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

Financial Due Diligence
It’s More Than Checking Boxes
June 6, 2012
Presented By: Thomas A. McLaughlin
www.tamclaughlin.net
tamclaughlin@comcast.net

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

www.nonprofitrisk.org
### Median Losses by Type of Organization (2012)

<table>
<thead>
<tr>
<th>Type of Organization</th>
<th>Median Losses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nonprofit</td>
<td>$100,000</td>
</tr>
<tr>
<td>Government</td>
<td>$142,000</td>
</tr>
<tr>
<td>Private Companies</td>
<td>$278,000</td>
</tr>
<tr>
<td>SEC Companies</td>
<td>$300,000</td>
</tr>
</tbody>
</table>

*Source: Association of Certified Fraud Examiners*

### ‘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

### Risk: Governance Structure

<table>
<thead>
<tr>
<th>Requirement</th>
<th>Organization A</th>
</tr>
</thead>
<tbody>
<tr>
<td>Required # of Board Members (by-laws)</td>
<td>Minimum of 6</td>
</tr>
<tr>
<td>Officers</td>
<td>Minimum of 3</td>
</tr>
<tr>
<td>Committees</td>
<td>2</td>
</tr>
<tr>
<td>Board meeting frequency</td>
<td>2-3 times/yr</td>
</tr>
<tr>
<td>Current # of Board Members</td>
<td>5</td>
</tr>
<tr>
<td>Average Board Attendance</td>
<td>51%</td>
</tr>
<tr>
<td>Average Staff Attendance</td>
<td>1</td>
</tr>
</tbody>
</table>
### Risk: Board Composition

<table>
<thead>
<tr>
<th>Organization</th>
<th>A</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nonprofit</td>
<td>0</td>
</tr>
<tr>
<td>For-Profit – Public</td>
<td>3</td>
</tr>
<tr>
<td>For-Profit – Private</td>
<td>13</td>
</tr>
<tr>
<td>Government</td>
<td>0</td>
</tr>
<tr>
<td>Other/non-affiliated</td>
<td>6</td>
</tr>
<tr>
<td>President/CEO or equivalent</td>
<td>9</td>
</tr>
</tbody>
</table>

www.nonprofitrisk.org

### 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

www.nonprofitrisk.org

© 2008
**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

---

**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 complacency
- Other donors stay away due to ‘turf’ concerns
- If government funder involved, may be easier target for cuts

---

Risk: Parochial Executive Experience

Green = Organizational experience
Blue = Experience elsewhere

---

www.nonprofitrisk.org
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

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
Problem: What to give Bruce?

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

Risk: The Valued Employee

Meet Bruce

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?

Risk: Long Time to Finish Audit

www.nonprofitrisk.org
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 audits.

We conducted our audit in accordance with generally accepted auditing standards. These 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

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?
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?

Risk: Too Little Cash

www.ccrllp.com © 2011

MUSEUM

Cash and savings Investments

Source: Nonprofit Finance Fund

THEATER

Cash and savings

www.nonprofitrisk.org
Problem: Build up of unpaid invoices

To analyze: ask . . .

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

Risk: High Accounts Receivable

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?

Risk: Large Investment in Real Estate
Conclusion/Questions
Thank you!

www.nonprofitrisk.org