

## **How to Assess Nonprofit Financial Performance**

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## **I. INTRODUCTION**

### **A. The Demand for Nonprofit Financial Performance Assessment**

The fundamental reason for nonprofit financial performance assessment is to determine how well an organization is fulfilling its mission. The financial numbers alone cannot answer this question, but they can provide insight into the sources of funding, the cost of service delivery, and an organization's ability to operate in the future.

Over the past decade, a second reason for conducting financial performance analyses of nonprofits has emerged. Several major financial scandals have rocked the nonprofit world, including embezzlement by the president of the United Way of America for (Murawski 1995) investment fraud by the head of the Foundation for New Era Philanthropy for perpetrating (Stecklow 1997), theft by leaders of the Episcopal and Baptist churches (Greene 1995; Fletcher 1999), improper use of funds by the head of the National Association for the Advancement of Colored People (NAACP) (Greene 1995), and excessively generous compensation of the president of Adelphi University due to an (Thornburg 1997). In the past decade, the issue of the non-profit financial reporting and accountability of the nonprofit sector has surfaced, including the adequacy of the current reporting and oversight mechanisms.

Given these issues, we argue that the nonprofit community's future economic success depends not only on the quality of its social and economic activities, but also on improving the way it measures its work and communicates these results to the sector multiple and diverse stakeholders. This report is designed to help participants in the nonprofit sector better address two issues:

- How should nonprofit financial performance be assessed?
- How can information about financial performance be made accessible to and usable by the multiple stakeholders in nonprofit organizations?

## **B. Research Undertaken to Design This Document**

The research underlying this document was conducted over a two-year period with a team of two faculty members and two research assistants. Initial input on the publication was received informally from nonprofit executives and in two structured focus groups. An additional focus group is planned to receive feedback that will make the publication more readable and useful to the nonprofit community. As an independent study, one assistant examined the existing “financial standards” developed by various nonprofit groups. We also developed a smaller related publication entitled “Reengineering Nonprofit Accountability: Toward a More Reliable Foundation for Regulation.” Both papers have benefited from feedback received from nonprofit and academic audiences at the annual Association on Research on Nonprofit Organizations and Voluntary Action (ARNOVA) meeting, the Association for Public Policy Analysis and Management (APPAM), the Midwest and annual meetings of the American Accounting Association, and the Chicago Area Nonprofit Seminar hosted at Northwestern University.

## **C. Acknowledgements**

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### **September 12 Focus Group**

Daniel Bassill, Cabrini Connections  
James Croft, The Field Museum  
Sarah Carroll, Illinois Facilities Fund  
Robert Caton, Kenneth Young Centers  
Eric Huffman, Over the Rainbow Association  
Jim Palos, Midtown Educational Foundation  
Dottie Johnson, Nonprofit Financial Center  
Harry Wells, Omni Youth Services, Inc.  
Brooke Wiseman, Girl Scouts of Chicago

### **September 14 Focus Group**

Barbara Buell, Chicago Panel on School Policy  
Alison Cooper, Fourth Presbyterian Church  
Thomas Berger, Executive Service Corp of Chicago  
Robert Humrickhouse, Howard Brown Health Center  
Jane Bilger, Illinois Facilities Fund  
Jack Connelly, Jobs for Youth - Chicago, Inc.  
Mike Wasserberg, South Suburban Public  
Action to Deliver Shelter (PADS)

## **II. THE NONPROFIT OPERATING ENVIRONMENT**

This section examines the purpose of nonprofits and the context in which they operate. We discuss the need to analyze nonprofit performance and then discuss the types of questions that are commonly asked when assessing nonprofits, the pertinent information needed to answer these questions and common mistakes made when analyzing nonprofit financial statements.

### **A. The Purpose and Function of Nonprofits**

Attempting to define the fundamental features of the disparate entities that constitute the nonprofit and voluntary sector is a difficult task fraught with obstacles and contradictions. Yet there are at least four features that connect these widely divergent entities: (1) they exist to fulfill a charitable purpose, (2) they function without the use of coercion; (3) they operate without distributing profits to shareholders; and (4) they exist without simple and clear lines of ownership and accountability. One of the primary goals of assessing financial performance is to assess how well an organization is fulfilling its mission and what are its prospects in the future.

Citizens cannot be compelled by nonprofit organizations to give their time or money in support of any collective goal. This means that, in principle at least, nonprofits must draw on a large reservoir of good will. Although many nonprofits' work and goals may be most closely aligned with government's activities, the non-coercive character of the sector is also what most starkly differentiates it from government, which can levy taxes, imprison violators of the law, and regulate behavior in a myriad of ways. The influential coercion that the public sector possesses is a powerful tool for moving collectivities toward common ends, but it is also a source of strife and contention. Trust

in government is now low (Nye, Zelikow, King 1997) making the effective use of state power more and more difficult as its legitimacy fades. For nonprofit and voluntary organizations, the use of coercion rarely arises. Donors give because they choose to do so. Volunteers work of their volition. Staff actively seek employment in these organizations often at lower wages than they might secure elsewhere. Clients make up their own minds that these organizations have something valuable to offer. Though they stand ready to receive, nonprofit and voluntary organizations *demand* nothing. As a consequence, nonprofits occupy a moral high ground of sorts compared to public sector organizations that have the ability to compel action and coerce those who resist.

In some ways, the non-coercive character of the nonprofit and voluntary sector situates it closer to the market than to government. Business depends on the free choice of consumers in a competitive market where alternatives are often plentiful and where no one has the capacity to compel anyone to purchase their goods or services. Similarly, nonprofit organizations cannot coerce participation or consumption of their services. When it comes to the mobilization of funds, the parallel between business and nonprofits is equally clear. Just as no one forces anyone to buy shares or invest in enterprises, no one forces anyone to give or volunteer in the nonprofit world. The flow of resources to a nonprofit depends entirely on the quality and relevance of their mission and their capacity to deliver value and the ability to convince potential donors of the same. To the extent that a business firm or a nonprofit organization appears to be performing well, investors and donors will be attracted to it. Should things take a turn for the worse in either case, investment funds and philanthropic funds usually seek out other options quickly.

The third feature of the nonprofit and voluntary organizations sharply

differentiates them from business firms. While corporations are able to distribute earnings to shareholders, nonprofit and voluntary organizations cannot make such distributions to outside parties and must use all residual funds for the advancement of the organization's mission (Hansmann 1986). By retaining residuals rather than passing them on to investors, nonprofit organizations seek to reassure clients and donors that their mission takes precedence over the financial remuneration of any interested parties. The non-distribution constraint is a tool that nonprofits can use to capitalize on failures in the market. Since there are certain services, such as child care and health care, that some consumers feel uncomfortable receiving if the provider is profit driven, nonprofits are able to step in and meet this demand by renouncing its profits.

While the non-coercive feature of nonprofits brings them closer to business and separates them from government, the non-distribution constraint pushes nonprofits closer to the public sector and away from the private sector. Government's inability to sell stakes in its ventures and pay out profits from the sale of goods or services is related to its need to be perceived as impartial and equitable. With nonprofits, the non-distribution constraint builds legitimacy and public confidence, though it is not linked to greater powers being vested in these organizations. In both cases, it also strongly reinforces the perception that these entities are acting in the good of the public.

The fourth feature of nonprofit and voluntary organizations is that they have unclear lines of ownership and accountability (Chisholm 1995) do you have this yet? . This trait separates these entities from both business and government. Businesses must meet the expectations of shareholders or they risk financial ruin. The ownership question in the business sector is clear, shareholders own larger or smaller amounts of equity in

companies depending on the number of shares held. Similarly, government is tethered to a well-identified group of individuals, namely voters. Executive and legislative bodies — and the public agencies they supervise at the federal, state, and local levels — must heed the will of the electorate to be able to pursue public purposes and retain the support and legitimacy needed to govern. Government is traditionally conceived of as “belonging” to citizens, though the ways in which this ownership claim can be exercised are severely limited. In the nonprofit sector there are no owners, and accountability are absent.

Several of these features have led nonprofit organizations to be the source of recent controversies. First, the noncoercive nature of the sector has been challenged by the growing move to mandate community service or volunteer work and pressure on board members to contribute monetarily. In the case of welfare reform, many states now require aid recipients to complete a community service requirement in order to continue to receive their monthly support payments.<sup>1</sup> A growing number of high schools now make volunteering with a local organization a condition for graduation. And of course, the courts continue to use community service as an alternative to incarceration. Second, the non-distribution constraint of nonprofit organizations has also been subject to considerable stress. In recent years, increased scrutiny of the high salary levels of many nonprofit executives has led some to question whether the “profits,” or more accurately increased program revenues, are in fact routinely distributed to staff in the form of generous compensation and benefit packages (Frumkin 2000, Frumkin and Andre-Clark 1999). Third, the ownerless character of nonprofit and voluntary organizations has been under growing assault as donors and communities have asserted increasing levels of

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<sup>1</sup> Most notably, Wisconsin and New York City transformed their public assistance programs and made community service or part-time employment a requirement.

control and influence. While these claims have rarely mounted to the level of ownership claims, the lines of accountability have been drawn more sharply, particularly as questions about the transfer of assets have come up when nonprofit organizations have attempted to convert to for-profit status.<sup>2</sup>

It should not be surprising therefore that the three fundamental features of nonprofit organizations have profoundly influenced the ability of the sector to develop meaningful forms of performance measurement and with strong accountability systems. First, it is difficult to assess how well a nonprofit is performing because there is no owner with an equity stake in nonprofits within the organization demanding or requiring measurement. Second, there are no bottom line of profitability or easily quantifiable outcomes that can be used as a benchmark, only the far more ambiguous notion of mission accomplishment. Third, the diffuse nature of ownership and stakeholding in the nonprofit sector raises the additional problem of building an accountability system that is consistent and meaningful across the sector. It is useful to focus on this last obstacle for in it the performance measurement problem and the accountability challenge come face to face.

## **B. Key stakeholders and their incentives and objectives**

In the nonprofit sector, the stakeholders can be broken down into two main groups: those outside the organization and those inside the organization. Among external stakeholders, it is possible to focus on three main groups: donors who provide charitable support, clients who use nonprofit services, and the community that benefits indirectly from the services. Donors have an interest in nonprofit performance and accountability to

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<sup>2</sup> For a good overview of the issues related to the conversion of hospitals from nonprofit to for-profit status, see Goddeeris and Weisbrod 1998, 1999.

ensure that charitable resources are not siphoned off for non-charitable purposes. Clients care about nonprofit performance and accountability because, in the absence of oversight, services may decline in quality or become too costly. Taxpayers and community members want performance and accountability because their tax burden may increase if exemptions are granted to ineffective organizations or by government grants funding programs that are not productive for the community.

Inside nonprofits, two different groups have a stake in nonprofit performance and accountability: the board and the staff. Board members have legal duties of care, loyalty, and obedience that require them to steward charitable resources responsibly. Staff, within nonprofits often working for low wages, have a financial and psychic stake in the performance of their organizations. It is useful to examine each of these five groups of stakeholders more carefully.

***Donors.*** Many charities are dependent to a greater or lesser extent on contributed income. These “donative” nonprofits gather funds from foundations, corporations, federated funders, and individuals in order to carry out their charitable missions. Institutional funders and large individual donors study the financial statements of nonprofits during the grant review process and request and receive detailed supplemental information on the state of the nonprofit organization. Some foundations have even demanded special financial controls or management reforms in the organizations that they fund. Some donors have adopted a venture capital approach to giving and have demanded more influence in key decisions. Individual giving, on the other hand, differs greatly from institutional giving and, in fact, accounts for the majority of charitable giving. Individual contributions are a means for donors to support causes that reflect their

own values and personal commitments. Research indicates that many individual contributors donate to organizations with which they have had personal contact, including universities they have attended, hospitals that have improved their families' health, churches that have guided them spiritually, and arts organizations that have entertained them (Odendahl 1990; Ostrower 1994). Due to these personal considerations and the lack of access to information, many individuals do not consider a charity's financial condition and performance in making their contribution decisions (Gordon and Khumawala 1999).

**Clients.** Over the past two decades, earned income – revenues derived from client fees or commercial ventures – has quietly become a critical engine of growth in the nonprofit sector. While some parts of the sector depend on charitable contributions, the majority of nonprofit organizations today rely on revenue that is derived from fees and other commercial activities. The dependence on fees and ventures exposes nonprofit organizations to market pressures, including client satisfaction. From the community mental health centers that offer services on a sliding scale based on income, to a boarding school that charges tuition and sells sweatshirts and coffee mugs to alumni, more and more charities have clients that look and act like customers. Although commercialization in the nonprofit sector has made clients more inquisitive about the price, selection and quality of the services they purchase from nonprofits, few clients ask tough questions or do much research before using nonprofit services. Often they rely on reputation as a proxy for programmatic performance and give little consideration to financial performance or condition.

**Community.** Within neighborhoods and communities, public charities are often viewed as critical resources, particularly where business investment is low and public

programs are lacking. Even in organized and politically engaged communities, few residents watch over the local nonprofits with a sense of ownership. Some community members may become involved in an organization by serving on an advisory board or volunteering in a particular program. Nevertheless, it is rare for members of the general public to actively oversee the operations of nonprofit organizations operating in their community. Although communities benefit indirectly from charities, rarely do they demand a community impact statement or attempt to scrutinize the agency's programs or finances.

**Board.** Boards play a critical role in nonprofit governance. Not only do they typically make the critical selection of the chief executive officer, they also play a central role in policy, financial decisions, and strategy formulation. Boards within nonprofits are mostly self-perpetuating, though sometimes they are appointed by outside bodies. In all cases, however, the board of a nonprofit organization must take an active role in ensuring that the organization's resources are used wisely and the mission is fulfilled. For the board, knowledge about the financial performance of the organization is particularly important because it is indicative of the performance of the staff. Boards hold staff accountable for performance, and the board are, in turn, held responsible by the public for the overall performance of the organization.

**Staff.** Within nonprofit organizations, staff play a central role in ensuring that the financial and programmatic goals of the organization are accomplished. The past three decades have seen a substantial change in the kind of people entering the nonprofit sector. Growing levels of professionalization within traditional fields of nonprofit activity and a new generation of ambitious social activists have placed nonprofit staff at the

center of the performance and accountability equation. Many staff seek out measures of performance to assess the effectiveness of their managerial decisions, though the range of such financial measures remains relatively limited. Having better measures would significantly assist not just staffs but also boards in assessing how well or poorly organizations are performing.

*In Sum:* Nonprofit organizations thus have many masters that they must serve, none of which is ultimately able to exert complete control over these organizations. Donors, clients, communities, board members, and staff, all have stakes, claims, or interests in nonprofit and voluntary organizations. Yet none of these parties can be clearly identified as the *key* stakeholder group. The relative strength of these claims depends on how an organization is funded and its chosen mission (Hansmann 1996). Their donors, some of who believe that as social investors, they have a real stake in their investees or donees, often hold nonprofit organizations that depend heavily on charitable contributions closely accountable. Nonprofits that are largely driven by the service fees or commercial revenues are in a different position. While these more commercial organizations do not have donors asserting claims over them, social entrepreneurs and professional staff may view themselves as the key stakeholders in these more businesslike organizations. Often, however, the lines of accountability are rendered more complex by the fact that many nonprofit organizations combine funding from multiple sources — foundations, corporations and government — with earned income, making it hard to point to any particular party as the key stakeholder. Although nonprofit and voluntary organizations are generally governed by boards as a solution to the accountability issue, board members are not owners but rather stewards that are held

responsible for the actions of their organization.

Each of these groups has a different stake in the future of nonprofit organizations, and each is affected differently by charities that fail to achieve their goals or fulfill their mission. Clients are affected if nonprofits perform poorly or inefficiently because the quality and affordability of services will decline and make the use of nonprofits less attractive. Contributors are affected when their charitable intent is thwarted because an organization fails to achieve its goals. Taxpayers and community members are also affected because the tax expenditure made to support nonprofit organizations is not being used to produce outcomes that are most beneficial to the community. Given these interests, government regulators would appear justified in taking an active role in keeping nonprofits from squandering charitable resources. However, one significant case has made clear that “poor performing” nonprofits have little to fear from the Internal Revenue Service, the principal agency charged with overseeing nonprofit organizations.

The case involved a now-defunct charity named United Cancer Council (UCC), which benefited from the fact that its name could easily be confused with one of the more established and reputable organizations working to find a cure for cancer. Between 1984 and 1989, UCC engaged the fundraising services of the firm Watson and Hughey, which sent out on behalf of UCC 80 million letters that raised a total of \$28.8 million in donations from the public. Of this large bounty, UCC received only \$2.3 million after the costs associated with fund raising were deducted. The IRS attempted to revoke UCC’s tax-exempt status because it entered into an agreement with a fundraiser that allowed the solicitor to keep the majority of the money sent in by contributors. The United States Court of Appeals for the Seventh Circuit reversed the decision of the Tax Court that the

IRS could strip a charity of its tax-exemption for entering into a foolish business deal that made it impossible for the organization to do much to help in the fight against cancer.

The Appeals Court found that it was unreasonable to penalize a nonprofit simply because it exercised poor judgment in its handling of its finances. While the expense to program ratio at UCC was so poor as to call into question the effectiveness of the entire organization, the Court found that as long as the deal was negotiated at arm's length and that the fund raisers were not insiders, charities need to have the freedom to pursue their missions as they see fit.

