

## **To donate or not to donate?**

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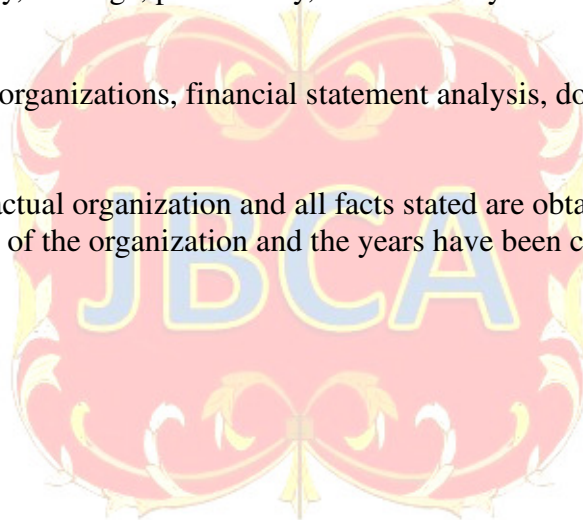
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### **ABSTRACT**

This case study offers students an opportunity to do a financial and operational analyses of a not-for-profit organization as a newly hired consultant to make a recommendation to a potential donor with \$100 million. All analyses are based on publicly available data of a not-for-profit organization. Students make a recommendation based on their assessment under the following aspects: mission, descriptive statistics, governance measures, and financial health assessed based on liquidity, leverage, profitability, and efficiency as well as efficient allocation of resources.

Keywords: not-for-profit organizations, financial statement analysis, donation, efficiency, consulting

This case is based on an actual organization and all facts stated are obtained from publicly available data. The name of the organization and the years have been changed to maintain anonymity.



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## INTRODUCTION

A newly hired consultant, Amy, is asked to provide a financial and operational assessment of St. Terry's University and provide advice on whether to donate to this university to a potential donor who considers donating \$100 millions. Amy has an accounting degree but did not take any not-for-profit accounting course during college. She contacted her professor and was provided with Cashwell et al. (2019), Clemenson and Sellers (2013), and Feng and Neely (2023) to help her approach this project more strategically. Amy decided to include the following major points and provided her recommendation to the prospective donor.

- Brief History and background of the organization including the mission of the organization, descriptive statistics of the organization such as the size of the organization in terms of the number of students etc., and other relevant details of the organization including its Sarbanes Oxley compliance measures shown in Part VI of Form 990.
- Analysis of the financial statements (Form 990 and the audited financial statements) to determine the fiscal health of the organization. The overall conclusion about the financial standing of the organization will be summarized under the following areas: liquidity, leverage, profitability, efficiency.
- Summary of the overall state of the organization, including a discussion as to the limitations, if any, of the financial statement analysis approach to assessing the ability of the organization to efficiently allocate resources and deliver on their tax-exempt mission.

In assessing the financial landscape of not-for-profit entities like St. Terry's University, a unique approach is required, distinct from commercial enterprises. Their missions, diverse in nature, steer beyond mere profit generation, with many relying on varied revenue streams from services, contributions, or membership dues. Trend analysis emerges as a vital tool in this context, highlighting deviations in financial ratios over time. Navigating the financial intricacies of not-for-profit academic institutions such as St. Terry's University offers both challenges and insights. The findings show that the university has improved its ability to cover short-term costs, with a clear rise in liquidity in recent times. While there was a trend of borrowing more in earlier periods, the latest figures suggest a shift towards a more balanced financial approach. Alongside these main observations, the university's consistent efficiency in managing its resources stands out, pointing to stable and well-organized operations. Therefore, St. Terry's University will allocate the donated funds effectively if they receive the donation.

## BACKGROUND

Saint Terry's University, founded in 1865, is set amidst the scenic backdrop of Ruthersburg, a historic town situated in the northern region of Tennessee. As the third oldest Catholic university in the United States, its mission is steeped in a commitment to faith, discovery, leadership, and community service. Overlooking the lush Catoclin Mountains, the campus provides an idyllic setting for learning. Within its borders stand the iconic Fradley Hall and the Phillows Library, two standout stone-brick structures. Fradley Hall serves as a hub for academic pursuits, while Phillips Library boasts an impressive collection of books, research materials, and the university's historical archives. The art, paintings, and manuscripts alone have costs nearing \$700,000. The preservation of these buildings is a testament to the university's respect for tradition. Situated a short distance from the heart of Ruthersburg, Saint Terry's

University is in proximity to local landmarks like the Basilica of the National Shrine of St. Francis of Assisi and the historic downtown. Nearby, one might also explore the Ruthersburg Antique Mall and several community staples, including JoJo's Restaurant & Tap House, the Ott House Pub, and the Palms Restaurant.

