
Government Funding of Nonprofits

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Nonprofit Financial Health: Two Disparate Worlds

- Financially healthy, organizationally stable
 - Examples: universities and hospitals
 - Multiple funding sources
 - Can charge full cost of services
 - High overhead reimbursement rates

Versus:

- Financially weak, organizationally unstable
 - Examples: human service agencies
 - Heavily reliant on restricted funding
 - Low overhead reimbursement rates
 - Need to raise matching and unrestricted funds

Organizational Capacities

Less Stable



More Stable

1. Culture Norms		
a. Mission vs. money	No overhead; all \$ for programs	LT mission and org sustainability
b. Staffing	Volunteer/charity for labor and staff	Paid program staff and support
c. Financials	Not profitable (not reinvesting)	Finances sustain operations and infrastructure
d. Time Horizon	Responds to immediate program needs	Exists to create LT social value
2. Strategy		
	No or poorly developed strategy or business plan Responds opportunistically to funders and potential partners	Strategy supports healthy norms Strategy augments business plan
3. Capacity		
a. Staffing	High turnover Low pay and few benefits Low experience Little training No career path	High retention Competitive pay and employee benefits Provides meaningful work Provides training and professional growth Plentiful learning opportunities
b. Systems/Infrastructure	Underinvestment Outdated technology ST focus Deferred maintenance	Integrated Capital budgeting LT and Capacity Focus Committed to asset maintenance
4. Operational Efficiency		
	More is better Keep costs low for programs	Structured experiments Scale, when warranted Scope
5. Performance Management		
	Focus on current activities and outputs Compliance oriented Command and control Oriented Crude, simplistic measures	Root-cause analysis Outcome/results oriented Performance driven management Total quality management (TQM) philosophy
6. Accountability		
	Reporting driven by regulation and funders	Active, informed board Reporting to key constituents

Financial Business Model

Less Sustainable



More Sustainable

1. Profitability

a. Revenues

Urgent short-term appeals
Heavy reliance on one-time donors
Uncertain revenue streams
Restricted programmatic funding
Time limited funding
Costly to raise
Undiversified revenue streams

Value or cost based pricing
Solid base of recurrent funders
Extensive unrestricted revenues
Diversified revenue base

b. Expenses

Overhead costs not fully recovered form grants
Program delivery absorbs all excess dollars

Full costing
Rich understanding of cost structure
Investments regularly made

c. Surplus

Breakeven operations
Additional revenues spent immediately on program

Regularly runs a surplus
Fully meet financial obligations
Surplus builds operating and capital reserves

2. Liquidity - Working Capital

Government reimbursement contracts
No cash on hand
Constant or growing reliance of line of credit
Bill payment difficult

Grants and contracts paid in advance
3-6 months of cash on hand
Unused line of credit
Sufficient cash to pay bills throughout year

3. Solvency

Little or no net assets

Operating reserves
Fixed Assets Maintenance & Plant Reserves
Endowments and Quasi-Endowments

4. Quality of Accounting Systems

Trust deemed sufficient
Few segregation of duties or internal controls
Manual or out of date records

Well-designed and functional accounting systems
Segregation of duties and internal controls
Timely and informative internal reports