This important ruling has effectively put a substantial damper on the government's ability to sanction nonprofits that perform inefficiently and ineffectively (Johnston 1999). More significantly, it revealed that nonprofit stakeholders will clearly need to take a more active role in scrutinizing financial performance. In most cases, the financial position of the nonprofit will be far more difficult to ascertain than in the UCC case. At present, however, few stakeholders from the five groups actively use information on nonprofit financial performance aside from a casual consideration of the program to total expense ratios (the program efficiency ratio).

### **C. Moving Beyond Efficiency**

Over the past decades, the nonprofit sector has experienced ever increasing competition for resources, stemming both from the growing number of nonprofit organizations that are seeking a limited pool of funding and from new pressures brought by a slew of new for-profit providers operating in field such human services and education. The most common response to this new environment has been that nonprofit organizations need to manage the operations more efficiently in order to fulfill their

missions. Improving management has been seen both as a way of raising operational effectiveness and a method of reducing costs. Dozens of books now aim to help nonprofit practitioners improve their organizations and manage more efficiently (Antos and Brimson 1994; Dropkin and LaTouche 1998; Drucker 1992; Eadies and Schrader 1997; Firstenberg 1996; Pynes and Schrader 1997; Wolf 1990). Many of these titles attempt to bring business concepts such as reengineering, quality management, and benchmarking to bear on the nonprofit sector, usually with the intent of raising the level of organizational and program performance. A common theme that emerges from these texts is that the absence of a traditional bottom line in the nonprofit sector – far from freeing nonprofits to blindly pursue their missions – means that these organizations must manage especially well and develop a special kind of operational discipline. Though rarely expressed directly, these books suggest that a management lag between nonprofit and business sectors can be closed with a direct transfer of managerial technology.

The push toward efficiency and performance has been fueled by the rapid professionalization of large parts of the nonprofit sector over the past three decades (Frumkin 1998). Many professional staff want to bring a new rigor to their work and develop standards to measure their performance, both as the basis for their own advancement within the field and in the effort to build a growing body of expert knowledge. For professionals, the ideas of reengineering processes and benchmarking are appealing because these techniques hold out the promise of supporting and justifying the move from volunteer labor to well compensated professional staffing. With their desire to avoid charges of amateurism that have plagued this sector in the past, the growing ranks

of nonprofit professionals have turned out to be the perfect audience for claims that cost effectiveness represents the new frontier of nonprofit management.

As professionalism has set in, competition for contributed income has intensified, particularly among start-up organizations. Many nonprofit managers confront the fact that there are often several nonprofit organizations with similar missions operating close by one another with little coordination. In some fields, the competition has gotten quite heated. In the case of international relief, efforts to win support have led to efforts at differentiation around overhead costs and programmatic efficiency. Knowing that individual donors to famine relief would, all things considered, prefer to see their funds reach those in need at the lowest cost possible, many relief agencies have come to compete for the distinction of having the lowest administrative and overhead costs -- a competition that is encouraged by the media, which regularly publishes, particularly around the holidays, ratings of charities designed to lead donors to lean and well run organizations. Under such conditions, it would appear that few managers could afford to ignore the question of cost efficiency, measured often in terms of the ratio of administrative to total expenses. Of course, the categorization of costs as either administrative or programmatic is a subject of considerable dispute and little practical guidance exists. Nonprofits may categorize the same cost differently over time or follow different practices than their peer organizations. This imprecision, in turn, can be seen as having the potential of intensifying the inclination of nonprofits to enter into the efficiency positioning game, since standards for challenging claims of efficiency are difficult to locate.

The inadequacy of the efficiency ratio approach to measuring nonprofit financial performance should be clear, however. While the efficiency ratio may – or may not -- tell stakeholders how tightly an organization is run, it will not speak to the underlying financial condition of the organization. To address these broader and more significant issues, other measures are needed. Later in this report, we seek to move beyond the simplest and most common measure of efficiency in order to locate new more meaningful ways of assessing how well nonprofits are marshalling their resources and how well they are positioning their organizations financially

#### **D. A Model for Performance Assessment**

Before considering specific financial performance metrics, it is important to understand the financial framework in which nonprofits operate (Figure 1). Adapted from a similar model developed for the business sector (Wilson 1995), the model has six components. Organizations conduct activities (*Organizational Activities*) that are reflected in the internal accounting system (*Accounting System*). Periodically, the organization prepares and disseminates financial statements to stakeholders (*Financial Disclosure*). The activities, accounting system, and financial disclosures may be examined or verified by internal or external parties (*Oversight and Monitoring*) to ensure that the activities conform to existing contracts, the accounting records accurately reflect the activities, and the financial reports conform to any disclosure requirements. Stakeholders, such as donors, clients, staff, community, the board, and government analyze the disclosures to develop a performance assessment of the organization (*Performance Assessment*). These assessments influence stakeholders' willingness to support or participate in these organizations in the future (*Decision about Support and*

*Participation*). Because these decisions have financial implications in this model, stakeholders should be able to affect the subsequent activities of the organization. A feedback system is thereby created: An organization's future support depends on not only its programmatic activities but also on its internal accounting decisions and ability to communicate its financial results to the stakeholder community.

**FIGURE 1:**  
**The Role of Performance Assessment**



Broadly, this model includes two key groups: the organization and the stakeholder community. The organization relies on its internal accounting system to develop the financial information it *supplies* to its stakeholders. The stakeholders, in turn, create a *demand* for information for decision-making purposes. The types of information and performance assessments vary based on the stakeholders' needs and interests. Both the organization and the stakeholders can influence the financial disclosures and monitoring what occurs in the system.

### III. THE QUALITY OF FINANCIAL REPORTING

#### A. Financial Disclosure Requirements

The heterogeneity of nonprofit organizations, including mission, industry classification, and size, has resulted in a plethora of financial disclosure requirements. First, nonprofits must obtain tax exemption from the IRS and the appropriate state authority by filing initial registration statements. Then, most nonprofits are subject to annual Form 990 tax filings. Nonprofit organizations (except religious organizations or those with over \$25,000 in annual revenues) must file an annual Form 990 and Schedule A with the Exempt Organization Division of the IRS. Filing organizations with gross receipts of \$100,000 or less and total assets less than \$250,000, can file a simplified form, Form 990 EZ. If a nonprofit engages in activities that are unrelated to their mission and earn a profit of over \$1,000, then it must file a Form 990T and potentially pay an unrelated business income tax (*UBIT*). Over time, the IRS has sporadically examined the forms.<sup>3</sup>

Recent legislation requires nonprofits to make the last three IRS filings available on a same-day basis and for a reasonable copying charge to anyone requesting in person or by mail.<sup>4</sup> Nonprofits are free from this requirement if they make their 990s "widely available" via the World Wide Web. This requirement has largely been fulfilled by the creation of Guidestar (an online organization that published scanned copies of 990s), but nonprofits should be aware that their most current filings may not be available online and that errors can be introduced in the web-conversion process.

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<sup>3</sup> Gordon, Greenlee and Nitterhouse (1999) report a 2.09 percent examination rate for nonprofits in 1994 as compared to 2.05 percent and 1.67 percent for corporate and individual filings, respectively.

<sup>4</sup> Internal Revenue Bulletin 1999-17. The final regulations on disclosure requirements are T.D. 8818 and are described at: [http://www.irs.gov/prod/bus\\_info/eo/topico00.pdf](http://www.irs.gov/prod/bus_info/eo/topico00.pdf).

Many states, federal grantmaking agencies, and institutional donors require that nonprofits provide supplemental disclosures, primarily audited financial statements. The generally accepted accounting principles (GAAP) for preparing audited nonprofit financial statements have evolved over the past 15 years, making these financial reports more comprehensive and more transparent to users than the Form 990. There have been five significant changes to the requirements. First, nonprofits are now required to capitalize and amortized new capital expenditures, similar to for-profit business (SFAS #93)<sup>5</sup>. Second, the financial statements now reflect multi-year funding commitments and more clearly depicted restrictions placed by donors on firm resources (SFAS #116 and #117). Third, cash flow statements are now required to reveal the magnitude and nature of net cash outflows and inflows. Fourth, accounting for investment securities now use their fair market value (rather than historical value) became mandated (SFAS #124) which means the organization's earnings and total assets will reflect the volatility in any investment portfolio. And finally fifth, the new nonprofit GAAP standards require federated fundraising organizations, community foundations and other related groups to reflect resources collected from the public with the purpose of redistribution to other nonprofits as liabilities rather than firm revenues (SFAS #136). By changing the accounting quality, the five new accounting standards have dramatically altered the audited information provided to the public. While the FASB implemented these changes to improve the quality of financial reporting, industry members and some academics have questioned their merits (Anthony 1995).

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<sup>5</sup> Nonprofits, such as museums, were encouraged but not required to reflect previously expensed fixed assets. As a result, current GAAP statements may substantially understate an organization's fixed assets and equity.

Before looking at federal requirements, it is important to note that there has long been considerable variation in the amount of state oversight of nonprofit finances. Along with the state form, nonprofits may be required to file audited financial statements with the state once an asset, revenue, or federal funding threshold has been exceeded. Figure 2 outlines the supplemental disclosure requirements by state. In 1997, the National Association of State Charities Officials and the National Association of Attorneys General began a project to standardize, simplify, and economize compliance under the states' solicitation laws. Today, nonprofits can file either the unique state forms or the Unified Registration Statement (URS) with 33 jurisdictions (32 states plus the District of Columbia).<sup>6</sup> Several states, notably California, Maryland and Minnesota, have created searchable web-databases that permit users to obtain state filing information on nonprofits registered in the state. The federal government has adopted different supplemental requirements. Since January 1, 1990, nonprofit organizations receiving substantial direct or indirect federal assistance are subject to even more stringent auditing requirements than GAAP under the Single Audit Act. These audits are governed by an Office of Management and Budget Circular A-133. The annual revenue threshold for an A-133 audit has increased over time to \$300,000. The Office of Management and Budget (OMB) has issued several circulars (A-110 and A-133) and amendments that outline the audit procedures, guidelines for allowable costs (that can be charged to federal grants) and designate "cognizant" federal agencies to which the auditor's compliance reports are

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<sup>6</sup> The Uniform Registration Statement is downloadable from:  
[http://www.nonprofits.org/library/gov/urs/ursweb\\_v211.pdf](http://www.nonprofits.org/library/gov/urs/ursweb_v211.pdf).

**FIGURE 2**  
**State Filing Requirements for Nonprofit Organizations**

***States that require audited financial statements along with 990 Forms for Registration and/or Annual Filing***

Alaska	Maryland	New York
Arkansas	Massachusetts	Pennsylvania
Connecticut	Michigan	Rhode Island
Georgia	Minnesota	Tennessee
Illinois	Mississippi	Utah
Kansas	New Jersey	West Virginia
Maine	New Mexico	Wisconsin

***States that require only Form 990 for Registration and/or Annual Filing***

Alabama	Louisiana	Oklahoma
Arizona	Missouri	Oregon
California	New Hampshire	South Carolina
Florida	North Dakota	Washington
Kentucky	Ohio	

***States that accept either a Form 990 or Audited Financial Statements***

North Carolina	Virginia
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***States that do not require Charitable Reporting***

Colorado	Indiana	South Dakota
Delaware	Montana	Texas
Hawaii	Nebraska	Vermont
Iowa	Nevada	Wyoming
Idaho		

Source: [http://www.nonprofits.org/library/gov/urs/o\\_appndx.htm](http://www.nonprofits.org/library/gov/urs/o_appndx.htm)

to be directed. These audits supplement traditional CPA audits with two sets of procedures: general requirements that apply to all auditees and specific requirements that are based on the program-funding source. The procedures are designed to ensure that nonprofits comply with statutory and regulatory requirements and fulfill the unique requirements of particular grant programs. As a result, A-133 and A-110 audits include auditing the operational activities of the organization as well as the accounting system. A downside to this addition is that these audits are costly since a CPA must have additional training, must conduct more extensive tests and prepare supplemental schedules and reports, and assume greater potential liability.

The current financial reporting system for nonprofits, however, does not offer this fuller disclosure to all stakeholders. Rather it requires that nonprofits only make the less reliable and relevant Form 990 readily available to the public, while leaving the preparation and disclosure of the more conservative audited financial reports to the discretion of the vast majority of nonprofits.

## **B. Accuracy of Disclosures**

Although the 990 tax filings are more available now than they have been in the past, the lack of reliability and relevance of the filings remains a concern to many. First, filings are not useful because they are often one to two years out of date. Because nonprofits are not punished for filing late and extensions are readily granted, the financial data available for most is often stale and irrelevant. Moreover, a solution is not readily available since the infrastructure necessary for making IRS filings quickly accessible does not presently exist (exist or available?). Second, most Form 990s go unverified. Some users believe that the IRS regularly conducts audits and therefore expect the 990 tax filings to be accurate. Unfortunately, The IRS has only a small enforcement office that has struggled to keep up with the explosive growth of the sector (Gaul

and Borowski 1993, Greene and Williams 1995). Academic research confirms these assertions (Abrahmson 1995; Orend, O'Neill & Mitchell 1997; Gordon, Greenlee, and Nitterhouse 1999). Nonprofit advocacy groups complain that 990 Forms typically contain high rates of mathematical errors, transposed digits, omitted information, and information inserted on the wrong lines (Quality 990, 1999). Many 990 Forms are prepared by outside preparers (is this true?), yet the source of these errors has not been examined. The IRS reports that over one-third of nonprofits fail to include the Schedule A, about one-fifth is not signed, and one-tenth indicates the wrong tax year. Third, the Form 990 fails to conform to GAAP (Froelich and Knoepfle 1996; Froelich, Knoepfle and Pollack 2000). Section IV explains the structure of the financial statement and outline the key differences between Form 990 and audited financial statements.

The problems of timeliness, lack of verification and bias may become increasingly problematic as 990 Forms become more available. Knowing that the Form 990 may be presented in on-line giving programs, charities may increasingly be tempted to engage in selective or misleading disclosures to increase contributions. Whether donors are or have been misled has not been extensively studied. Tinkelman (1999) found that audited nonprofits that report higher program efficiency ratios experience a higher growth rate in donations. Frumkin and Kim (2001) found that organizations reporting lower ratios of administrative to total expenses on the Form 990 did not receive significantly higher amounts of private support than organizations reporting less efficient operations.

Why are these inaccuracies allowed to persist? Donors, clients and communities do not have the legal standing to sue nonprofit organizations for misuse of funds or misleading reporting. Instead, they must rely on an organization's board and government regulators. While the IRS or the state attorney generals' offices have the ability to prosecute, they have not historically had the

resources or inclination. Before 1996, the primary oversight tool was the IRS's ability to deny a new organization tax-exempt status. This tool was infrequently used, with only 520 of 46,887 applications by new organizations being denied in 1994 (Hawks 1997).

For years, the IRS imposed only one penalty on existing charities that were engaging in questionable financial dealings: it would revoke the tax-exemption of an organization. The primary reasons for this action were employee fraud or illegitimate compensation practices. Employees that commit fraud were often quietly terminated. Given the difficulty of determining these problems, the IRS rarely used its revocation power and occasionally, enters into closing agreements with charities to resolve conflicts over the use of charitable resources.

Recently, new "intermediate sanctions" were enacted to penalize nonprofits that pay excessive compensation and the IRS has published new regulations that clarify both the definition of insider (i.e. which individuals could potentially receive excess compensation) and describe its process for compensation comparison and evaluation (Frumkin and Andre-Clark 1999). Most significantly, the intermediate sanctions penalty, a targeted excise tax, is designed to give the IRS a moderate penalty that will allow more moderate enforcement actions with less extreme remedies rather than exemption revocation or closing agreements. And yet, the new sanctions do not apply to or penalize nonprofits that engage in fraudulent or misleading reporting. In summary, as it is now structured, the nonprofit financial disclosure system is based largely on the IRS Form 990, which has been shown to be a frequently unreliable and often an irrelevant source of information. Although the existing system does not encourage accurate or timely reporting, to date, no resolution has successfully been implemented for the sector.

### **C. Other Limitations To Accurate Assessments of Financial Performance**

Financial disclosure, however, is not the only area in which the accountability system could be improved: The accounting systems in many nonprofits are in poor order. A large numbers of potential users of nonprofit financial reports are unsure what information is available and how to obtain access to those materials. Many users do not know how to read and interpret financial statements. The end result is predictable: Few users are able to conduct performance assessments of nonprofits and make informed decisions about future support or participation. Given the scope of these problems, we argue that the nonprofit community's future economic success relies on its ability to communicate effectively and fairly its results to its constituencies.

### **D. The Role of “Watchdog” Organizations**

Beyond oversight by the IRS, nonprofits are scrutinized by a number of information intermediaries and rating services. Seeking to address the lack of active use of information about nonprofit organizations, several independent agencies have emerged to rate and evaluate nonprofit organizations. Many of these agencies develop standards they use to evaluate organizations based on audited financial information (rather than the Form 990), data on corporate governance and additional explanatory information on program services. The specific standards of six leading groups are provided in Appendix 5 and will be discussed further in Section V. The general focus of these “Watchdog” groups targets the largest nonprofit organizations. Two of the more prominent organizations the National Charities Information Bureau (NCIB) and the Philanthropic Advisory Service of the Council of Better Business Bureau, are in the process of merging. Potentially, this merger could create a watchdog of sufficient size and stature that its ratings would be actively used by a wide group of stakeholders.