The University offers an extensive range of academic programs through its five divisions: the College of Liberal Arts, Division of Continuing Studies, the Gerry School of Business, School of Education, and the School of Natural Science and Mathematics. The College of Liberal Arts is the cornerstone of Saint Terry's classical education, offering a wide array of distinct majors. Guided by a dedicated faculty, the college emphasizes a holistic education, with students often delving into interdisciplinary projects and exploring the interconnections of knowledge across various fields. The tuition for graduate studies stands at \$600 per credit hour.

The Division of Continuing Studies is meticulously designed for non-traditional students and working professionals. With an extensive faculty, programs run in adaptable formats to meet the needs of those balancing work and study. Offering a blend of in-person evening classes that meet one night per week, weekend workshops, and online course options, it provides a versatile learning environment for its diverse student body. The tuition for accelerated/adult undergraduate students is priced at \$563 per credit hour.

The Gerry School of Business boasts a comprehensive range of major programs, blending theoretical and hands-on learning experiences. With its esteemed faculty and expansive curriculum, the school frequently hosts guest lectures from leading industry professionals and provides students opportunities for internships with its network of corporate partners. The tuition for graduate studies stands at \$700 per credit hour.

The School of Education, backed by a passionate faculty team, offers both undergraduate and graduate pathways. The school is renowned for incorporating practical teaching experiences in local schools, ensuring that its students are not only well-versed in educational theories but also prepared to teach upon graduation. Continuous professional development is a hallmark, with various workshops and seminars punctuating the academic year. Those pursuing graduate studies in education can anticipate a tuition of \$600 per credit hour and subject to fees of \$275 for the Teacher Internship Lab I and \$350 for the Teacher Internship Lab II. The School also offers full-time teachers at Catholic schools a significant 50% tuition reduction, underscoring its commitment to educators.

The School of Natural Science and Mathematics is a nexus of innovation and rigorous academic exploration. With a team of experts leading the way, students here are frequently immersed in labs and fieldwork, ensuring a deeply experiential learning journey. The tuition for graduate studies stands at \$700 per credit hour.

Undergraduate students at Saint Terry's can expect a full-time tuition cost of \$45,660 annually, while those opting for part-time courses will be billed at a rate of \$1,440 per credit hour. The total annual fees for undergraduate students at Saint Terry's are set at \$1,580. Meanwhile, accelerated/adult undergraduate students are priced at \$563 per credit hour.

St. Terry's University provides a spectrum of opportunities for supporters committed to ensuring a prosperous future for the next generation of mountaineers. Donors have the flexibility to opt for online donations, corporate gifts, or sending checks directly to the Office of Alumni Engagement. Valuing the importance of individualized contributions, the university highlights various giving opportunities, from the Annual Fund to the chance to make planned gifts by joining the 1808 Legacy Society. Further avenues of support include donating appreciated stocks, securities, or directly contributing to the University Endowment. In the previous year, the "Matty

Cup” Golf tournament made a significant impact, amassing gross receipts of \$18,520. Additionally, three other special fundraising events brought in a commendable \$50,995. On the operational front, the university invested \$101,810 in that year for specialized fundraising services, collaborating with two renowned entities: Campbell & Company and Ro Walker Company, emphasizing a thorough approach to its fundraising endeavors.

## FINANCIAL RATIOS AND TREND ANALYSIS

In analyzing the financial performance of Saint Terry’s University, the following four areas will be used for financial review: liquidity, solvency, profitability, and efficiency. It is essential that nonprofits maintain an adequate level of liquidity to meet current obligations. The current ratio and the quick ratio are the same as those used in for-profit analysis, whereas the defensive interval, liquid funds amount, and liquid funds indicator are unique to nonprofit analysis, most notably because nonprofit organizations have net assets (which may or may not be restricted) rather than equity. In addition to maintaining an adequate level of liquidity in the short term, nonprofits must be sure they can cover their total obligations in the long term. Based on the liquidity ratios analysis, St. Terry’s University’s fiscal health exhibits a mixed picture. The quick ratio, which indicates the university’s ability to meet short-term obligations without resorting to selling long-term assets, has experienced a notable decline from 2019 to 2022. This suggests a decreasing ability to cover current liabilities with available assets. While the quick ratio has seen a decrease over the past years, suggesting a potential challenge in meeting short-term obligations, other indicators paint a brighter picture. The Liquid Funds Amount has shifted from negative to positive values, showcasing significant improvement in liquidity. The Defensive Interval, a metric reflecting how long the university could operate using only liquid assets, remained relatively stable over the years, indicating consistent financial resilience. Likewise, the Liquid Funds Indicator displayed a positive trend from 2019 to 2022, signifying a favorable shift in liquidity position. In conclusion, while there are some concerns regarding the quick ratio, the overall trend in liquidity ratios suggests that the university has improved its financial liquidity over time, providing a foundation for better financial health and adaptability in the long term.