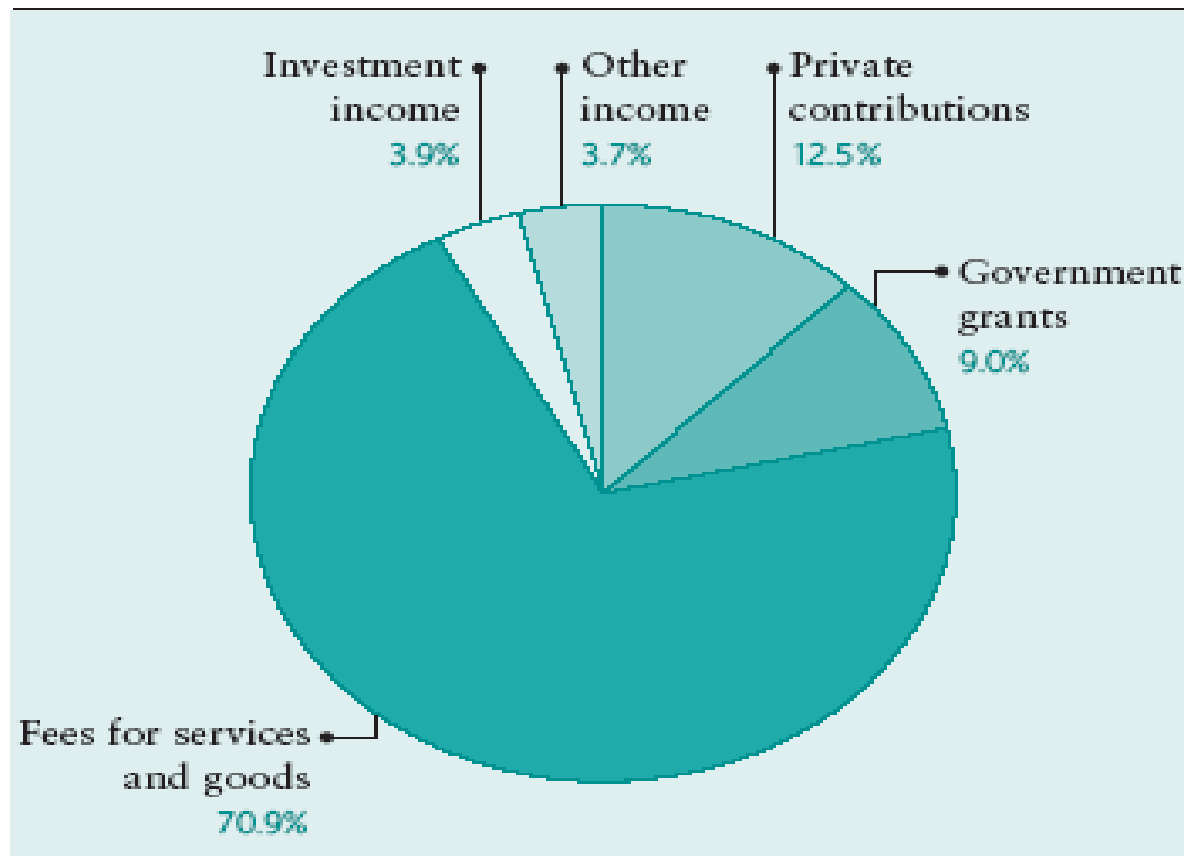
5. Capital Structure

Little or no equity or LT debt

Matched book, i.e.
LT debt and equity match of exceed LT assets

Revenue Sources for Public Charities

Figure 2. Sources of Revenue for Reporting Public Charities, 2004



Source: NCCS National Nonprofit Research Database, Special Research Version (2004).

Government Sources of Support for Nonprofits

- Government Grants (9% of nonprofit revenues – 2004 Form 990 Data) (\$100B)
- Government Contracts
- Government Tax Subsidies
 - Income Tax Exemption
 - Charitable Deductions

Financial Health of MA Nonprofit Providers



- Study conducted for Executive Office of Health and Human Services
- Sample

Over 650 providers that derive at least 5% of their total revenues from purchase of service (POS)