## IV. UNDERSTANDING FINANCIAL STATEMENTS

### A. Overview

This section will describe the structure underlying the financial statements and explain how the statements stated in the Form 990 differ from those in audited financial statements. Sample financial statements are included in this section, while sample 990 Tax returns are presented in Appendix 1.<sup>7 8</sup>

The accounting system for nonprofits is designed to capture the economic activities of the firm and its financial position. The financial statements are constructed based on the “Accounting Equation” in which:

$$\text{Assets} = \text{Liabilities} + \text{Net Assets}$$

This equation states that the things of value that the nonprofit organization owns (*assets*) are equal to its outstanding debt (*liabilities*) plus the portion of assets funded by the nonprofit’s own resources (*net assets*). In a for-profit setting, net assets are labeled *equity* or *net worth*. Until the mid-1990s, nonprofits labeled this account *fund balance*. The accounting equation is the basis of one of the four financial statements called the *Statement of Financial Position*, *Statement of Financial Condition* or *Balance Sheet*.

However, the accounting equation does not provide information on how or why the assets, liabilities or net assets changed over time. As a result, the financial statements provide a second report called the *Statement of Activity* or *Income Statement*. This statement explains how net

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<sup>7</sup> For more detailed explanation of the relation between GAAP, the IRS Form 990 and other nonprofit financial reports see Sumariwalla, R. D. and W. C. Levis. *Unified Financial Reporting System for Not-for-Profit Organizations*. San Francisco: Jossey-Bass, Inc. (2000).

<sup>8</sup> To better understand the GAAP requirements for nonprofit organizations, see the AICPA Audit and Accounting Guide for Not-for-Profit Organizations put out by the American Institute for Certified Public Accountants.

assets changed from one date to another. Essentially, net assets increase when revenues are recorded and decrease when expenses are recorded as follows:

$$\text{Revenues} - \text{Expenses} = \text{Change in Net Assets}$$

In a for-profit context, revenues less expenses is called *net income* or *net profit* and is an indicator of the firm's success. For non-profits, the change in net assets is a *surplus* or *deficit* that is carried forward. Rather than focusing on profit, a nonprofit focuses upon fulfilling its mission. Therefore, the annual surplus or deficit is not necessarily informative about a non-profit's success. One way to assess a nonprofit's performance is to examine how it spends its resources. Hence, many nonprofits prepare a third financial statement called the *Statement of Functional Expenses* that depicts how total expenses are distributed between three functional areas:

$$\text{Total Expenses} = \text{Program Expenses} + \text{Fundraising Expenses} + \text{Administrative Expenses}$$

The distribution between these three areas is a reflection of the nonprofit's mission, values, success and accounting practices.

There are two accounting methods that are commonly used by nonprofit organizations when maintaining their accounting records. The easiest system is the *cash method* of accounting. Under this system, the organization records revenues when cash is received and expenses when cash is paid. While simple, the cash method does not accurately reflect the economic condition of the nonprofit organization. For example, it can receive commitments for donations in advance of cash receipts or incur debts before paying the associated bills. As a result, an alternative method of accounting has been developed called the *accrual method*. CPAs prefer the accrual method since it requires that revenues be recorded when earned and expenses when incurred.

While the 990 tax form can be completed according to the cash method, audited financial statements must be presented on the accrual basis. For simplicity, many nonprofits maintain their records on a cash basis and convert them to an accrual basis at year-end to prepare the annual financial statements. To ensure that financial statements are presented in consistent fashion year to year and are comparable between firms, audited financial statements must be prepared in accordance with *generally accepted accounting principles* (GAAP).<sup>9</sup>

While an accrual-basis Statement of Activity portrays economic changes in the net assets of the firm, stakeholders may also want to understand the nature of cash inflows and outflows. So, an additional financial statement must be presented called the *Statement of Cash Flows*. The statement divides cash movements into three broad categories:

$$\text{Change in Cash} = \text{Cash from Operations} + \text{Cash from Investing} + \text{Cash from Financing}$$

Each of the four financial statements and accompanying footnotes will now be discussed in more depth. The financial statements of a fictitious nonprofit, the National Youth Training and Resources Organization (NYTRO), will be used as an illustration.

#### **B. Statement of Financial Condition (Part IV of the Form 990)**

The statement provides a snapshot at one point of time of the financial position of the nonprofit. The assets always balance the liabilities and net equity since each asset must be *funded* by resources provided by others or by the organization itself. The Statement of Financial Condition is generally prepared at the end of the fiscal year. Some larger organizations prepare

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<sup>9</sup> An independent body known as the Financial Accounting Standards Board (FASB) sets the accounting standards that are followed by for-profit and not-for-profit organizations. The Governmental Accounting Standards Board (GASB) sets generally accepted accounting principles for state and local governmental units.

this report quarterly or monthly. Figure 3 depicts the comparative statement of financial condition for NYTRO.

The assets are listed in order of their *liquidity*, i.e. their ability to be converted into cash. The most common assets for nonprofits include:

- o Cash and cash equivalents: These are the funds on deposit in the bank or in highly liquid and secure securities, such as US treasury bills. In an audited financial statement cash (or any other asset) that is received with a donor-imposed restriction that limits its long term use must be classified in a separate account from the unrestricted cash.
- o Pledges or Grants Receivable: This represents amounts that have been committed to the organization by an outside donor. Rather than the full or *gross* amount that is due, these receivables are carried at *net realizable value*, i.e. the amount that the nonprofit expects to receive.
- o Prepaid Expenses: Costs, such as insurance, that are paid in advance of receiving benefits. This asset declines in value (and is recorded as an expense) as the benefit associated with this cost is consumed.
- o Investments: This represents the value of stocks and bonds that are held as investments. In audited financial statements, the amount reported is the *fair market value* on the date the financial statements are prepared. On the tax return, this amount may be the *fair market value*, the *historical cost* of the investments purchased or even the lower of the *fair market value* or the *historical cost*.
- o Fixed Assets: This account is also called Property, Plant and Equipment. This amount includes the historical cost of land as well as the *net book value* of other long-lived physical assets. The *net book value* is the historical cost of long-lived assets less accumulated

depreciation. The value of fixed assets on the balance sheet does not reflect fair market value or the cost of replacement, since these assets are not generally intended to be sold. Instead the accounting is designed to allocate the cost of a long-lived asset over its useful life. In general, the value of fixed assets is reduced each year by recording a non-cash *depreciation* expense. Often the value of the asset drops according to a straight-line method that reduces the value in equally sized increments over the estimated useful life of the asset.

Note that prior to 1994, the full cost of purchasing a fixed asset was expensed immediately. Hence, many valuable tangible assets were not reflected as an asset in the financial records. When nonprofits implemented the new standard, many chose to not *capitalize* (i.e. record as an asset) the old fixed assets. As a result, many nonprofits have *understated* assets and net assets on their books.

- o Collections: Nonprofits may own works of art, historical treasures, or similar items that may not decline in value. Nonprofits must select a policy for recording collection items and consistently apply it to all collections. Some nonprofits chose to retroactively capitalize its collection that had been expensed and depreciate it. Others continued the policy of expensing all acquisitions and contributed collection items immediately. If the collection is capitalized, then depreciation need not be taken of the economic benefit of the asset is not consumed over time.

The most common liabilities include:

- o Accounts Payable: Amounts owed to vendors or creditors for goods or services rendered; unpaid bills. Unpaid wages, taxes or grants can be included in this account or reported separately if significantly large.
- o Grants Payable: Grant amounts promised to individuals or other organizations.

- o Refundable Advances: Also known as deferred revenue. Grants received from donors that have not been recognized as revenue because the conditions of the grant have not been met.
- o Due to Third Parties: Certain nonprofit organizations, such as the United Way and federated membership organizations, collect contributions from one group and transfer them to another nonprofit. When these organizations are operating as a transfer agent with no *variance power* to change the recipient, then the associated cash receipts are not recorded as revenues by the transfer agent, rather they are carried as liabilities.
- o Long Term Debt: The principal and interest owed to a creditor. These debts can be in the form of bank loans, publicly traded bonds, or privately arranged debt financing.

The net assets are divided into three categories:

- o Unrestricted: The portion of net assets that is not restricted by donor-imposed stipulations. This amount is positive when the sum of historical revenues and gains from unrestricted contributions exceeds the amount of unrestricted expenses. The amount is negative when the total historical unrestricted expenses exceeds the unrestricted revenues.
- o Temporarily Restricted: The portion of the net assets that are limited by donor-imposed stipulations that either expire with time or can be fulfilled by actions of the organization.
- o Permanently Restricted: The portion of the net assets that are limited by donor-imposed stipulations that will not expire with time or be fulfilled by actions of the organization. An endowment is an example of permanently restricted funds.

**FIGURE 3**  
**Statement of Financial Condition**

<b>National Youth Training and Resources Organization</b>		
<b>Comparative Statements of Financial Position</b>		
<b>For the Years Ended December 31, 1999 and 2000</b>		
	<u>2000</u>	<u>1999</u>
<b>Assets</b>		
Cash	\$ 200,000	142,000
Pledges Receivable (net)	120,000	65,000
Investments	755,000	700,000
Prepaid Expenses	15,000	13,000
Fixed Assets (net)	220,000	40,000
Total Assets	<u>\$ 1,310,000</u>	<u>\$ 960,000</u>
<b>Liabilities and Net Assets</b>		
<b>Liabilities</b>		
Accounts Payable	50,000	60,000
Grants Payable	25,000	
Refundable Advances	20,000	
Long Term Debt	200,000	-
Total Liabilities	<u>\$ 295,000</u>	<u>\$ 60,000</u>
<b>Net Assets</b>		
Unrestricted	\$ 325,000	\$ 300,000
Temporarily Restricted	45,000	-
Permanently Restricted	645,000	600,000
Total Net Assets	<u>\$ 1,015,000</u>	<u>\$ 900,000</u>
Total Liabilities and Net Assets	<u>\$ 1,310,000</u>	<u>\$ 960,000</u>

### **C. Statement of Activities (Part I of the Form 990)**

The Statement of Activities provides information on the operating activities of a nonprofit between one date and another. The statement provides information on the mix of revenues and expenses. It may also be a useful predictor of future activities. The statement measures activities as resources received and spent. In the case of a nonprofit, it may not fully capture the program service inputs, short-term outputs, or long term outcomes. To emphasize that the statement may not fully reflect an organization's activities, some nonprofits call this report the Statement of Revenues, Expenses, and Changes in Net

Assets. The statement of activity is divided between the activities that are unrestricted, temporarily restricted, and permanently restricted. It is generally presented in a multicolumnar format (as seen in Figure 4). When revenues are recorded, they are classified into one of the three columns based upon the intent of the donor. Unless otherwise specified, donations, fee for services, even investment income is considered to be unrestricted revenues.

**FIGURE 4**  
**Statement of Activities**

<b>National Youth Training and Resources Organization</b> <b>Statement of Activities</b> <b>For the Year Ended December 31, 2000</b>				
<b>Changes in Unrestricted Net Assets:</b>	<b>Unrestricted</b>	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>	<b>Total</b>
Revenues and Gains:				
Public Contributions (net)	\$ 800,000	\$ 165,000	\$ 45,000	\$ 1,010,000
Program Service Revenue	46,000			46,000
Investment Income	42,000	5,000		47,000
Net Assets Released from Restrictions	125,000	(125,000)		0
Total Revenues, Gains, Other Support	<u>\$ 1,013,000</u>	<u>\$ 45,000</u>	<u>\$ 45,000</u>	<u>\$ 1,103,000</u>
Expenses and Losses:				
Program Services	\$ 676,000			\$ 676,000
General Administration	197,000			197,000
Fund-Raising	115,000			115,000
Total Expenses and Losses	<u>\$ 988,000</u>			<u>\$ 988,000</u>
<b>Increase in Net Assets</b>	<u>\$ 25,000</u>	<u>\$ 45,000</u>	<u>\$ 45,000</u>	<u>\$ 115,000</u>
Net Assets at Beginning of Year	300,000	0	600,000	900,000
Net Assets at End of Year	\$325,000	\$45,000	\$645,000	\$1,015,000

The most common revenues for nonprofits are:

- o Contributions are an unconditional transfer of cash or other assets to a nonprofit or a settlement or cancellation of a liability in a voluntary nonreciprocal transfer. This includes unconditional promises to pay cash or other assets in the future. To be recognized as revenues, there must be some documentation to verify that the promise was made and received.

If a donor imposes a *restriction* on the contribution than the use of the contributed assets is limited; however, the donor can not demand repayment. These contributions are recorded as either temporarily or permanently restricted revenues depending on the donor's restrictions. When the restriction expires, the amount of the contribution is removed from the temporarily restricted section of the statement of activity and placed in the unrestricted column. In the case of NYTRO in Figure 4, \$125,000 of previously restricted revenues were removed from the temporarily restricted column and recorded in the unrestricted section.

If however the donor imposes a *condition*, then the proposed contribution may be rescinded. If the asset is received in advance of the condition being fulfilled, then the asset transfer is recorded as a liability (refundable advance) rather than a revenue. When the *conditions* are met, then this liability is eliminated, and revenues are recorded.

Contributions are recorded at their fair market value at the time of the gift. If the contribution is a series of future cash payments, then the discounted present value of the payments is recorded in revenues immediately as if there were an implied interest rate associated with the donation. With the passage of time, the interest component of the contribution is recognized as a contribution. If uncertainty is associated with the future payments, the nonprofit can reduce the value of a contribution by the anticipated defaults.

Some contributions are not provided in cash, rather they are in the form of *in-kind* goods and services. Organizations often seek to include these non-cash contributions to provide a more complete picture of the organization's funding sources and activities. When recorded

in the financial statements, they are recorded as equal and offsetting revenues and expenses. Recognition of most contributed goods and services can not be included in statement of activities on the Form 990, but can be disclosed in a later section. Under GAAP, most contributed goods can be recorded as an offsetting contribution and expense when the unconditional transfer occurs. Contributions of collection items are not required to be recognized as revenues under certain conditions. Contributed services can be recognized if they require specialized (i.e. professional) skills and create or enhance a non-financial asset.

- o Program Service Revenues are exchanges between a nonprofit and a another party, in which the nonprofit provides a service in exchange for a transfer of a cash or another asset. Increasingly nonprofits are relying on fees from governmental agencies or from clients to pay for services.
- o Membership Dues: Some organizations have members that pay an annual fee to receive some basic services.
- o Special Events Revenue: Revenues raised by special fundraising events are recorded separately from contributions. Under GAAP, the gross revenues from the events are recorded as revenues and the associated costs are shown as fundraising expenses. In the Form 990, the associated costs are recorded as a reduction in revenues rather than fundraising expenses.
- o Investment Income: This reflects the income earned off the investment portfolio. It includes dividends on stock as well as interest on bonds. Under the cash basis, this would be when the dividends and interest are received. Realized gains/losses on investment securities may be included in this account or under as its own line item. Under GAAP accounting,

investment income will also include changes in the market value of the investments, i.e. changes in the unrealized gains and losses in investment securities.

In the Statement of Activities, the expenses are divided into three functional categories:

- o Program Expenses are the costs associated with the delivery of goods and services to beneficiaries, customers or members that fulfill the organizational mission.
- o Fundraising Expenses include publicizing and conducting fundraising campaigns, maintaining donor mailing lists, conducting special fund-raising events, preparing and distributing fund-raising manuals, and other activities involved in soliciting contributions or memberships.
- o Administrative Expenses include general and managerial costs such as oversight, business management, record-keeping, budgeting, financing and related administrative activities.

#### **D. Statement of Functional Expenses (Part II of the Form 990)**

The Statement of Functional Expenses is a statement that is unique to nonprofit organizations. It provides information on the distribution of costs between three functional categories and by natural categories, such as salaries, occupancy costs, and depreciation. If an organization has several major programs, it can separate program expenses into several categories as seen in Figure 5. For most organizations this statement is optional. Voluntary health and welfare organization, however, are required to issue this statement.

Many costs are actually joint costs that are incurred to deliver both program and support services. When joint costs arise, the management must allocate the costs to the appropriate functional categories.

**FIGURE 5**  
**Statement of Functional Expenses**

National Youth Training and Resources Organization Statement of Functional Expenses For the Year Ended December 31, 2000					
	Program Services		Supporting Services		Total Expenses
	Educational/ Scholarships	Recreational Programs	General Administration	Fund- Raising	
Salaries	\$ 65,000	\$ 88,000	\$ 82,000	\$ 15,000	\$ 250,000
Employee Benefits	15,000	22,000	20,000	3,000	60,000
Payroll Taxes	7,000	11,000	10,000	1,500	29,500
Total Personnel Costs	\$ 87,000	\$ 121,000	\$ 112,000	\$ 19,500	\$ 339,500
Professional Fees	-	-	-	45,500	45,500
Supplies	45,000	10,000	8,000	8,000	71,000
Telephone	10,000	15,000	7,000	7,000	39,000
Postage	10,000	5,000	5,000	3,000	23,000
Occupancy Costs	20,000	20,000	15,000	3,000	58,000
Equipment Rental and Maintenance	5,000	5,000	20,000	-	30,000
Printing and Publications	20,000	45,000	\$ 2,000	26,000	93,000
Travel	40,000	40,000	\$ 1,000	3,000	84,000
Conferences and Meetings	20,000	15,000	7,500	-	42,500
Scholarships	143,000	-	-	-	143,000
Interest	-	-	14,500	-	14,500
Total before Depreciation	\$ 400,000	\$ 276,000	\$ 192,000	\$ 115,000	\$ 983,000
Depreciation	-	-	5,000	-	5,000
Total Expenses	400,000	276,000	197,000	115,000	\$ 988,000

**D. Statement of Cash Flows (not included in the Form 990)**

The final financial statement provides information on the cash inflows and outflows of the organization between one date and another. The cash flows are separated into three different business activities as shown in Figure 6:

- o Cash from Operating Activities: This section depicts the cash inflows and outflows arising for the organization's primary business of raising unrestricted and temporarily restricted funding and providing program services.

