to 'turf' concerns
- If government funder involved, may be easier target for cuts

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Risk: The 'Over-busy' Corporation

Problem: A single successful nonprofit corporation has grown highly complex

- Mission drift
- Strategic confusion
- Vulnerability to government payment policies
- Mixed risk profile
- Client groups may be overlooked

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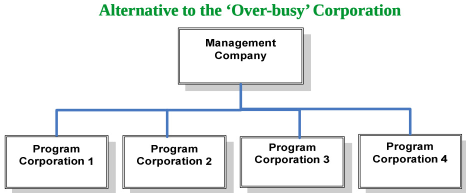
Alternative to the 'Over-busy' Corporation



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Risk: The Valued Employee

Acknowledged: Bruce is a gem

- Long time employee
- Always willing to pitch in
- Early in, late to leave for home
- Never takes a vacation

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Risk: The Valued Employee

Problem: What to give Bruce?

- A promotion?
- A raise?
- A bonus?
- All three?

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Risk: The Valued Employee

Meet Bruce

www.ccrllp.com © 2011

Risk: Long Time to Finish Audit

Problem: Yearly audits not finished promptly.

To analyze: calculate # of days between end of fiscal year and date of opinion letter. If more than ~120 days, ask why . . .

If part of understanding with auditors, probably okay
If unplanned:

- Learn reasons for the delay
- What has changed since then, if anything?
- Fair question; what other poor systems do we have?

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Independent Auditors' Report

The Board of Directors

Boston, Massachusetts

We have audited the accompanying statement of financial position of American Nonprofit as of June 30, 2011 and the related statements of activities, functional expenses and cash flows for the year then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of American Nonprofit as of June 30, 2011 and the results of its operations and its cash flows for the year then ended, in conformity with generally accepted accounting principles.

October 28, 2011

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Risk: Too Much Cash

Problem: Excess cash is 'lazy money'

Ask if planned or unplanned. If unplanned, ask:

- Is it one time only or ongoing?
- Who else is aware?
- Who manages the asset (is cash under control of unsupervised staff?)
- Why not invest some for longer term?

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Form 990 (2009) 04-2687260 Page 11

Part X Balance Sheet

	(A) Beginning of year		(B) End of year
1 Cash - non-interest-bearing	496,794.	1	592,648.
2 Savings and temporary cash investments		2	

d MISCELLANEOUS	91,358.	74,349.		17,009.
e TEMP HELP	15,154.	15,154.		
f All other expenses				
25 Total functional expenses. Add lines 1 through 24f	2,902,142.	2,642,910.	234,373.	24,859.

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Risk: Too Little Cash

Problem: Inadequate cash may be a prelude to bankruptcy

Ask if planned or unplanned. If unplanned, ask:

- Is it one time only or ongoing?
- Who else is aware?
- Who manages the asset (is cash under control of unsupervised staff?)
- Why not invest some for longer term?

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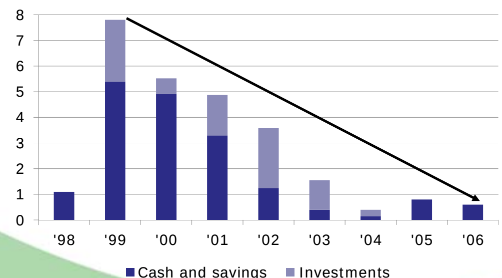
MUSEUM



www.nonprofitrisk.org Source: Nonprofit Finance

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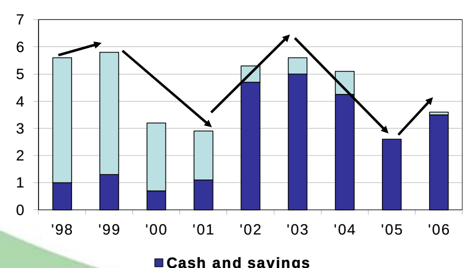
THEATER



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Risk: High Accounts Receivable

Problem: Build up of unpaid invoices

To analyze: ask . . .

- Who supervises the asset?
- Is this from slow billing or slow collection? Or both?

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Risk: Large Investment in Real Estate

Problem: 'Property/plant/equipment' is largest item on balance sheet.

Use Accounting Age of Property to gauge seriousness (see next slide)

Ask if real estate is fully used in programming or for management purposes (offices, etc.). If yes, probably okay. If not, ask:

- How many parcels of real estate?
- What are future prospects of programs involved? Remember, governmental budget cuts are on the horizon for many kinds of programs
- If cuts come, can real estate be quickly re-purposed?
- If not, can one or more pieces be sold or rented out?

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10 a Land, buildings, and equipment cost or other basis Complete Part VI of Schedule D	10a	419,425.			
b Less accumulated depreciation	10b	301,429.	58,989.	10c	117,996.

22 Depreciation, depletion, and amortization	47,204.	27,459.	19,745.	

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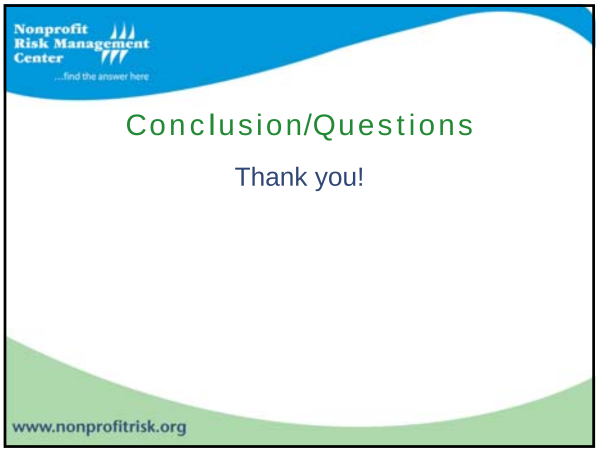
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Conclusion/Questions
Thank you!
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