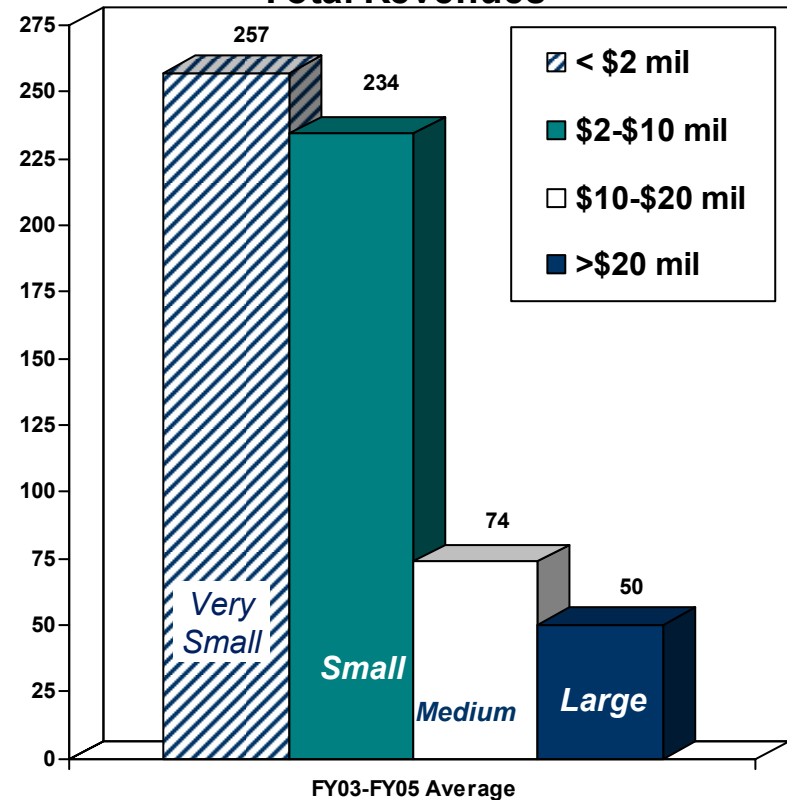
Exclusions:

- Hospitals, universities, and foundations
- Aging services access points (ASAPs)
- Organizations exceeding \$200 mil in revenues.
- Organizations with more than 40% of their revenues from non-program sources