This section can be depicted in one of two formats. Both methods result in the same net cash from operating activities amount. In the main body of the cash flow statement in Figure 6 is the *direct method* that essentially restates the unrestricted and temporarily restricted portions of the income statement as if it were on the cash basis. The reconciliation at the bottom of the figure is an example of the *indirect method*. The indirect method starts with the change in net assets from the Statement of Activity and converts it from the accrual to cash basis using various adjustments. Given the design of accounting records, most nonprofits use the indirect format to depict their cash from operations.

- o Cash from Investing Activities: This section depicts the cash inflows and outflows associated with the purchase and sale of long-lived assets and investments.
- o Cash from Financing Activities: This section depicts the cash inflows and outflows associated with receipts and repayments of funds provided by creditors and by donors whose permanently restricted contributions are recognized in the statement of activity.

When the three sections are totaled the statement of cash flows explains how the cash at the beginning of the reporting period was converted to the balance at the end of the period.

**FIGURE 6**  
**Statement of Cash Flows**

<b>National Youth Training and Resources Organization</b>	
<b>Statement of Cash Flows</b>	
<b>For the Year Ended December 31, 2000</b>	
<b>Cash Flows from Operating Activities:</b>	
Cash Received from Unrestricted and Temporarily Restricted Contributors	\$ 930,000
Cash Received from Service Recipients	46,000
Grants Paid	(118,000)
Cash paid to Employees and Suppliers	(837,500)
Interest Paid	(14,500)
Interest and Dividends Received	37,000
Net Cash from Operating Activities	<u>\$ 43,000</u>
<b>Cash Flows from Investing Activities:</b>	
Purchase of Investments	\$ (45,000)
Fixed Asset Purchases	(185,000)
Net Cash Used for Investing Activities	<u>\$ (230,000)</u>
<b>Cash Flows from Financing Activities:</b>	
Addition to Endowment	\$ 45,000
Issuance of Long Term Debt	200,000
Net Cash from Financing Activities	<u>\$ 245,000</u>
Net Increase in Cash	\$ 58,000
Beginning Cash Balance	142,000
Ending Cash Balance	<u>\$ 200,000</u>
 <b>Reconciliation of change in net assets to net cash provided by operating activities</b>	
Change in Net Assets	\$ 115,000
Adjustments	
Depreciation Expense	5,000
Restricted Contributions to Endowment	(45,000)
Increase in Pledges Receivable	(55,000)
Increase in Refundable Advances	20,000
Increase in Grants Payable	25,000
Decrease in Accounts Payable	(10,000)
Increase in Prepaid Expenses	(2,000)
Unrealized Gains in Long-Term Investments	(10,000)
Net Cash Provided by Operations	<u>\$ 43,000</u>

## **E. Footnotes**

The footnotes are an important but often overlooked component of the audited financial statements. These notes describe the accounting principles used by the management of the nonprofit in preparing the financial statement. If joint costs are allocated, generally the footnotes will describe how these allocation decisions are made. The notes include a description of the entity being audited, which can include a depiction of the mission and key programs. If a nonprofit receives or has restricted funding, then the footnotes provide detailed information on the amounts, time and nature of stipulations imposed. Nonprofits can disclose the use of contributed services that are not recorded as revenues. If a nonprofit has expensed its collection, then it must describe its collection and accounting and stewardship policies for collections. It must also describe items that are removed from the collection for any reason and disclose the fair market value of those items.

### **E. The Role of an External Auditor**

Depending on a nonprofit's size and funding sources, it may be required to have an annual financial audit. An audit is a systematic examination of the financial records of the organization. A *financial audit* undertaken by a certified public accountant (CPA) following a set of prescribed auditing procedures. The auditor's work may include examining the internal controls and a systematic analysis of the substantial transactions. The auditor is asked to provide an *audit opinion* on whether the financial statements are presented fairly in all material respects the financial position of the organization and in conformity with generally accepted accounting principles. If the auditors believe that the statements meet these expectations, then they issue an *unqualified* opinion as in Figure 7. If the financial statements do not meet these criteria, they can issue a *qualified* opinion, and the auditor's letter would indicate the reason for the qualification.

The auditors can also issue an unqualified opinion modified by explanatory language. For example, if they feel the statements are fairly stated but outside parties should be warned about a financial problem, they occasionally include wording indicating concern about an organization's ability to continue as a *going concern*.

**FIGURE 7**  
**Unqualified Audit Opinion**

Independent Auditor's Report

We have audited the accompanying statement of financial position of the National Youth Training and Resources Organization as of December 31, 2000 and the related statements of activities, functional expenses and cash flows for the year then ended. These financial statements are the responsibility of the management of the National Youth Training and Resources Organization. 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 the 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 the National Youth Training and Resources Organization as of December 31, 2000 and the changes in its net assets and its cash flows for the year then ended in conformity with generally accepted accounting principles.

(Signature)

(Date)

As an alternative to a full financial audit, a nonprofit can hire an outside auditor to either *compile* or *review* the financial statements. A compilation means that the auditor has looked at the financial statements without verifying any of the balances or assuring that the statements

adhere to GAAP. With a review, an accountant has conducted an examination of the accounting records and provides an assurance that he is not aware of any material modifications needed to make the statements conform with GAAP. A review entails substantially more work for an auditor than a compilation, but it provides a negative, or weaker assurance, than an audit. These services may improve the reliability or relevance of the financial statements; however, the auditors have not thoroughly examined the financial records and are not providing an opinion on the accuracy of the financial statements. In either case, the auditors issue a letter that can be sent to outsiders. These letters will use the words *compilation* or *review* instead of audit.

Generally, if a nonprofit organization receives \$300,000 in federal awards either directly or indirectly, it is subject to a special *A-133 audit*. The Office of Management and Budget (OMB) Circular #133 prescribes the audit requirements which include a traditional financial audit as well as an audit to examine an organization's internal control structure in more detail, to verify that the federal funds were handled and spent in compliance with the grant, and to assess whether the organization is in compliance with various federal laws. These audits must be conducted by CPAs that have undertaken additional training.

In addition to the audit opinion, most auditors also provide the nonprofit organization with information regarding their *audit findings*. These findings are shortcomings in the financial system, such as poor internal controls, weak accounting practices, or insufficient safeguarding of assets. The auditor often requests that these shortcomings be corrected before the next audit is conducted. To help assess the quality of financial management, board members and substantial stakeholders can request information regarding the audit findings.

A final audit issue to consider is the quality of the auditor. Auditors vary considerably in their overall knowledge of accounting and auditing as well as their specific experience in not-for-

profits. Unfortunately, some auditors do not perform a quality audit of a not-for-profit. This may be because they are inexperienced, are doing the work *pro bono*, or believe it is unlikely that there will be adverse consequences from doing a substandard job. Before relying on the auditor's opinion, it is important to determine whether the auditor completed a high-quality audit.

#### **F. Supplemental Disclosures in an Annual Report**

Some nonprofits prepare a special annual report that is distributed to donors or other interested parties. A recent study (Christensen and Mohr 2001) indicates that museums frequently prepare such reports. They found that the reports varied in length from 2 to 220 pages. Most but not all contained financial statements. The financial information comprised 10% of the report, in contrast to corporate annual reports that were 48% financial information. The museum reports often contain information on attendance, the donors and their giving levels, a description of the organization and its mission, and a discussion of the past year's activities including major acquisitions and tallies of volunteer hours. A similar study of environmental organizations (Khumawala, Gordon, and Kraut 2001) finds that financial information composes about 10% of the annual report; supplemental disclosures include program descriptions, the success of various lobbying efforts as well as lists of board members, donors and staff.

#### **G. Supplemental Disclosures in the Form 990**

The Form 990 is designed primarily as an informational tax return. Hence, the form is designed to help the IRS determine if a nonprofit is in compliance with various federal laws and is permitted to maintain its tax-exemption. Figure 8 outlines the supplemental disclosures included in the Form 990.

## FIGURE 8

### Differences in Reporting Requirements Between the Form 990 and Audited Financial Statements

#### Present in the Form 990 but not required for audited financial statements

- Information on officers, directors and compensation (was Schedule A, now Part V)
- Description of mission and program services (optional in audited financials) (Part III)
- Partial reconciliation between Form 990 and audited financial statements (Part IV-A and Part IV-B)
- Responses to yes/no questions regarding compliance with various legal requirements (Part VI)
- Analysis of income-producing activities (used to determine if firm is fulfilling operational tests required to maintain exempt status) (Parts VII and VIII)
- Ownership information on taxable subsidiaries (Part IX)
- Information regarding transfers associated with personal benefit contracts (Part X)

#### Present in audited financial statements but missing from the Form 990:

- Information on whether the statements are audited and received a qualified or unqualified opinion
- Accounting principles used to prepare the statements
- Description of the entity being audited
- Cash flow statement
- Amounts, timing and conditions associated with restricted funds

#### Practices in the Form 990 that are not consistent with Generally Accepted Accounting Principles (GAAP):

- The accounting method for many accounts are not disclosed in the 990
- Use of an indeterminate basis for allocating joint costs to program activities rather than to administrative or fundraising activities in Form 990
- Unrealized gains and losses on investments are reported in the Form 990 but are reflected in value of the investments and the equity in the audited financial statements
- Recognition of most contributed goods and services can not be included in the Form 990, while certain non-cash contributions can be included in the audited financials
- Limited or no information is disclosed about revenues and expenditures associated with restricted funds are provided in the 990
- Indirect costs of selling merchandise (such as selling, general and administrative costs) can be included in cost of goods sold
- The 990 requires that nonprofits carry revenues from sales of merchandise, special events, and rental activities net of expenses as a gain/loss included in revenue rather than having the separate components shown in revenues and expenses. GAAP accounting allows netting of only for incidental or peripheral activities.

## V. FINANCIAL PERFORMANCE MEASURES

Based on the focus groups and informal interviews, we identified questions commonly asked by the stakeholders to assess the performance of a nonprofit:

**FIGURE 9**  
**Questions Asked to Assess Financial Performance**

1. Mission
  - o What is your organizational mission?
  - o Is the mission consistent with the stakeholder's values?
  - o How does that translate into goals and objectives?
  - o What is the business model/strategy?
  - o What are present obstacles to fulfilling the mission?
2. Service Delivery
  - o What is the demand for these services?
  - o What type, volume and quality of services are delivered?
  - o Are these services compatible with mission?
  - o Are they meeting goals and objectives (are \$ spent on right stewardship things)?
  - o What are present obstacles in service delivery?
3. Organizational Management
  - o What is the experience and expertise of management?
  - o What is the quality of internal support systems?
  - o What is the administrative efficiency?
  - o What is the appropriateness of compensation?
4. Organizational Funding
  - o What cash funds are available?
  - o What non-cash contributions (goods, services volunteers) are used and available?
  - o How financial supportive are board and community?
  - o How financial supportive are commercial activities?
  - o Is there continuity of support and diversity of income streams?
  - o How compatible is the funding with the mission?
  - o How efficiency is fundraising and development?
  - o What are present obstacles in funding and support?
5. Financial Health
  - o What is the cash flow position?
  - o How financially stable is the organization?
  - o Does it have accumulated wealth to sustain it if funding is reduced?
6. Financial Management
  - o What is the quality of internal control system?
  - o How prudent is the cash and investment management?
  - o Are non-financial assets prudently managed?

For many stakeholders, the most critical questions relate to an organization's mission, its appropriateness, and its success in fulfilling it. These first two issues cannot be readily answered using financial or quantitative measures.<sup>10</sup> This section will examine how the third issue of program accomplishment may be answerable, in part, through eight sets of financial measures. We will do this by describing various financial analysis techniques and how they apply in the nonprofit setting. These techniques have been drawn from a variety of sources including Tuckman and Chang 1991, Gross, Warshauer, Larkin 1991, Hodgkinson and Weitzman 1996, Stevenson, Pollak, and Lampkin 1997, Forrester 1998, Maddox 1999, and Froelich, Knoepfle, Pollak 2000.

### **A. Peer Benchmarking**

In many cases, it is difficult to look at the financial statements alone and gain insight into the operation of the firm and its current and long-term prospects. Benchmarking a firm against a peer can lend perspective to the analysis. Several attributes should be considered when searching for an appropriate benchmark. Often computing an average of three to four organizations will create a benchmark that is not overly volatile. The peers should be roughly comparable in mission, industry classification, and size. When benchmarking compensation or changes in program services, it is often helpful to use nonprofit organizations in the same geographic area or sensitive to the same fluctuations in funding. The nonprofit itself may be able to suggest some suitable peers. Alternatively, one can search the IRS tax filings for similar organizations. The recent filings are industry coded using the National Taxonomy of Exempt Entities (NTEE). This

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<sup>10</sup> A publication that addresses these issues is *The Five Most Important Questions You will Ever Ask about Your Nonprofit Organization* by Peter F. Drucker.

classification system is being replaced by the North American Industry Classification System (NAICS), which also covers for-profit organizations.<sup>11</sup>

## **B. Common-Sizing Financial Statements**

To become familiar with an organization's emphasis, it is helpful to determine how its resources are distributed. This can be accomplished through *common sizing*, i.e. converting to percentages, several financial statements. The Statement of Financial Condition is generally divided by total assets, the Statement of Activities is divided by total revenues, and the Statement of Functional Expenses is divided by total expenses. The following insights can be developed:

- o Asset Concentrations: Analysis of the asset mix can help identify the resources available to deliver future services. Missing from this analysis is the value of a nonprofit's staff or any internally developed expertise. Many older nonprofits have not capitalized their fixed assets or may be holding valuable collections that are not reflected at their fair market value on the financial statements. Hence, an analyst may want to develop a list of unidentified assets.
- o Revenue Concentrations: By looking at the mix of revenues, one can assess a non-profit's reliance on different forms of revenue, see if this reliance has shifted over time, or if it has a substantially different profile from some of its industry peers. If a nonprofit is following GAAP and receives large multi-year grants then the contributions will be high in years that grants are awarded and relatively small in the subsequent years. A common practice when analyzing these firms is to average revenues over three years.
- o Expense Concentrations: This analysis can reveal the nature of the *production function* needed to run organization. For example, how important are personnel costs relative to total costs; does the organization provide indirect services through giving grants to others or

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<sup>11</sup> For more information on these classification systems, go to: <http://nccs.urban.org/ntee-cc/index.htm>

does it provide the services directly. The expense concentrations also indicate whether resources are consumed by delivering program services or support services (fundraising and administrative). One particular measure that many stakeholders use is the program efficiency ratio which is  $\frac{\text{Program Expenses}}{\text{Total Expenses}}$ . This measure indicates what percentage of the resources consumed are used to provide program services. As seen in Appendix 3, several watchdog organizations rely on this as a key measure of success. The *Chronicle of Philanthropy* publishes comparative ratios for large nonprofits each year. Many nonprofits emphasize their efficiency in marketing materials, by stating things like for every dollar you give x% is spent on program.

Unfortunately, this statement is often inaccurate. Many large contributions are provided on a temporarily restricted basis with stipulations that the funds be spent often exclusively on program services. The small, individual donations are then used to cover administrative and fundraising costs.

Since the program efficiency ratio is a prominent ratio, it may be subject to financial misreporting. Nonprofits purchase goods and services that may provide benefits to program as well as fundraising and administration. Through an allocation process, joint costs such as salaries, employee benefits, and rent are distributed between the three functional areas. Historically, nonprofits have been accused of allocating too many costs of direct mail marketing campaigns to program expenses. GAAP now limits this joint cost allocation decision. With about one-third of all nonprofits reporting zero fundraising expenses on their 990 Form, it is suspected that some nonprofits still intentionally allocate a disproportionate amount to program expenses. Finally, assessing program efficiency using the Form 990 produces artificially favorable efficiency ratios. Since the Form 990 allows

the organization to record various administrative and fundraising costs as reductions in revenues rather than expenses, these support service expenses are understated relative to program expenses.

### **C. Trend Analysis**

Another technique to analyze an organization is to conduct a trend analysis. For this approach, at least three years of financial information is required. The annual growth rates in important accounts such as program expenses, support services, total revenues, cash and compensation are computed. Generally, stakeholders look for positive and sustained growth in these categories with program expenses growing as fast or faster than support services or compensation. If this is not occurring, it may be that the organization had previously underinvested in compensation or support functions, or it may be an indicator that management is inefficient or is being excessively compensated or accepting perquisites, such as an expense account. If revenue growth consistently exceeds program service growth, it may be an indication that the organization is strengthening its long-term financial health or that it is not sufficiently expanding its programs.

### **D. Comparisons in Relation to the Budget**

Another method of assessing an organization's performance is to compare its reported financial information to its budget. Most nonprofits undertake an annual budgeting process that entails developing budget projections for the following year, obtaining the approval of the board for incurring the anticipated expenses, carrying out its operations, and then reporting to the board on its performance for the year. The annual budget is not a formally disclosed document, but board members and selected donors can receive copies.

## E. Profitability Measures

In a for-profit setting, it is critical to know if the firm is operating profitably. For non-profits, the excess of revenues over expenses is not necessarily an indicator of good performance. In small non-profits, many budget their operations to ensure that they provide the maximum program services. One measure of that is whether revenues are fully consumed as expenses in the period received, i.e. the organization never reports a profit or a loss.

As a firm becomes larger, it is more difficult to operate with expenses fully offsetting revenues. Larger nonprofits seek to regularly report a modest excess of unrestricted revenues over expenses, creating some slack in the organization that can be used to support services of there are delays in receiving funding or an unexpected drop in revenues.

Larger organizations often have investments and some moneymaking activities. The objective is to generate a profit that can be used to finance the program services. For these activities, it is common to compare the profit to the size of the activity. For example:

- o Return on Investments is defined as  $\frac{\text{Investment Income}}{\text{Average Investments}}$
- o Gross Margin is defined as  $\frac{\text{Sales of Merchandise} - \text{Cost of Goods Sold}}{\text{Sales of Merchandise}}$
- o Margin on Rental Activities is defined as  $\frac{\text{Rental Revenue} - \text{Rental Expenses}}{\text{Rental Revenue}}$

## F. Liquidity Ratios

A concern for many nonprofits is their ability to pay their obligations on time (*liquidity*). Today, in for-profit companies, liquidity is assessed by looking at *free cash flows*. This is often measured by: Cash from Operating Activities + Cash from (Nondiscretionary) Investments. Since the Form 990 does not require a cash flow statement, it is often not possible to compute free cash flows. Instead, analysts compute more traditional liquidity measures as follows:

- o Current Ratio is defined as  $\frac{\text{Current Assets}}{\text{Current Liabilities}}$ , where current assets are the assets that will be converted into cash in the next 12 months, and current liabilities are the debts that become due in the next 12 months. It is measure of a nonprofit's ability to pay its obligations on time. Nonprofit balance sheets often do not classify assets and liabilities as current or long-term. An estimate of current assets includes cash, receivables, inventories, and prepaid expenses. An estimate for current liabilities is total liabilities minus bonds, mortgages and bank debt maturing in over one year.
- o Net Working Capital is defined as Current Assets- Current Liabilities. This is an alternative method of assessing a nonprofit's ability to pay its short-term obligations.
- o Days Cash On Hand is defined as  $\frac{\text{Cash and Cash Equivalents}}{\text{Monthly Expenses}}$ . Assuming that the organization stops receiving revenues, this measures gives a sense of how many months a nonprofit can continue to pay bills. It has been suggested that having at least, three, if not six months of cash on hand is desirable.
- o  $\frac{\text{Accounts Payable}}{\text{Monthly Expenses}}$ . This measure indicates how many months of expenses are still owed to creditors.

### **G. Measures of Financial Distress or Vulnerability**

While liquidity measures help assess a nonprofit's ability to continue in operations in the short term, they not as helpful in predicting long term viability, i.e. *solvency*. The basic definition of solvency is whether net assets are positive. However, nonprofits can be viable with negative

net assets. This because many important assets of the firm are not recorded in the financial system at all or are severely understated. An alternative measure is leverage, which is often defined as  $\frac{\text{Total Liabilities}}{\text{Total Assets}}$ . The measure indicates how much of a nonprofit's assets are funded by other people's money. Debt financing is important to allow nonprofit's to grow and to help asset intensive organizations support and expand their facilities. However, an overly high reliance on debt financing can put a nonprofit at risk. If creditors become concerned, they may demand debt repayment or be reluctant make new loans. If the nonprofit fails to make debt or interest payments in a timely fashion, the creditors can force the termination or liquidation of the organization.

Several academic studies have examined the measures that are mostly likely to predict financial distress or vulnerability in the form of a substantial decline in program services or in net assets (Tuckman and Chang 1991, Greenlee and Trussel 2000, Trussel and Greenlee 2001). These studies indicate that when the following ratios differ substantially and adversely from their industry peers, these firms are more likely to experience financial distress:

- o Profit Margin defined as  $\frac{\text{Total Revenues} - \text{Total Expenses}}{\text{Total Revenues}}$
- o Revenue Concentration Index defined as the sum of squares of each revenue source divided by total revenues.
- o Administrative Cost Ratio defined as  $\frac{\text{Administrative Expenses}}{\text{Total Expenses}}$
- o Equity Balances defined as  $\frac{\text{Total Equity}}{\text{Total Revenues}}$
- o Size defined as the natural log of total assets.

## H. Activity and Efficiency Measures

The primary efficiency measure used to assess nonprofits is the program efficiency ratio described in the subsection on common sizing. While frequently used, the program efficiency does not reflect well the activity of the firm. When reported accurately the program efficiency ratio depicts the input costs of the services provided. Most stakeholders are interested in the direct deliverables (outputs) or the long term benefits outcomes. Given the present financial disclosures, it is not possible to determine the number of clients served, the man-hours of services provided, or the any measurable benefits received.

Recent concern over the inability to assess this critical element of performance has led to books aimed to improve their organizations and manage more efficiently (Antos and Brimson 1994; Dropkin and LaTouche 1998; Drucker 1992; Eadies and Schrader 1997; Firstenberg 1996; Pynes and Schrader 1997; Wolf 1990). Many attempt to bring business concepts such as reengineering, quality management, and benchmarking to bear on the nonprofit sector, usually with the intent of raising the level of organizational and program performance. Hence, the reader should recognize that an important limitation of current financial statements is their relative inability to assess whether an organization is efficiently accomplishing its mission.

A more fruitful activity may be to assess fundraising efficiency using a measure such as

$$\frac{\text{Fundraising Expenses}}{\text{Contributions} + \text{Special Event Revenue}}$$
. The measure assesses the cost of generating a dollar of

contributions. An analysis by the National Center for Charitable Statistics that revealed that on one-third of recent 990 tax forms reported zero fundraising expenses. One suspicion is that nonprofits are allocating fundraising expenses to program or administrative costs, allowing them to reduce this ratio to zero. In addition, a number of nonprofits may be recording revenues from direct mail and telemarketing campaigns as the receipts less the associated fundraising expenses.

Alternatively, a fundraising ratio of zero may indicate that the agency is accepting contributions from federated fundraising agencies, such as the United Way, or headquarters/umbrella organizations, and these agencies are recording the fundraising expenses. Rather than an indicator of fundraising efficiency, a fundraising ratio of zero may indicate that the financial statements do not materially reflect the financial condition of the organization.

## **I. Compensation Issues**

A final area to consider is compensation. Three issues regularly emerge in the nonprofit setting: Are top executives excessively compensated? Are other employees adequately compensated? Are employees effectively compensated? The first question can be examined by looking at Form 990 and the required Schedule A that includes the salary, benefits and expense account disclosures for the five highest paid employees of the organization. These amounts can be compared to compensation reported by comparable institutions on their Form 990s. Nonprofits, however, can understate an individual's compensation by creating multiple reporting entities. For example, hospitals often pay doctors through both their operating nonprofit and an associated foundation. Each tax return only reports a portion a doctor's total compensation. The latter two questions are more difficult to determine. The total compensation and benefits are reported in the statement of functional expenses, however, headcount is not provided. As regards the effectiveness of the compensation, many nonprofits do not pay incentive compensation, since such payments may be interpreted as violating the *nondistribution constraint* that prohibits nonprofits from distributing their excess earnings to third parties. The latter two questions can best be answered by asking management for supplemental information.

## **VI. CONCLUSIONS**

This report has discussed the state of nonprofit financial reporting and provided advice on how to analyze a nonprofit's financial performance using currently available information. In this section, we present some expected enhancements in financial reporting and outline a plan for making additional improvements.

### **A. Anticipated Improvements**

Stakeholders interested in a single nonprofit tax filing are presently able to go the Guidestar website and download a scanned version of the document. The National Center for Charitable Statistics is completing a "digitized" version of these filings. The digitized information is expected to be available in late 2001 and will allow users to analyze almost all of the Form 990 datafields for almost all recent filers of the Form 990 and 990EZ.

Recently, the National Association of State Charity Officials (NASCO) has worked together to develop a unified registration statement. In the eleven participating states, a nonprofit will be able to complete a single annual filing that will be accepted in a number of states. The NCCS is working with NASCO and others to develop software that will allow nonprofits to file the unified registration statement electronically. Potentially, this software may accommodate more complex financial reporting, such as audited financial statements.

A third project underway at NCCS will produce information that will classify not only the nonprofit by its industry code but also classify its programs. This project relies heavily on the information reported in Part III of the Form 990. Currently, this section is often left empty or is not accurately completed by the nonprofit filing the return.

### **B. A Plan for An Improved Performance Assessment**

In conclusion, we present six policy proposals for performance assessment starting with modest improvements that can be made quickly and building to more ambitious options for overhauling the system. We would recommend a graduated approach to making changes in the nonprofit accountability system, as stakeholders become more active and engaged in using data on nonprofit financial performance.

First, the Internal Revenue Service should revise the 990 forms to conform to generally accepted accounting principles (GAAP) and encourage dissemination of audited financial statements. By following GAAP, the users will obtain information on the consolidated entity (rather than just a single legal entity), a cash flow statement, and more detailed data on restricted funds and other operations of the firm. This expanded disclosure will improve the understanding of individual organizations, enhance the allocation of resources within the community, and better achieve nonprofit accountability. Just as only nonprofits with a minimum of \$25,000 in revenues are required to file a 990 form, a reasonable cut-off could be established for the preparation of audited financial statements. The threshold in many states is \$125,000 in annual revenues. Right now there is considerable uncertainty in the accuracy of the information reported in the 990 forms. Stakeholders need assurance that the financial data, particularly as it relates to executive compensation, administrative overhead, and other non-program expenditures are reported consistently and accurately. Moving to a system that requires GAAP accounting and the use of audited financial statements would be a first step in improving reliability and relevance.

Second, information technology now makes it possible for this information to be shared much sooner and more broadly. There is no compelling reason that tax filings (and audited financial statements) could not be filed electronically by nonprofit organizations and quickly posted on the web. Timely and publicly accessible filings will reduce search costs for donors and

is a first step in reducing the information asymmetries between small and large funders. Public-private partnership could develop downloadable software for creating and submitting the tax filings as well as the infrastructure for receiving and posting these filings. As mentioned, some early initiatives are underway.

Third, education and public information could improve stakeholders' understanding of the importance of financial reporting to sensible performance assessments. A public information campaign could raise awareness of differences in nonprofit operating practices and impress on donors, clients and communities the importance of being informed about nonprofit organizations they support directly or indirectly. Even though private support is often provided without restrictions, public information and awareness could only improve the allocation of resources to the nonprofit community and encourage better nonprofit management. We therefore believe that a broad initiative aimed at activating stakeholders would be critical to any successful reengineering of nonprofit accountability.

Fourth, more relevant disclosures should be provided to stakeholders. In particular, management discussion and analysis (MD&A) and indicators of program activity could be included in the financial reports (Herzlinger 1996 and 1997). Financial measures may effectively capture the key risk and return measures of for-profit organizations. However, the value added of nonprofits is not measured by the dollars spent on program services, but rather in the reach of its programs. While measuring impact and effectiveness remains difficult, there are proxy measures of program activity that can still be collected and disseminated. Encouraging more extensive disclosure of program rationale, inputs (e.g. number of employees and volunteers), and outputs (e.g. number of clients served and hours of service delivered) would be a useful first step.

Our fifth recommendation recognizes that providing more extensive and reliable information more quickly may be insufficient. The amount of financial reporting by publicly traded firms and extensive SEC enforcement activities demonstrate an important point: Even the best financial reporting system alone cannot prevent fraud and fraudulent reporting. Whenever substantial amounts of money are involved, abuses are likely to occur. The nonprofit sector now constitutes 12 percent of the US economy and 10 percent of the workforce and continues to grow. For this reason, greater coordination the nonprofit financial reporting system is necessary and may require a new organization, whose primary focus is non-profit organizations. A range of organizational structures and powers are possible. This body could be an independent, self-regulating organization, like the FASB, New York Stock Exchange, or NASDAQ. It could be a quasi-independent government agency, like the Federal Reserve System. Alternatively, it could be an intergovernmental agency, such as the Federal Financial Institutions Examination Council that oversees regulatory filings and examinations of financial institutions. Finally, it could be a federal agency, such as the SEC that could either work cooperatively with the IRS or subsume the responsibilities of the Exempt Organizations Division. The ability to sanction or fine an organization for late, erroneous, or fraudulent reporting would be an important power for this agency.

Once established, the new agency could be funded in one or more ways: The system could be funded with annual filing fees that are based on a sliding scale. This scale could range from \$50 to 250 per year, and perhaps an initial application fee of \$100. With 600,000 nonprofit filers with an average filing fee of \$100, such a system would generate \$60-65 million to launch a top quality information dissemination system. Alternatively, the system could be funded by a range of parties, including government agencies, foundations, corporations, and federated funders,

which use this data in their decision-making and evaluation of nonprofits regularly. While this approach would remove the costs from the nonprofit agencies, it would be difficult to support and sustain in the long run given the changing priorities of many funders. Another option would be to create an endowment to support this initiative, which could be funded by a combination of fees from the nonprofits and contributions from funders. A final option would be to attempt to finance the system by charging users who access the data a fee. This is the least workable of the options given the scale of the initiative and the fact that demand for the data must be stimulated and cultivated.

Sixth, we suggest that an independent commission be created to study the nonprofit reporting system and make recommendations for the new agency and its funding. While we are not recommending a specific organizational structure or duties for the new agency, the process by which this organization is formed is important. The present financial reporting system does not provide the reliable and relevant information that the stakeholders should demand, and nonprofit organizations are not held accountable for providing this type of information. These commissions have been successfully in the business setting. The Wheat Commission led to the redesign of the standard setting process and the creation of FASB. More recently, the Jenkins Committee re-evaluated the business-reporting model, leading to a greater emphasis on reporting of non-financial outcomes by businesses. The goal of the commission would be to develop a blueprint for an effectively operating nonprofit reporting system and new agency based on input from the stakeholder, regulator and nonprofit communities. The commission would design an implementation plan complete with recommended funding proposals. It would then work to develop a consensus behind its recommended plan and achieve implementation.

In constructing any new system for improving performance assessment, it will be critical to have nonprofit organizations actively involved in all aspects of the system's design. The experience of the credit unions is instructive in this regard. Their oversight system is popular among participants precisely because there is ample opportunity for input and control. Any new nonprofit accountability system must therefore be supported by the nonprofits themselves. This will entail convincing the sector that better information and more informed donors will strengthen support for nonprofits and generate greater levels of support in the long run.

By working simultaneously to improve the supply of nonprofit financial information and to stimulate demand for this information, a new nonprofit reporting agency – conveying data based on audited financial statements – could lay a strong foundation for the sector's continued growth. Improving the sector's accountability system will go along way toward building the trust that nonprofits need to thrive in the growing space left open between the state and the market.

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**Return of Organization Exempt From Income Tax**

Under section 501(c) of the Internal Revenue Code (except black lung benefit trust or private foundation), section 527, or section 4947(a)(1) nonexempt charitable trust

▶ The organization may have to use a copy of this return to satisfy state reporting requirements.

**2000****Open to Public Inspection****A For the 2000 calendar year, or tax year period beginning** , 2000, and ending , 20**B** Check if applicable:

- ☐ Change of address  
☐ Change of name  
☐ Initial return  
☐ Final return  
☐ Amended return

Please use IRS label or print or type. See Specific Instructions.

**C** Name of organization

Number and street (or P.O. box if mail is not delivered to street address) Room/suite

City or town, state or country, and ZIP code

**D** Employer identification number**E** Telephone number

( )

**F** Check ☐ if application pending**G** Organization type (check only one) ▶ ☐ 501(c) ( ) ◀ (insert no.) ☐ 527 or ☐ 4947(a)(1)• **Section 501(c)(3) organizations and 4947(a)(1) nonexempt charitable trusts must attach a completed Schedule A (Form 990 or 990-EZ).****J** Accounting method: ☐ Cash ☐ Accrual ☐ Other (specify) ▶

**K** Check here ☐ if the organization's gross receipts are normally not more than \$25,000. The organization need not file a return with the IRS; but if the organization received a Form 990 Package in the mail, it should file a return without financial data. Some states require a complete return.

Note: H and I are not applicable to section 527 orgs.

**H(a)** Is this a group return for affiliates? ☐ Yes ☐ No**H(b)** If "Yes," enter number of affiliates ▶**H(c)** Are all affiliates included? ☐ Yes ☐ No

(If "No," attach a list. See inst.)