- Data

This analysis drew on Uniform Financial Report (UFR) submissions for 2003-2005.

Human Service Providers by
Total Revenues



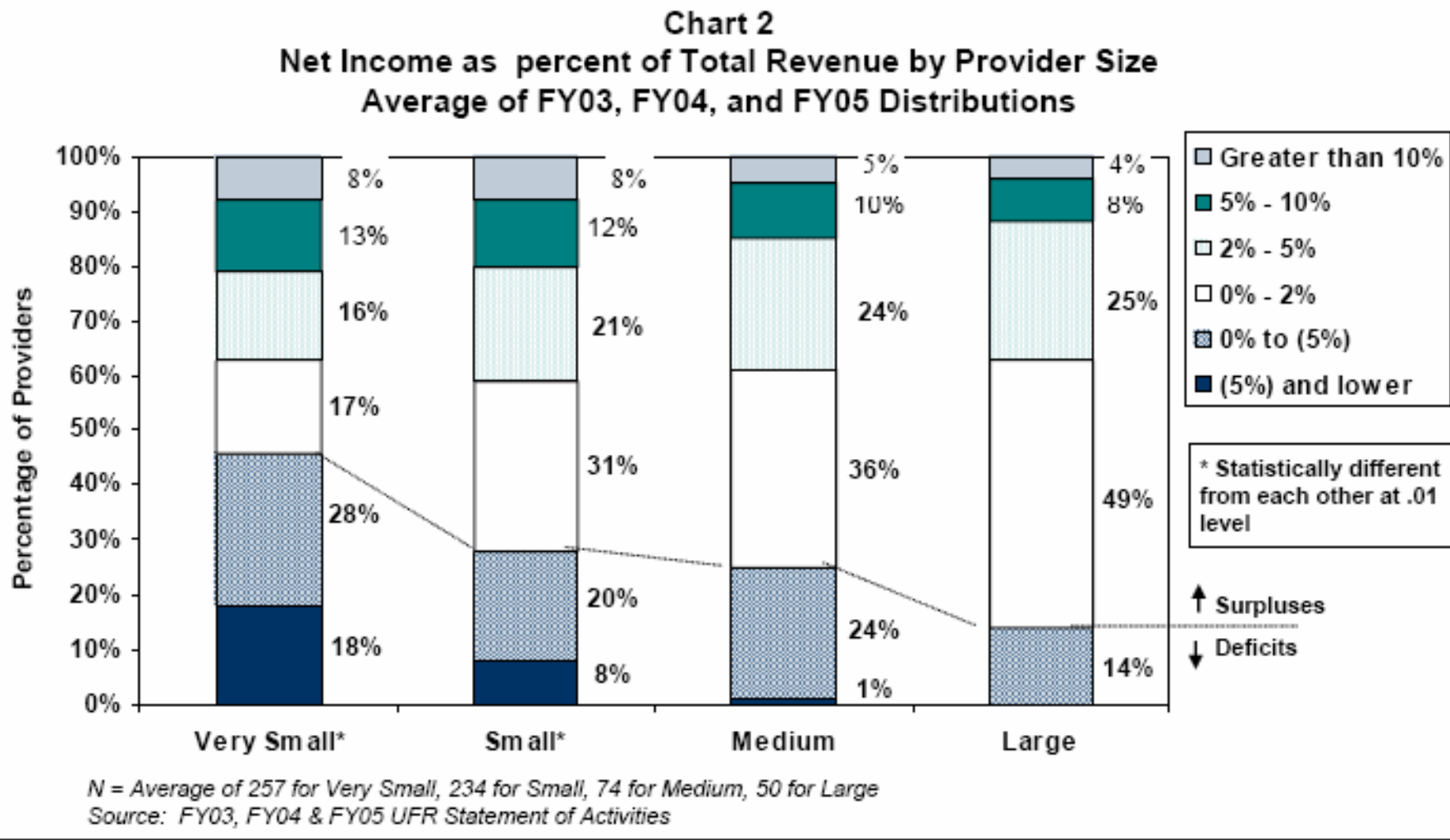
N= 660 in FY03, 654 in FY04 and 655 in FY05