**H(d)** Is this a separate return filed by an organization covered by a group ruling? ☐ Yes ☐ No**I** Enter 4-digit group exemption no. (GEN) ▶**L** Check this box if the organization is **not** required to attach Schedule B (Form 990 or 990-EZ) ▶ ☐**Part I Revenue, Expenses, and Changes in Net Assets or Fund Balances** (See Specific Instructions on page 16.)

Revenue	<b>1</b>	Contributions, gifts, grants, and similar amounts received:			
	<b>a</b>	Direct public support	<b>1a</b>		
	<b>b</b>	Indirect public support	<b>1b</b>		
	<b>c</b>	Government contributions (grants)	<b>1c</b>		
	<b>d</b>	<b>Total</b> (add lines 1a through 1c) (cash \$ _____ noncash \$ _____)			<b>1d</b>
	<b>2</b>	Program service revenue including government fees and contracts (from Part VII, line 93)			<b>2</b>
	<b>3</b>	Membership dues and assessments			<b>3</b>
	<b>4</b>	Interest on savings and temporary cash investments			<b>4</b>
	<b>5</b>	Dividends and interest from securities			<b>5</b>
	<b>6a</b>	Gross rents	<b>6a</b>		
	<b>b</b>	Less: rental expenses	<b>6b</b>		
	<b>c</b>	Net rental income or (loss) (subtract line 6b from line 6a)			<b>6c</b>
<b>7</b>	Other investment income (describe ▶ )			<b>7</b>	
	<b>8a</b>	Gross amount from sales of assets other than inventory	(A) Securities	(B) Other	
	<b>b</b>	Less: cost or other basis and sales expenses	<b>8a</b>	<b>8b</b>	
	<b>c</b>	Gain or (loss) (attach schedule)	<b>8c</b>		
	<b>d</b>	Net gain or (loss) (combine line 8c, columns (A) and (B))			<b>8d</b>
	<b>9</b>	Special events and activities (attach schedule)			
	<b>a</b>	Gross revenue (not including \$ _____ of contributions reported on line 1a)	<b>9a</b>		
	<b>b</b>	Less: direct expenses other than fundraising expenses	<b>9b</b>		
	<b>c</b>	Net income or (loss) from special events (subtract line 9b from line 9a)			<b>9c</b>
	<b>10a</b>	Gross sales of inventory, less returns and allowances	<b>10a</b>		
	<b>b</b>	Less: cost of goods sold	<b>10b</b>		
<b>c</b>	Gross profit or (loss) from sales of inventory (attach schedule) (subtract line 10b from line 10a)			<b>10c</b>	
<b>11</b>	Other revenue (from Part VII, line 103)			<b>11</b>	
<b>12</b>	<b>Total revenue</b> (add lines 1d, 2, 3, 4, 5, 6c, 7, 8d, 9c, 10c, and 11)			<b>12</b>	
Expenses	<b>13</b>	Program services (from line 44, column (B))			<b>13</b>
	<b>14</b>	Management and general (from line 44, column (C))			<b>14</b>
	<b>15</b>	Fundraising (from line 44, column (D))			<b>15</b>
	<b>16</b>	Payments to affiliates (attach schedule)			<b>16</b>
	<b>17</b>	<b>Total expenses</b> (add lines 16 and 44, column (A))			<b>17</b>
Net Assets	<b>18</b>	Excess or (deficit) for the year (subtract line 17 from line 12)			<b>18</b>
	<b>19</b>	Net assets or fund balances at beginning of year (from line 73, column (A))			<b>19</b>
	<b>20</b>	Other changes in net assets or fund balances (attach explanation)			<b>20</b>
	<b>21</b>	Net assets or fund balances at end of year (combine lines 18, 19, and 20)			<b>21</b>

**Part II Statement of Functional Expenses**

All organizations must complete column (A). Columns (B), (C), and (D) are required for section 501(c)(3) and (4) organizations and section 4947(a)(1) nonexempt charitable trusts but optional for others. (See Specific Instructions on page 20.)

<i>Do not include amounts reported on line 6b, 8b, 9b, 10b, or 16 of Part I.</i>		(A) Total	(B) Program services	(C) Management and general	(D) Fundraising
<b>22</b>	Grants and allocations (attach schedule) . . . . . (cash \$ _____ noncash \$ _____)	<b>22</b>			
<b>23</b>	Specific assistance to individuals (attach schedule)	<b>23</b>			
<b>24</b>	Benefits paid to or for members (attach schedule).	<b>24</b>			
<b>25</b>	Compensation of officers, directors, etc. . . . .	<b>25</b>			
<b>26</b>	Other salaries and wages . . . . .	<b>26</b>			
<b>27</b>	Pension plan contributions . . . . .	<b>27</b>			
<b>28</b>	Other employee benefits . . . . .	<b>28</b>			
<b>29</b>	Payroll taxes . . . . .	<b>29</b>			
<b>30</b>	Professional fundraising fees . . . . .	<b>30</b>			
<b>31</b>	Accounting fees . . . . .	<b>31</b>			
<b>32</b>	Legal fees . . . . .	<b>32</b>			
<b>33</b>	Supplies . . . . .	<b>33</b>			
<b>34</b>	Telephone . . . . .	<b>34</b>			
<b>35</b>	Postage and shipping . . . . .	<b>35</b>			
<b>36</b>	Occupancy . . . . .	<b>36</b>			
<b>37</b>	Equipment rental and maintenance . . . . .	<b>37</b>			
<b>38</b>	Printing and publications . . . . .	<b>38</b>			
<b>39</b>	Travel . . . . .	<b>39</b>			
<b>40</b>	Conferences, conventions, and meetings . . . . .	<b>40</b>			
<b>41</b>	Interest . . . . .	<b>41</b>			
<b>42</b>	Depreciation, depletion, etc. (attach schedule)	<b>42</b>			
<b>43</b>	Other expenses (itemize): <b>a</b> .....	<b>43a</b>			
	<b>b</b> .....	<b>43b</b>			
	<b>c</b> .....	<b>43c</b>			
	<b>d</b> .....	<b>43d</b>			
	<b>e</b> .....	<b>43e</b>			
<b>44</b>	<b>Total functional expenses</b> (add lines 22 through 43). <i>Organizations completing columns (B)-(D), carry these totals to lines 13-15.</i>	<b>44</b>			

**Reporting of Joint Costs.** Did you report in column (B) (Program services) any joint costs from a combined educational campaign and fundraising solicitation? . . . . . ☐ Yes ☐ No

If "Yes," enter (i) the aggregate amount of these joint costs \$ \_\_\_\_\_; (ii) the amount allocated to Program services \$ \_\_\_\_\_; (iii) the amount allocated to Management and general \$ \_\_\_\_\_; and (iv) the amount allocated to Fundraising \$ \_\_\_\_\_

**Part III Statement of Program Service Accomplishments** (See Specific Instructions on page 23.)

What is the organization's primary exempt purpose? ► .....

All organizations must describe their exempt purpose achievements in a clear and concise manner. State the number of clients served, publications issued, etc. Discuss achievements that are not measurable. (Section 501(c)(3) and (4) organizations and 4947(a)(1) nonexempt charitable trusts must also enter the amount of grants and allocations to others.)

**Program Service Expenses**

(Required for 501(c)(3) and (4) orgs., and 4947(a)(1) trusts; but optional for others.)

<b>a</b>	..... ..... ..... (Grants and allocations \$ .....)	
<b>b</b>	..... ..... ..... (Grants and allocations \$ .....)	
<b>c</b>	..... ..... ..... (Grants and allocations \$ .....)	
<b>d</b>	..... ..... ..... (Grants and allocations \$ .....)	
<b>e</b>	Other program services (attach schedule) (Grants and allocations \$ .....)	
<b>f</b>	<b>Total of Program Service Expenses</b> (should equal line 44, column (B), Program services) . . . . .	

**Part IV Balance Sheets** (See Specific Instructions on page 23.)

<b>Note:</b> Where required, attached schedules and amounts within the description column should be for end-of-year amounts only.		(A) Beginning of year	(B) End of year
<b>Assets</b>	<b>45</b> Cash—non-interest-bearing . . . . .		<b>45</b>
	<b>46</b> Savings and temporary cash investments . . . . .		<b>46</b>
	<b>47a</b> Accounts receivable . . . . . <b>47a</b>		<b>47c</b>
	<b>b</b> Less: allowance for doubtful accounts . . . . . <b>47b</b>		
	<b>48a</b> Pledges receivable . . . . . <b>48a</b>		<b>48c</b>
	<b>b</b> Less: allowance for doubtful accounts . . . . . <b>48b</b>		
	<b>49</b> Grants receivable . . . . .		<b>49</b>
	<b>50</b> Receivables from officers, directors, trustees, and key employees (attach schedule) . . . . .		<b>50</b>
	<b>51a</b> Other notes and loans receivable (attach schedule). . . . . <b>51a</b>		<b>51c</b>
	<b>b</b> Less: allowance for doubtful accounts . . . . . <b>51b</b>		
	<b>52</b> Inventories for sale or use . . . . .		<b>52</b>
	<b>53</b> Prepaid expenses and deferred charges . . . . .		<b>53</b>
	<b>54</b> Investments—securities (attach schedule). . . . . <input type="checkbox"/> Cost <input type="checkbox"/> FMV		<b>54</b>
	<b>55a</b> Investments—land, buildings, and equipment: basis . . . . . <b>55a</b>		<b>55c</b>
	<b>b</b> Less: accumulated depreciation (attach schedule). . . . . <b>55b</b>		
<b>56</b> Investments—other (attach schedule) . . . . .		<b>56</b>	
<b>57a</b> Land, buildings, and equipment: basis . . . . . <b>57a</b>		<b>57c</b>	
<b>b</b> Less: accumulated depreciation (attach schedule). . . . . <b>57b</b>			
<b>58</b> Other assets (describe ► )		<b>58</b>	
<b>59</b> <b>Total assets</b> (add lines 45 through 58) (must equal line 74) . . . . .		<b>59</b>	
<b>Liabilities</b>	<b>60</b> Accounts payable and accrued expenses . . . . .		<b>60</b>
	<b>61</b> Grants payable . . . . .		<b>61</b>
	<b>62</b> Deferred revenue . . . . .		<b>62</b>
	<b>63</b> Loans from officers, directors, trustees, and key employees (attach schedule). . . . .		<b>63</b>
	<b>64a</b> Tax-exempt bond liabilities (attach schedule) . . . . .		<b>64a</b>
	<b>b</b> Mortgages and other notes payable (attach schedule) . . . . .		<b>64b</b>
	<b>65</b> Other liabilities (describe ► )		<b>65</b>
<b>66</b> <b>Total liabilities</b> (add lines 60 through 65) . . . . .		<b>66</b>	
<b>Net Assets or Fund Balances</b>	<b>Organizations that follow SFAS 117, check here</b> <input type="checkbox"/> and complete lines 67 through 69 and lines 73 and 74.		
	<b>67</b> Unrestricted . . . . .		<b>67</b>
	<b>68</b> Temporarily restricted . . . . .		<b>68</b>
	<b>69</b> Permanently restricted . . . . .		<b>69</b>
	<b>Organizations that do not follow SFAS 117, check here</b> <input type="checkbox"/> and complete lines 70 through 74.		
	<b>70</b> Capital stock, trust principal, or current funds . . . . .		<b>70</b>
	<b>71</b> Paid-in or capital surplus, or land, building, and equipment fund . . . . .		<b>71</b>
	<b>72</b> Retained earnings, endowment, accumulated income, or other funds . . . . .		<b>72</b>
	<b>73</b> <b>Total net assets or fund balances</b> (add lines 67 through 69 OR lines 70 through 72; column (A) must equal line 19 and column (B) must equal line 21) . . . . .		<b>73</b>
<b>74</b> <b>Total liabilities and net assets / fund balances</b> (add lines 66 and 73)		<b>74</b>	

Form 990 is available for public inspection and, for some people, serves as the primary or sole source of information about a particular organization. How the public perceives an organization in such cases may be determined by the information presented on its return. Therefore, please make sure the return is complete and accurate and fully describes, in Part III, the organization's programs and accomplishments.

**Part IV-A** Reconciliation of Revenue per Audited Financial Statements with Revenue per Return (See Specific Instructions, page 25.)

<b>a</b>	Total revenue, gains, and other support per audited financial statements . . . ▶	<b>a</b>	
<b>b</b>	Amounts included on line <b>a</b> but not on line 12, Form 990:	<b>b</b>	
(1)	Net unrealized gains on investments . . . \$		
(2)	Donated services and use of facilities \$		
(3)	Recoveries of prior year grants . . . \$		
(4)	Other (specify): ..... \$		
	Add amounts on lines (1) through (4) ▶	<b>b</b>	
<b>c</b>	Line <b>a</b> minus line <b>b</b> . . . . . ▶	<b>c</b>	
<b>d</b>	Amounts included on line 12, Form 990 but not on line <b>a</b> :	<b>d</b>	
(1)	Investment expenses not included on line 6b, Form 990 . . . \$		
(2)	Other (specify): ..... \$		
	Add amounts on lines (1) and (2) ▶	<b>d</b>	
<b>e</b>	Total revenue per line 12, Form 990 (line <b>c</b> plus line <b>d</b> ) . . . . . ▶	<b>e</b>	

**Part IV-B** Reconciliation of Expenses per Audited Financial Statements with Expenses per Return

<b>a</b>	Total expenses and losses per audited financial statements . . . ▶	<b>a</b>	
<b>b</b>	Amounts included on line <b>a</b> but not on line 17, Form 990:	<b>b</b>	
(1)	Donated services and use of facilities \$		
(2)	Prior year adjustments reported on line 20, Form 990 . . . . . \$		
(3)	Losses reported on line 20, Form 990 . . . \$		
(4)	Other (specify): ..... \$		
	Add amounts on lines (1) through (4) ▶	<b>b</b>	
<b>c</b>	Line <b>a</b> minus line <b>b</b> . . . . . ▶	<b>c</b>	
<b>d</b>	Amounts included on line 17, Form 990 but not on line <b>a</b> :	<b>d</b>	
(1)	Investment expenses not included on line 6b, Form 990 . . . \$		
(2)	Other (specify): ..... \$		
	Add amounts on lines (1) and (2) ▶	<b>d</b>	
<b>e</b>	Total expenses per line 17, Form 990 (line <b>c</b> plus line <b>d</b> ) . . . . . ▶	<b>e</b>	

**Part V** List of Officers, Directors, Trustees, and Key Employees (List each one even if not compensated; see Specific Instructions on page 25.)

(A) Name and address	(B) Title and average hours per week devoted to position	(C) Compensation (If not paid, enter -0-.)	(D) Contributions to employee benefit plans & deferred compensation	(E) Expense account and other allowances

**75** Did any officer, director, trustee, or key employee receive aggregate compensation of more than \$100,000 from your organization and all related organizations, of which more than \$10,000 was provided by the related organizations? ▶ ☐ Yes ☐ No  
If "Yes," attach schedule—see Specific Instructions on page 26.

**Part VI Other Information** (See Specific Instructions on page 26.)

	N/A	Yes	No
<b>76</b> Did the organization engage in any activity not previously reported to the IRS? If "Yes," attach a detailed description of each activity . . .	<b>76</b>		
<b>77</b> Were any changes made in the organizing or governing documents but not reported to the IRS? . . . If "Yes," attach a conformed copy of the changes.	<b>77</b>		
<b>78a</b> Did the organization have unrelated business gross income of \$1,000 or more during the year covered by this return? .	<b>78a</b>		
<b>b</b> If "Yes," has it filed a tax return on <b>Form 990-T</b> for this year? . . . . .	<b>78b</b>		
<b>79</b> Was there a liquidation, dissolution, termination, or substantial contraction during the year? If "Yes," attach a statement . . .	<b>79</b>		
<b>80a</b> Is the organization related (other than by association with a statewide or nationwide organization) through common membership, governing bodies, trustees, officers, etc., to any other exempt or nonexempt organization? . . .	<b>80a</b>		
<b>b</b> If "Yes," enter the name of the organization ► . . . . . and check whether it is <input type="checkbox"/> exempt <b>OR</b> <input type="checkbox"/> nonexempt.			
<b>81a</b> Enter the amount of political expenditures, direct or indirect, as described in the instructions for line 81 . . . . . <b>81a</b>	<b>81a</b>		
<b>b</b> Did the organization file <b>Form 1120-POL</b> for this year? . . . . .	<b>81b</b>		
<b>82a</b> Did the organization receive donated services or the use of materials, equipment, or facilities at no charge or at substantially less than fair rental value? . . . . .	<b>82a</b>		
<b>b</b> If "Yes," you may indicate the value of these items here. Do not include this amount as revenue in Part I or as an expense in Part II. (See instructions for reporting in Part III.) . . . . . <b>82b</b>	<b>82b</b>		
<b>83a</b> Did the organization comply with the public inspection requirements for returns and exemption applications?	<b>83a</b>		
<b>b</b> Did the organization comply with the disclosure requirements relating to quid pro quo contributions? . .	<b>83b</b>		
<b>84a</b> Did the organization solicit any contributions or gifts that were not tax deductible? . . . . .	<b>84a</b>		
<b>b</b> If "Yes," did the organization include with every solicitation an express statement that such contributions or gifts were not tax deductible? . . . . .	<b>84b</b>		
<b>85 501(c)(4), (5), or (6) organizations. a</b> Were substantially all dues nondeductible by members? . . . . .	<b>85a</b>		
<b>b</b> Did the organization make only in-house lobbying expenditures of \$2,000 or less? . . . . . If "Yes" was answered to either 85a or 85b, <b>do not</b> complete 85c through 85h below unless the organization received a waiver for proxy tax owed for the prior year.	<b>85b</b>		
<b>c</b> Dues, assessments, and similar amounts from members . . . . . <b>85c</b>	<b>85c</b>		
<b>d</b> Section 162(e) lobbying and political expenditures . . . . . <b>85d</b>	<b>85d</b>		
<b>e</b> Aggregate nondeductible amount of section 6033(e)(1)(A) dues notices . . . . . <b>85e</b>	<b>85e</b>		
<b>f</b> Taxable amount of lobbying and political expenditures (line 85d less 85e) . . . . . <b>85f</b>	<b>85f</b>		
<b>g</b> Does the organization elect to pay the section 6033(e) tax on the amount in 85f? . . . . .	<b>85g</b>		
<b>h</b> If section 6033(e)(1)(A) dues notices were sent, does the organization agree to add the amount in 85f to its reasonable estimate of dues allocable to nondeductible lobbying and political expenditures for the following tax year? . .	<b>85h</b>		
<b>86 501(c)(7) orgs.</b> Enter: <b>a</b> Initiation fees and capital contributions included on line 12 . . . . . <b>86a</b>	<b>86a</b>		
<b>b</b> Gross receipts, included on line 12, for public use of club facilities . . . . . <b>86b</b>	<b>86b</b>		
<b>87 501(c)(12) orgs.</b> Enter: <b>a</b> Gross income from members or shareholders . . . . . <b>87a</b>	<b>87a</b>		
<b>b</b> Gross income from other sources. (Do not net amounts due or paid to other sources against amounts due or received from them.) . . . . . <b>87b</b>	<b>87b</b>		
<b>88</b> At any time during the year, did the organization own a 50% or greater interest in a taxable corporation or partnership, or an entity disregarded as separate from the organization under Regulations sections 301.7701-2 and 301.7701-3? If "Yes," complete Part IX . . . . .	<b>88</b>		
<b>89a 501(c)(3) organizations.</b> Enter: Amount of tax imposed on the organization during the year under: section 4911 ► ; section 4912 ► ; section 4955 ►			
<b>b 501(c)(3) and 501(c)(4) orgs.</b> Did the organization engage in any section 4958 excess benefit transaction during the year or did it become aware of an excess benefit transaction from a prior year? If "Yes," attach a statement explaining each transaction. . . . .	<b>89b</b>		
<b>c</b> Enter: Amount of tax imposed on the organization managers or disqualified persons during the year under sections 4912, 4955, and 4958. . . . . ►			
<b>d</b> Enter: Amount of tax on line 89c, above, reimbursed by the organization. . . . . ►			
<b>90a</b> List the states with which a copy of this return is filed ►			
<b>b</b> Number of employees employed in the pay period that includes March 12, 2000 (See inst.) . . . . . <b>90b</b>	<b>90b</b>		
<b>91</b> The books are in care of ► Telephone no. ► ( ) Located at ► ZIP code ►			
<b>92</b> Section 4947(a)(1) nonexempt charitable trusts filing Form 990 in lieu of <b>Form 1041</b> —Check here . . . . . ► <input type="checkbox"/> and enter the amount of tax-exempt interest received or accrued during the tax year . . . . . <b>92</b>	<b>92</b>		

**Part VII Analysis of Income-Producing Activities** (See Specific Instructions on page 30.)

Enter gross amounts unless otherwise indicated.		Unrelated business income		Excluded by section 512, 513, or 514		(E) Related or exempt function income
		(A) Business code	(B) Amount	(C) Exclusion code	(D) Amount	
<b>93</b>	Program service revenue:					
<b>a</b>						
<b>b</b>						
<b>c</b>						
<b>d</b>						
<b>e</b>						
<b>f</b>	Medicare/Medicaid payments . . . . .					
<b>g</b>	Fees and contracts from government agencies					
<b>94</b>	Membership dues and assessments . . . . .					
<b>95</b>	Interest on savings and temporary cash investments					
<b>96</b>	Dividends and interest from securities . . . . .					
<b>97</b>	Net rental income or (loss) from real estate:					
<b>a</b>	debt-financed property . . . . .					
<b>b</b>	not debt-financed property . . . . .					
<b>98</b>	Net rental income or (loss) from personal property					
<b>99</b>	Other investment income . . . . .					
<b>100</b>	Gain or (loss) from sales of assets other than inventory					
<b>101</b>	Net income or (loss) from special events . . . . .					
<b>102</b>	Gross profit or (loss) from sales of inventory . . . . .					
<b>103</b>	Other revenue: <b>a</b> _____					
<b>b</b>	_____					
<b>c</b>	_____					
<b>d</b>	_____					
<b>e</b>	_____					
<b>104</b>	Subtotal (add columns (B), (D), and (E)) . . . . .					
<b>105</b>	<b>Total</b> (add line 104, columns (B), (D), and (E)). . . . .					

**Note:** Line 105 plus line 1d, Part I, should equal the amount on line 12, Part I.

**Part VIII Relationship of Activities to the Accomplishment of Exempt Purposes** (See Specific Instructions on page 31.)

Line No. ▼	Explain how each activity for which income is reported in column (E) of Part VII contributed importantly to the accomplishment of the organization's exempt purposes (other than by providing funds for such purposes).

**Part IX Information Regarding Taxable Subsidiaries and Disregarded Entities** (See Specific Instructions on page 31.)

(A) Name, address, and EIN of corporation, partnership, or disregarded entity	(B) Percentage of ownership interest	(C) Nature of activities	(D) Total income	(E) End-of-year assets
	%			
	%			
	%			
	%			

**Part X Information Regarding Transfers Associated with Personal Benefit Contracts** (See Specific Instructions on page 31.)

- (a) Did the organization, during the year, receive any funds, directly or indirectly, to pay premiums on a personal benefit contract? ☐ Yes ☐ No
- (b) Did the organization, during the year, pay premiums, directly or indirectly, on a personal benefit contract? ☐ Yes ☐ No

**Note:** If "Yes" to (b), file Form 8870 and Form 4720 (see instructions).

**Please  
Sign  
Here**

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than officer) is based on all information of which preparer has any knowledge. (**Important:** See General Instruction W, on page 14.)

Signature of officer \_\_\_\_\_ Date \_\_\_\_\_ Type or print name and title. \_\_\_\_\_

**Paid  
Preparer's  
Use Only**

Preparer's signature \_\_\_\_\_ Date \_\_\_\_\_ Check if self-employed ☐ Preparer's SSN or PTIN \_\_\_\_\_  
Firm's name (or yours if self-employed) and address, and ZIP code \_\_\_\_\_ EIN \_\_\_\_\_ Phone no. ( ) \_\_\_\_\_



**SCHEDULE A**  
**(Form 990 or 990-EZ)**

Department of the Treasury  
Internal Revenue Service

**Organization Exempt Under Section 501(c)(3)**

(Except Private Foundation) and Section 501(e), 501(f), 501(k),  
501(n), or Section 4947(a)(1) Nonexempt Charitable Trust

**Supplementary Information—(See separate instructions.)**

▶ **MUST be completed by the above organizations and attached to their Form 990 or 990-EZ**

OMB No. 1545-0047

**2000**

Name of the organization

Employer identification number

**Part I Compensation of the Five Highest Paid Employees Other Than Officers, Directors, and Trustees**  
(See page 1 of the instructions. List each one. If there are none, enter "None.")

(a) Name and address of each employee paid more than \$50,000	(b) Title and average hours per week devoted to position	(c) Compensation	(d) Contributions to employee benefit plans & deferred compensation	(e) Expense account and other allowances
Total number of other employees paid over \$50,000 . . . . . ▶				

**Part II Compensation of the Five Highest Paid Independent Contractors for Professional Services**  
(See page 1 of the instructions. List each one (whether individuals or firms). If there are none, enter "None.")

(a) Name and address of each independent contractor paid more than \$50,000	(b) Type of service	(c) Compensation
Total number of others receiving over \$50,000 for professional services . . . . . ▶		

**Part III** Statements About Activities

	Yes	No
<b>1</b> During the year, has the organization attempted to influence national, state, or local legislation, including any attempt to influence public opinion on a legislative matter or referendum? . . . . . If "Yes," enter the total expenses paid or incurred in connection with the lobbying activities ► \$ _____ Organizations that made an election under section 501(h) by filing Form 5768 must complete Part VI-A. Other organizations checking "Yes," must complete Part VI-B AND attach a statement giving a detailed description of the lobbying activities.	<b>1</b>	
<b>2</b> During the year, has the organization, either directly or indirectly, engaged in any of the following acts with any of its trustees, directors, officers, creators, key employees, or members of their families, or with any taxable organization with which any such person is affiliated as an officer, director, trustee, majority owner, or principal beneficiary:		
<b>a</b> Sale, exchange, or leasing of property? . . . . .	<b>2a</b>	
<b>b</b> Lending of money or other extension of credit? . . . . .	<b>2b</b>	
<b>c</b> Furnishing of goods, services, or facilities? . . . . .	<b>2c</b>	
<b>d</b> Payment of compensation (or payment or reimbursement of expenses if more than \$1,000)? . . . . .	<b>2d</b>	
<b>e</b> Transfer of any part of its income or assets? . . . . . If the answer to any question is "Yes," attach a detailed statement explaining the transactions.	<b>2e</b>	
<b>3</b> Does the organization make grants for scholarships, fellowships, student loans, etc.? . . . .	<b>3</b>	
<b>4a</b> Do you have a section 403(b) annuity plan for your employees? . . . . .	<b>4a</b>	
<b>b</b> Attach a statement to explain how the organization determines that individuals or organizations receiving grants or loans from it in furtherance of its charitable programs qualify to receive payments. (See page 2 of the instructions.)		

**Part IV** Reason for Non-Private Foundation Status (See pages 2 through 5 of the instructions.)

The organization is not a private foundation because it is: (Please check only **ONE** applicable box.)

- 5** ☐ A church, convention of churches, or association of churches. Section 170(b)(1)(A)(i).
- 6** ☐ A school. Section 170(b)(1)(A)(ii). (Also complete Part V, page 5.)
- 7** ☐ A hospital or a cooperative hospital service organization. Section 170(b)(1)(A)(iii).
- 8** ☐ A Federal, state, or local government or governmental unit. Section 170(b)(1)(A)(v).
- 9** ☐ A medical research organization operated in conjunction with a hospital. Section 170(b)(1)(A)(iii). **Enter the hospital's name, city, and state ►** \_\_\_\_\_
- 10** ☐ An organization operated for the benefit of a college or university owned or operated by a governmental unit. Section 170(b)(1)(A)(iv). (Also complete the **Support Schedule** in Part IV-A.)
- 11a** ☐ An organization that normally receives a substantial part of its support from a governmental unit or from the general public. Section 170(b)(1)(A)(vi). (Also complete the **Support Schedule** in Part IV-A.)
- 11b** ☐ A community trust. Section 170(b)(1)(A)(vi). (Also complete the **Support Schedule** in Part IV-A.)
- 12** ☐ An organization that normally receives: **(1) more than 33⅓%** of its support from contributions, membership fees, and gross receipts from activities related to its charitable, etc., functions—subject to certain exceptions, and **(2) no more than 33⅓%** of its support from gross investment income and unrelated business taxable income (less section 511 tax) from businesses acquired by the organization after June 30, 1975. See section 509(a)(2). (Also complete the **Support Schedule** in Part IV-A.)
- 13** ☐ An organization that is not controlled by any disqualified persons (other than foundation managers) and supports organizations described in: **(1)** lines 5 through 12 above; or **(2)** section 501(c)(4), (5), or (6), if they meet the test of section 509(a)(2). (See section 509(a)(3).)

Provide the following information about the supported organizations. (See page 5 of the instructions.)

(a) Name(s) of supported organization(s)	(b) Line number from above

- 14** ☐ An organization organized and operated to test for public safety. Section 509(a)(4). (See page 5 of the instructions.)

**Part IV-A Support Schedule** (Complete only if you checked a box on line 10, 11, or 12.) **Use cash method of accounting.****Note:** You may use the worksheet in the instructions for converting from the accrual to the cash method of accounting.

Calendar year (or fiscal year beginning in) . ▶	(a) 1999	(b) 1998	(c) 1997	(d) 1996	(e) Total
<b>15</b> Gifts, grants, and contributions received. (Do not include unusual grants. See line 28.) . . . . .					
<b>16</b> Membership fees received . . . . .					
<b>17</b> Gross receipts from admissions, merchandise sold or services performed, or furnishing of facilities in any activity that is not a business unrelated to the organization's charitable, etc., purpose . . . . .					
<b>18</b> Gross income from interest, dividends, amounts received from payments on securities loans (section 512(a)(5)), rents, royalties, and unrelated business taxable income (less section 511 taxes) from businesses acquired by the organization after June 30, 1975 . . . . .					
<b>19</b> Net income from unrelated business activities not included in line 18 . . . . .					
<b>20</b> Tax revenues levied for the organization's benefit and either paid to it or expended on its behalf. . . . .					
<b>21</b> The value of services or facilities furnished to the organization by a governmental unit without charge. Do not include the value of services or facilities generally furnished to the public without charge. . . . .					
<b>22</b> Other income. Attach a schedule. Do not include gain or (loss) from sale of capital assets . . . . .					
<b>23</b> Total of lines 15 through 22. . . . .					
<b>24</b> Line 23 minus line 17. . . . .					
<b>25</b> Enter 1% of line 23 . . . . .					
<b>26 Organizations described on lines 10 or 11:</b> <b>a</b> Enter 2% of amount in column (e), line 24. . . . . ▶					<b>26a</b>
<b>b</b> Attach a list (which is not open to public inspection) showing the name of and amount contributed by each person (other than a governmental unit or publicly supported organization) whose total gifts for 1996 through 1999 exceeded the amount shown in line 26a. Enter the sum of all these excess amounts. . . . . ▶					<b>26b</b>
<b>c</b> Total support for section 509(a)(1) test: Enter line 24, column (e) . . . . . ▶					<b>26c</b>
<b>d</b> Add: Amounts from column (e) for lines: 18 _____ 19 _____ 22 _____ 26b _____ . . . . . ▶					<b>26d</b>
<b>e</b> Public support (line 26c minus line 26d total) . . . . . ▶					<b>26e</b>
<b>f</b> <b>Public support percentage (line 26e (numerator) divided by line 26c (denominator))</b> . . . . . ▶					<b>26f</b> %
<b>27 Organizations described on line 12:</b> <b>a</b> For amounts included in lines 15, 16, and 17 that were received from a "disqualified person," attach a list (which is not open to public inspection) to show the name of, and total amounts received in each year from, each "disqualified person." Enter the sum of such amounts for each year:  (1999) _____ (1998) _____ (1997) _____ (1996) _____					
<b>b</b> For any amount included in line 17 that was received from a nondisqualified person, attach a list to show the name of, and amount received for each year, that was more than the <b>larger</b> of (1) the amount on line 25 for the year or (2) \$5,000. (Include in the list organizations described in lines 5 through 11, as well as individuals.) After computing the difference between the amount received and the larger amount described in (1) or (2), enter the sum of these differences (the excess amounts) for each year:  (1999) _____ (1998) _____ (1997) _____ (1996) _____					
<b>c</b> Add: Amounts from column (e) for lines: 15 _____ 16 _____ 17 _____ 20 _____ 21 _____ . . . . . ▶					<b>27c</b>
<b>d</b> Add: Line 27a total _____ and line 27b total _____ . . . . . ▶					<b>27d</b>
<b>e</b> Public support (line 27c total minus line 27d total). . . . . ▶					<b>27e</b>
<b>f</b> Total support for section 509(a)(2) test: Enter amount on line 23, column (e) . . . . . ▶					<b>27f</b>
<b>g</b> <b>Public support percentage (line 27e (numerator) divided by line 27f (denominator))</b> . . . . . ▶					<b>27g</b> %
<b>h</b> <b>Investment income percentage (line 18, column (e) (numerator) divided by line 27f (denominator))</b> . . . . . ▶					<b>27h</b> %
<b>28 Unusual Grants:</b> For an organization described in line 10, 11, or 12 that received any unusual grants during 1996 through 1999, attach a list (which is not open to public inspection) for each year showing the name of the contributor, the date and amount of the grant, and a brief description of the nature of the grant. Do not include these grants in line 15. (See page 5 of the instructions.)					