Source: UFR Statement of Activities, FY03, FY04 & FY05

Funding Sources

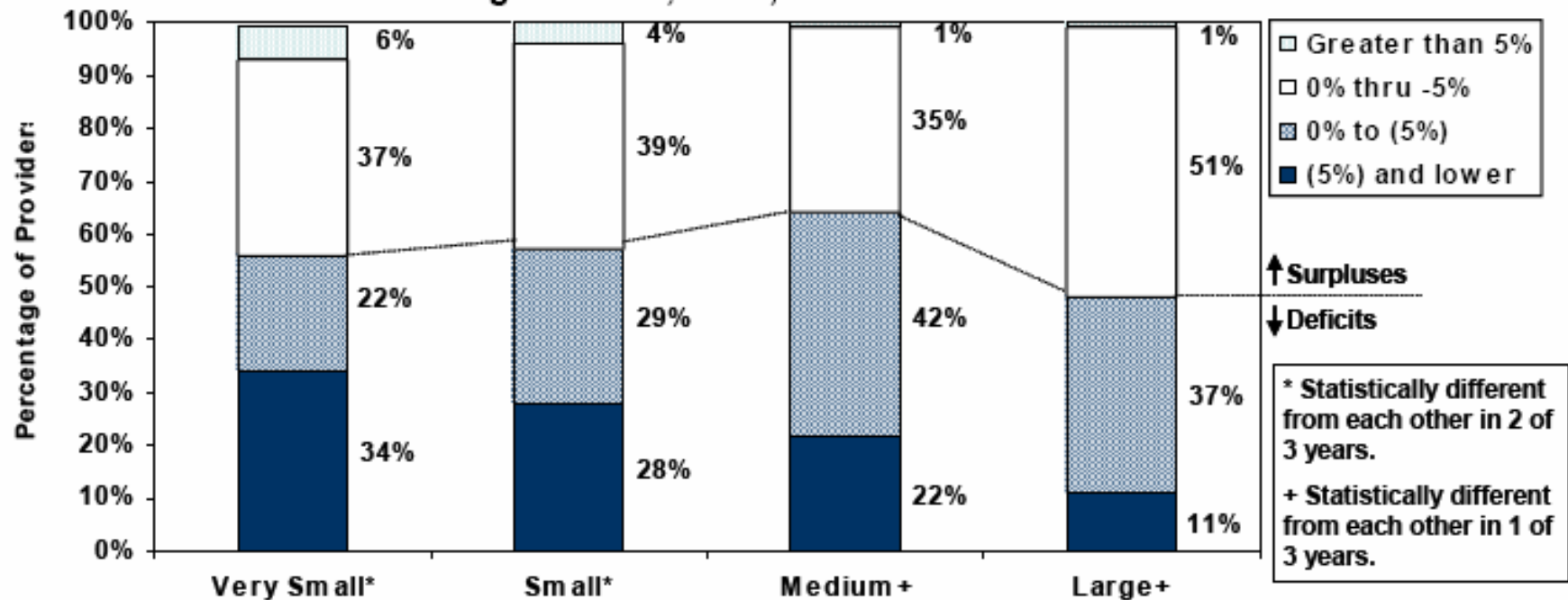
- Overall, 43% of providers have only one EOHHS funding source, 30% have two.
- Providers with 3 sources have higher net incomes than those with 2 or less. Very small and small providers were most likely to have only 1 or 2 funding sources.
- About 60% of providers have a predominant funding source (40% of total revenue).
 - Very small and small providers were most likely to have a predominant funding source
 - Large providers were least likely to have a predominant funder, though 40% did have one.
- Dept. of Mental Retardation and Early Education and Care are more likely to be predominant funders than other state agencies.
- Dept. of Social Services and Dept of Public Health were the next most frequent predominant funding sources.
- There was no statistically significant difference in the profitability for providers for simply having a predominant state agency
- However, those that have DMR as a predominant funder are less likely to have losses.