**Part V Private School Questionnaire** (See page 5 of the instructions.)  
**(To be completed ONLY by schools that checked the box on line 6 in Part IV)**

	Yes	No
<b>29</b> Does the organization have a racially nondiscriminatory policy toward students by statement in its charter, bylaws, other governing instrument, or in a resolution of its governing body? . . . . .	<b>29</b>	
<b>30</b> Does the organization include a statement of its racially nondiscriminatory policy toward students in all its brochures, catalogues, and other written communications with the public dealing with student admissions, programs, and scholarships? . . . . .	<b>30</b>	
<b>31</b> Has the organization publicized its racially nondiscriminatory policy through newspaper or broadcast media during the period of solicitation for students, or during the registration period if it has no solicitation program, in a way that makes the policy known to all parts of the general community it serves? . . . . . If "Yes," please describe; if "No," please explain. (If you need more space, attach a separate statement.)	<b>31</b>	
. . . . .		
. . . . .		
<b>32</b> Does the organization maintain the following:		
<b>a</b> Records indicating the racial composition of the student body, faculty, and administrative staff? . . . . .	<b>32a</b>	
<b>b</b> Records documenting that scholarships and other financial assistance are awarded on a racially nondiscriminatory basis? . . . . .	<b>32b</b>	
<b>c</b> Copies of all catalogues, brochures, announcements, and other written communications to the public dealing with student admissions, programs, and scholarships? . . . . .	<b>32c</b>	
<b>d</b> Copies of all material used by the organization or on its behalf to solicit contributions? . . . . .	<b>32d</b>	
If you answered "No" to any of the above, please explain. (If you need more space, attach a separate statement.)		
. . . . .		
<b>33</b> Does the organization discriminate by race in any way with respect to:		
<b>a</b> Students' rights or privileges? . . . . .	<b>33a</b>	
<b>b</b> Admissions policies? . . . . .	<b>33b</b>	
<b>c</b> Employment of faculty or administrative staff? . . . . .	<b>33c</b>	
<b>d</b> Scholarships or other financial assistance? . . . . .	<b>33d</b>	
<b>e</b> Educational policies? . . . . .	<b>33e</b>	
<b>f</b> Use of facilities? . . . . .	<b>33f</b>	
<b>g</b> Athletic programs? . . . . .	<b>33g</b>	
<b>h</b> Other extracurricular activities? . . . . .	<b>33h</b>	
If you answered "Yes" to any of the above, please explain. (If you need more space, attach a separate statement.)		
. . . . .		
. . . . .		
<b>34a</b> Does the organization receive any financial aid or assistance from a governmental agency? . . . . .	<b>34a</b>	
<b>b</b> Has the organization's right to such aid ever been revoked or suspended? . . . . .	<b>34b</b>	
If you answered "Yes" to either 34a or b, please explain using an attached statement.		
. . . . .		
<b>35</b> Does the organization certify that it has complied with the applicable requirements of sections 4.01 through 4.05 of Rev. Proc. 75-50, 1975-2 C.B. 587, covering racial nondiscrimination? If "No," attach an explanation . . . . .	<b>35</b>	

**Part VI-A Lobbying Expenditures by Electing Public Charities** (See page 7 of the instructions.)  
 (To be completed **ONLY** by an eligible organization that filed Form 5768)
Check here **a** ☐ if the organization belongs to an affiliated group.Check here **b** ☐ if you checked "a" above and "limited control" provisions apply.
**Limits on Lobbying Expenditures**

(The term "expenditures" means amounts paid or incurred.)

		(a) Affiliated group totals	(b) To be completed for ALL electing organizations
<b>36</b>	Total lobbying expenditures to influence public opinion (grassroots lobbying) . . . . .	<b>36</b>	
<b>37</b>	Total lobbying expenditures to influence a legislative body (direct lobbying) . . . . .	<b>37</b>	
<b>38</b>	Total lobbying expenditures (add lines 36 and 37) . . . . .	<b>38</b>	
<b>39</b>	Other exempt purpose expenditures . . . . .	<b>39</b>	
<b>40</b>	Total exempt purpose expenditures (add lines 38 and 39). . . . .	<b>40</b>	
<b>41</b>	Lobbying nontaxable amount. Enter the amount from the following table— <b>If the amount on line 40 is—</b> <b>The lobbying nontaxable amount is—</b> Not over \$500,000 . . . . . 20% of the amount on line 40. . . . . Over \$500,000 but not over \$1,000,000 . . \$100,000 plus 15% of the excess over \$500,000 Over \$1,000,000 but not over \$1,500,000 . \$175,000 plus 10% of the excess over \$1,000,000 Over \$1,500,000 but not over \$17,000,000 . \$225,000 plus 5% of the excess over \$1,500,000 Over \$17,000,000 . . . . . \$1,000,000 . . . . . 	<b>41</b>	
<b>42</b>	Grassroots nontaxable amount (enter 25% of line 41) . . . . .	<b>42</b>	
<b>43</b>	Subtract line 42 from line 36. Enter -0- if line 42 is more than line 36 . . . . .	<b>43</b>	
<b>44</b>	Subtract line 41 from line 38. Enter -0- if line 41 is more than line 38 . . . . .	<b>44</b>	

**Caution:** If there is an amount on either line 43 or line 44, you must file Form 4720.
**4-Year Averaging Period Under Section 501(h)**
(Some organizations that made a section 501(h) election do not have to complete all of the five columns below.  
See the instructions for lines 45 through 50 on page 9 of the instructions.)

Calendar year (or fiscal year beginning in) ►	Lobbying Expenditures During 4-Year Averaging Period				
	(a) 2000	(b) 1999	(c) 1998	(d) 1997	(e) Total
<b>45</b> Lobbying nontaxable amount. . . . .					
<b>46</b> Lobbying ceiling amount (150% of line 45(e)).					
<b>47</b> Total lobbying expenditures . . . . .					
<b>48</b> Grassroots nontaxable amount . . . . .					
<b>49</b> Grassroots ceiling amount (150% of line 48(e)).					
<b>50</b> Grassroots lobbying expenditures . . . . .					

**Part VI-B Lobbying Activity by Nonelecting Public Charities**

(For reporting only by organizations that did not complete Part VI-A) (See page 9 of the instructions.)

During the year, did the organization attempt to influence national, state or local legislation, including any attempt to influence public opinion on a legislative matter or referendum, through the use of:

	Yes	No	Amount
<b>a</b> Volunteers. . . . .			
<b>b</b> Paid staff or management (Include compensation in expenses reported on lines <b>c</b> through <b>h</b> ). . . . .			
<b>c</b> Media advertisements . . . . .			
<b>d</b> Mailings to members, legislators, or the public . . . . .			
<b>e</b> Publications, or published or broadcast statements . . . . .			
<b>f</b> Grants to other organizations for lobbying purposes . . . . .			
<b>g</b> Direct contact with legislators, their staffs, government officials, or a legislative body . . . . .			
<b>h</b> Rallies, demonstrations, seminars, conventions, speeches, lectures, or any other means . . . . .			
<b>i</b> Total lobbying expenditures (add lines <b>c</b> through <b>h</b> ). . . . .			

If "Yes" to any of the above, also attach a statement giving a detailed description of the lobbying activities.

**Part VII** Information Regarding Transfers To and Transactions and Relationships With Noncharitable Exempt Organizations (See page 9 of the instructions.)

**51** Did the reporting organization directly or indirectly engage in any of the following with any other organization described in section 501(c) of the Code (other than section 501(c)(3) organizations) or in section 527, relating to political organizations?

**a** Transfers from the reporting organization to a noncharitable exempt organization of:

Yes	No
-----	----

(i) Cash . . . . .

51a(i)		
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(ii) Other assets . . . . .

a(i)		
a(ii)		

**b** Other transactions:

(i) Sales or exchanges of assets with a noncharitable exempt organization . . . . .

$\alpha(n)$		

(ii) Purchases of assets from a noncharitable exempt organization . . . . .

b(i)		
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(iii) Rental of facilities, equipment, or other assets

b(i)		
b(ii)		

(iv) Reimbursement arrangements

b(ii)		
b(iii)		

(v) Loans or loan guarantees

b(iii)		
b(iv)		

(vi) Performance of services or membership or fundraising solicitations

b(v)		
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Sharing of facilities, equipment, mailing lists, other assets, or paid employees

$b(v)$		
$b(vi)$		

<b>c</b>	Sharing of facilities, equipment, mailing lists, other assets, or paid employees . . . . .	<b>c</b>	
<b>d</b>	If the answer to any of the above is "Yes," complete the following schedule. Column (b) should always show the fair market value of the goods, other assets, or services given by the reporting organization. If the organization received less than fair market value in any transaction or sharing arrangement, show in column (d) the value of the goods, other assets, or services received:		

B(VI)		
C		

c		
---	--	--

market value of the

[illegible]

**52a** Is the organization directly or indirectly affiliated with, or related to, one or more tax-exempt organizations described in section 501(c) of the Code (other than section 501(c)(3)) or in section 527? ☐ Yes ☐ No

**b** If "Yes," complete the following schedule:

[illegible]

## Appendix 2: Summary of Nonprofit Accountability Standards

<u>Suggested Key Indicators for Entire Nonprofit Sector</u>			
<u>Sources:</u>	<u>American Inst. of Philanthropy</u>	<u>Better Business Bureau</u>	<u>National Charities Info. Bureau</u>
<u>Areas Addressed</u>			<u>Charities Review Council of Minnesota</u>
<b>Board</b> - size - meetings		3 x per year	Minimum-5 voting members 2 in-person meetings/year  At least 3 x per year
<b>Mission</b>		Clear description	Formally stated  Stated & accomplishments
<b>Programs</b>			Consistent with mission
<b>Use of Funds</b> - Program - Fundraising - Administrative - Net Assets	At least 60% of annual expenses Fundraising & Administrative combined = 40% or less. Less than three years is "reasonable"	At least 50% Fundraising & admin. =50% or less.	At least 70% Fundraising & administration = 30% or less combined Not more than 2 x current or next year operating expenses
<b>Fund-raising Efficiency</b>	Expenses = 35% or less of revenue raised.	Expenses = 35% or less of revenue raised.	
<b>Information</b> - Annual Report - Audit		Yes Yes	Yes Yes & same terms
<b>Accounting</b>		GAAP; functional allocation; "full disclosure of economic resources & obligations"; same applies for consolidated financials"; detailed annual budget.	
<b>Other</b>			No violation of state/federal laws

## Appendix 2: Summary of Nonprofit Accountability Standards (continued)

<b>Sources:</b>		<u>Suggested Key Indicators for Entire Nonprofit Sector</u>	<u>Maryland Assoc. of Nonprofits</u>
<b>Areas Addressed</b>			
<b>Board</b>	- size		At least 5
	- meetings		At least 4 x per year
<b>Mission</b>		Consistency between goals and mission, measured by: (1) asset turnover ratio and (2) <i>liquidity ratio</i>	Formally stated
			Defined, cost-effective procedures for program eval.
<b>Programs</b>			
<b>Use of Funds</b>			
- Program		76% cited from landmark national survey by James Cook ( <i>Forbes</i> , October 28, 1991)	
- Fundraising			
- Administrative			
- Net Assets			"Reasonable over time; 3:1 ratio of fundraising revenue/expenses for 5 yr. & older Nonprofit"
<b>Fundraising Efficiency</b>		18% cited from landmark national survey by James Cook ( <i>Forbes</i> , October 28, 1991)	
<b>Information</b>	- Annual Report		Yes
	- Audit		Audit for NFPs with budgets greater than \$300,000
<b>Accounting</b>			Internal financial statements at least quarterly
			Written conflict of interest pol.
<b>Other</b>			No violation of state/federal laws
		"Intergenerational Equity" - to compare current current period balance sheet with prior year balance sheet. After adjusting for inflation, if equal, then equity achieved.	

## Appendix 3: Sources of Nonprofit Financial Information

### Websites:

Alliance for Nonprofit Management <http://www.allianceonline.org>  
American Association of Museums <http://www.aam-us.org>  
American Hospital Association <http://www.aha.org>  
American Institute of Certified Public Accountants <http://www.aicpa.org>  
Aspen Institute <http://www.aspeninst.org>  
Association for Research on Nonprofit Organizations & Voluntary Action <http://www.arnova.org>  
Association of American Colleges and Universities <http://www.aacu-edu.org>  
Attorney General of the State of Illinois <http://www.ag.state.il.us>  
Attorney General of the State of Minnesota <http://www.ag.state.mn.us>  
Better Business Bureau's Philanthropic Advisory Service <http://www.bbb.org/about/pas.asp>  
California Association of Nonprofits <http://www.canonprofits.org>  
Canadian Centre for Philanthropy <http://www.ccp.ca>  
Center for Nonprofits (New Jersey Association) <http://www.njnonprofits.org>  
Charity Watch <http://www.charitywatch.org>  
Charities Review Council of Minnesota <http://www.crcmn.org>  
Chronicle of Philanthropy <http://www.philanthropy.com>  
Colorado Association of NonProfit Organizations <http://www.canpo.org>  
Delaware Association of Nonprofit Agencies <http://www.delawarenonprofit.org>  
Donors Forum of Chicago <http://www.donorsforum.org>  
Evangelical Council for Financial Accountability <http://www.ecfa.org>  
Financial Accounting Standards Board <http://www.rutgers.edu/Accounting/raw/fash>  
FindIt.Org – The Resource for Nonprofit Information <http://www.findit.org>  
Guidestar <http://www.guidestar.org>  
Harvard University's Hauser Center for Nonprofit Organizations <http://www.ksghauser.harvard.edu>  
Healthcare Financial Management Association <http://www.hfma.org>  
Hearts and Minds <http://www.heartsandminds.org>  
Illinois CPA Society <http://www.icpas.org>  
Independent Sector <http://www.indepsec.org>  
Indiana University Center on Philanthropy <http://www.philanthropy.iupui.edu>  
Interactive Knowledge for Nonprofits Worldwide <http://www.iknow.org>  
Internet Nonprofit Center <http://www.nonprofits.org>  
Literature of the Nonprofit Sector <http://www.fdncenter.org/onlib/lmps/index.html>  
Management Assistance Program for Nonprofits <http://www.mapnp.org>  
Maryland Association of Nonprofit Organizations <http://www.mdnonprofit.org>  
Michigan Nonprofit Association <http://www.mna.msu.edu>  
Minnesota Council of Nonprofits <http://www.mncn.org>  
Moody's Investor Services <http://www.moodys.com>  
National Association of College & University Business Officers <http://www.nacubo.org>  
National Center for Charitable Statistics <http://nccs.urban.org>  
National Charities Information Bureau <http://www.give.org>  
National Endowment for the Arts <http://www.arts.endow.gov>  
National Society of Fundraising Executives <http://www.nsfre.org>  
NewProfit, Inc. (Venture Capital for the Nonprofit Sector) <http://www.newprofit.com>  
Nonprofit Coordinating Committee of New York <http://www.npccny.org>  
Nonprofit "Cyber-Accountability" <http://www.bway.net/~hbograd/cyb-acc.html>  
Nonprofit Resources Catalogue [http://www.clark.net/pub/pwalker/General\\_Nonprofit\\_Resources](http://www.clark.net/pub/pwalker/General_Nonprofit_Resources)  
Online Compendium of Fed/State Regulations for Nonprofits <http://www.muridae.com/nporegulation>  
Peter F. Drucker Foundation for Nonprofit Management <http://www.pfdf.org>  
Standard & Poors <http://www.standardpoor.com>  
Technical Assistance for Community Services (Oregon & Wash. Assoc.) <http://www.tacs.org>  
Texas Association of Nonprofit Organizations <http://www.tano.org>

**Authoritative Sources on Nonprofits:**

**Financial Accounting Standards Board (FASB)**

- o Statement of Financial Accounting Concepts #4: Objectives of Financial Reporting by Nonbusiness Organizations
- o Statement of Financial Accounting Concepts #6: Elements of Financial Statements
- o Statement of Financial Accounting Standards #93: Recognition of Depreciation by Not-for Profit Organizations
- o Statement of Financial Accounting Standards #116: Accounting for Contributions Received and Contributions Made
- o Statement of Financial Accounting Standards #117: Financial Statements of Not-for-Profit Organizations
- o Statement of Financial Accounting Standards #124: Accounting for Certain Investments Held by Not-for-Profit Organizations
- o Statement of Financial Accounting Standards #136: Asset Transfers to Nonprofit Intermediaries

**American Institute of Certified Public Accountants (AICPA)**

- o AICPA Audit and Accounting Guide for Not-for-Profit Organizations
- o AICPA Audit and Accounting Guide for Health Care Organizations
- o Statement of Position 92-9: Audits of Not-for-Profit Organizations Receiving Federal Awards
- o Statement of Position 98-2: Accounting for Costs of Activities of Not-for-Profit Organizations and State and Local Governmental Units that Include Fund Raising
- o Statement of Position 98-3: Audits of States, Local Governments, and Not-for-Profit Organizations Receiving Federal Awards

**Discussion Groups:**

ARNOVA: [ARNOVA-L@WVNVM.WVNET.EDU](mailto:ARNOVA-L@WVNVM.WVNET.EDU)

NCCS: [NCCSdata@ui.urban.org](mailto:NCCSdata@ui.urban.org)

Charity Channel: [LISTSERV@CHARITYCHANNEL.COM](mailto:LISTSERV@CHARITYCHANNEL.COM)

Cyberaccountability: <http://listserv.aol.com/archives/cyb-acc.html>

**Practitioner Journals:**

Chronicle of Philanthropy

Nonprofit Times

Nonprofit World

Not-for-profit CEO Monthly Letter

**Publishers of Nonprofit Books:**

American Hospital Association Press

Aspen Institute

Center on Philanthropy

Harvard University Press

Independent Sector

Jossey-Bass (part of John Wiley)

**Organizations Offering Nonprofit Research Conferences:**

Association on Research on Nonprofit Organizations and Voluntary Action (ARNOVA)

Independent Sector

International Society for Third Sector Research