One-Third of Providers Experience Organization-Wide Deficits Each Year



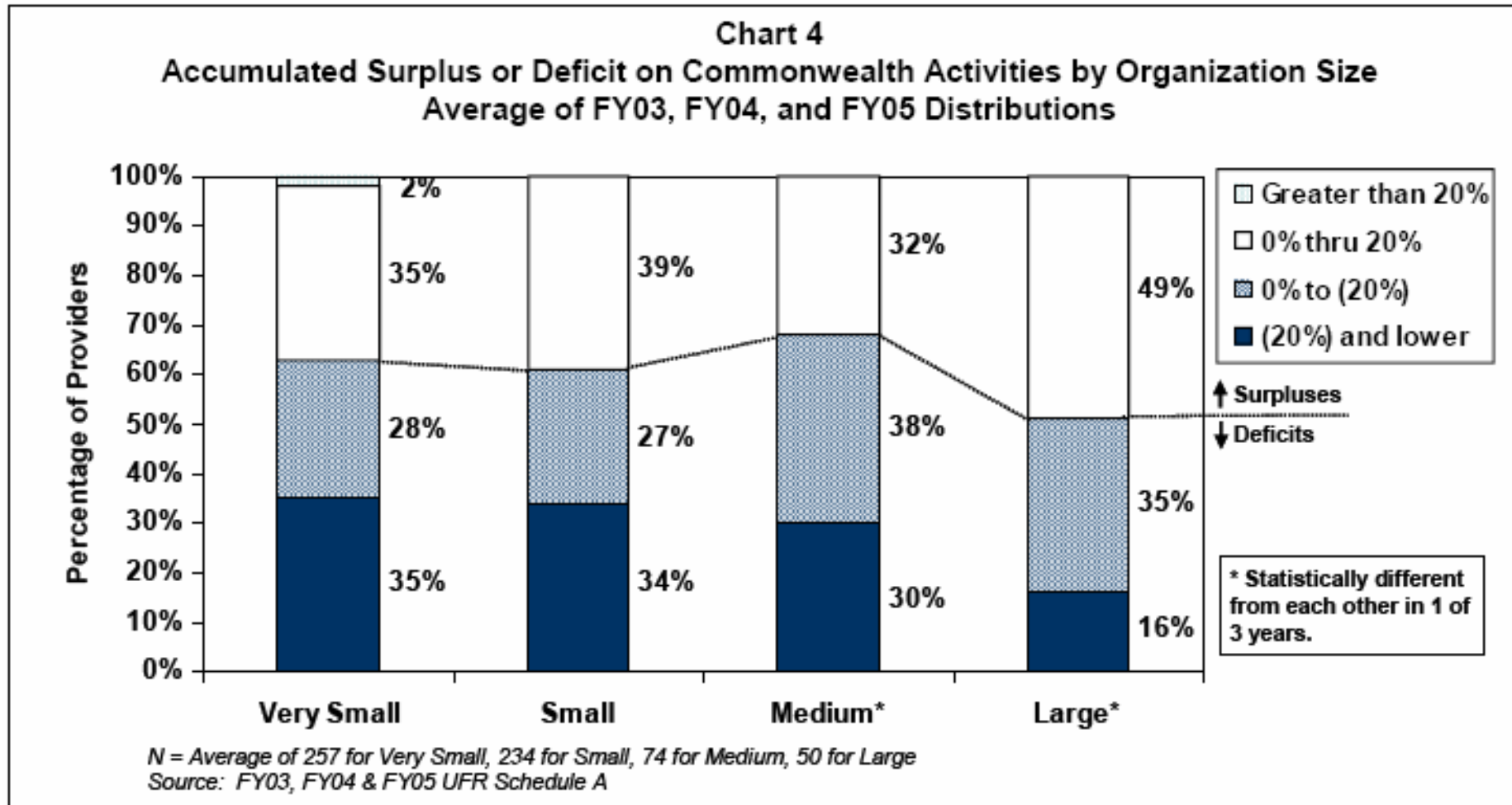
Fifty-six Percent of Providers Report Deficits on Commonwealth Activities Each Year

Chart 3
Profitability on Commonwealth Activities by Organization Size
Average of FY03, FY04, and FY05 Distributions

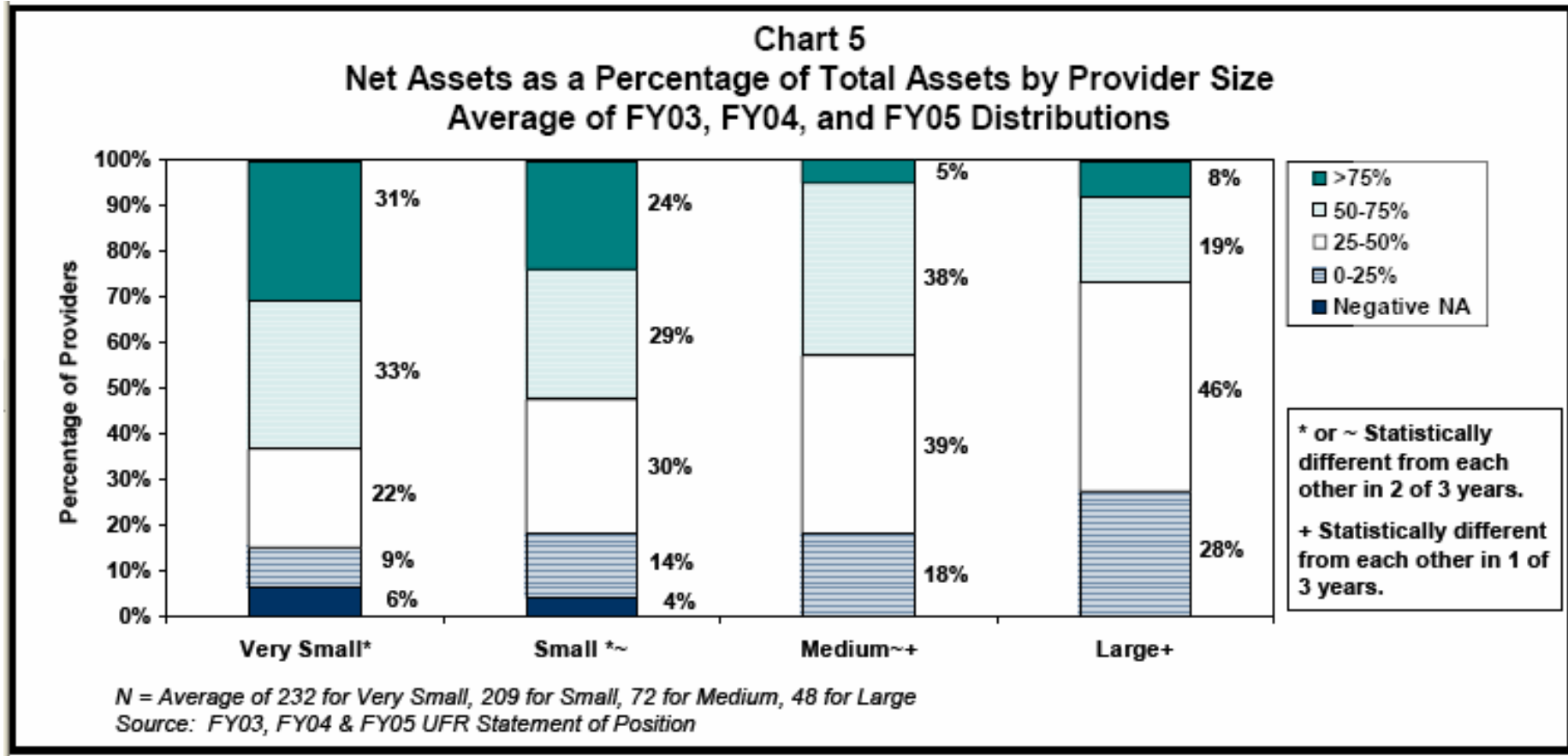


N = Average of 257 for Very Small, 234 for Small, 74 for Medium, 50 for Large
 Source: FY03, FY04 & FY05 UFR Schedule A

About 60% of Providers have Cumulative Deficits on their Commonwealth Activities since 1993



Almost Half of Providers have Liabilities in Excess of Net Assets; Four Percent Have Negative Net Assets



Other Key Descriptive Findings

- Only 22% of Providers have Expendable Net Assets Of Three Months of Expenses or More
- 14% have Zero or Negative ENA
- Almost Half of Providers do not Generate Sufficient Cash to Generate Positive Cash From Operations
- Sixty Percent of Providers Have Less than One Month of Cash on Hand at Year-End
- One-Third of Providers Have Over 45 Days of Unpaid Receivables

Regression-Related Findings

- The surplus /deficit on the Commonwealth's business is the statistically significant factor affecting providers' overall profitability.
- Commonwealth renews contracts 5-9 years, but are generally level funded.
- Providers must generate contributions, commercial and investment revenue to subsidize Commonwealth programs to breakeven
- Providers (e.g. smaller orgs.) less able to generate such revenues are in the most difficult financial condition.
- The Commonwealth has not explicitly recognized its reliance on these revenues, nor developed policies that take them into account.

Improving Government Funding of Nonprofits

- Pay 100% for contracted services
 - Allow higher overhead rates on all forms of government contracts
 - Reduce or eliminate the matching funds requirements
- Single NGO Funding Act (like the Single Audit Act)
 - Standardize grant applications and reporting
 - Standardize contract applications and reporting
 - Encourage the unified chart of accounts (UCOA)
- Revise NGO Accounting Standards & Regulations
 - Consistent Operating Measure
 - Require Management Discussion & Analysis (MD&A)
 - Demand “fair disclosure” (NGO Reg FD)
 - Statement of Activities prepared as under GASB GAAP