Solvency ratios provide insights into the university’s long-term operational capability. The debt-to-asset ratio mirrors the for-profit analysis, while the debt-to-net-asset ratio and times interest earned ratio offer nuanced perspectives due to the presence of net assets in nonprofit universities, as opposed to equity and net income. Excessive leverage can render a university susceptible to future financial disruptions. In assessing the solvency ratios for St. Terry’s University, different trends emerge in the institution’s fiscal position. The Debt-to-asset Ratio has increased over time but saw a positive shift recently, signaling better asset management relative to debt. This is mirrored in the Debt-to-net asset Ratio, which demonstrated an increasing dependence on debt financing before a recent correction. Meanwhile, the Times Interest Earned Ratio, essential for gauging the ability to handle interest obligations, experienced a dip followed by a recovery. In summary, while earlier years indicated a growing dependence on debt, recent metrics indicate a move towards improved solvency, hinting at a more stable financial future for the university.

Profitability ratios reveal the extent to which the university is generating surpluses or deficits. The return on investment ratio aligns with for-profit analysis principles, while the savings indicator, similar to profit margin, accounts for the university’s primary mission, which is not centered on profit maximization. Universities experiencing significant deficits risk fiscal distress, while those accumulating large surpluses may face stakeholder criticism for perceived



resource hoarding. Examining the profitability ratios for St. Terry's University, the analysis provides a mixed picture of the institution's financial health. The Return on Investments ratio reflects a gradual increase over the years, indicating a favorable trend in the university's ability to generate returns on its invested capital. This suggests a strengthening financial position and efficient resource utilization. However, this positive trend is somewhat offset by the Savings Indicator. This particular metric, which serves as a measure of the institution's ability to generate surplus or deficits, reveals a downward trend from 2020 to 2022. This could be indicative of challenges in maintaining profitability or increased expenditures. In conclusion, the university has shown promising signs of improved profitability, as evidenced by the Return on Investments ratio. While the university showcases promising signs in its return on investments, the diminishing Savings Indicator suggests areas of concern. Addressing these challenges will be crucial to ensure sustained profitability and financial health in the coming years.

Finally, universities aim to be efficient with the resources entrusted to them. Efficiency ratios measure what proportion of the total expenses is spent on programs compared with administrative and fundraising activities. **Efficiency ratios** in universities evaluates how expenditures align with their primary objectives and mission. The use of efficiency ratios provides insight into how funds are split between core academic pursuits and other operational aspects, such as administration and fundraising. Universities utilize specific metrics, like the administrative expense ratio and program service ratio, because they categorize outlays based on their distinct functions, whether they serve the institution's main mission, administrative purposes, or fundraising efforts. It is imperative that universities strike a balance in resource allocation. While it's crucial to invest significantly in core programs, neglecting essential administrative functions can compromise the institution's overall sustainability and effectiveness. Efficiency ratios at St. Terry's University reveal contrasting trends between administrative and program-related activities. The Administration Expense Ratio has consistently remained stable, suggesting the university has adeptly managed its administrative costs. In contrast, the Program Service Ratio, which measures how effectively resources are allocated to the university's primary services or programs, has seen a slight decline. This trend highlights potential challenges in directing resources towards essential academic and extracurricular activities. In conclusion, while administrative efficiency at St. Terry's University appears strong, the decrease in the Program Service Ratio points to areas needing attention to ensure the institution's overall effectiveness.

Drawing from the 2022 financial ratios of St. Terry's University and a comparable institution located in California, several distinctions become prominent. For that specific year, the latter institution manifested superior liquidity, evidenced by its elevated quick ratio, indicating a formidable stance in managing short-term financial obligations. Furthermore, its diminished debt-to-asset ratio in 2022 suggests a conservative approach to leveraging, emphasizing financial stability. Conversely, for the same year, St. Terry's University excelled in optimizing returns on its investments, evidenced by its remarkable ROI. Moreover, its superior program service ratio for 2022 signifies a robust commitment to its academic and extracurricular endeavors. However, the other university's increased admin expense ratio could signal potential inefficiencies or heightened administrative expenditures. In sum, while both universities showcased specific strengths in 2022, St. Terry's effectively championed its primary mission and yielded impressive investment outcomes, though improvements in liquidity could further enhance its financial portfolio. The use of the term "championed" was based on the Program Service Ratio which indicates how much of the institution's resources are allocated toward its

primary services or programs. A higher Program Service Ratio suggests that a larger portion of the university's expenditures is dedicated to its primary academic and extracurricular endeavors, implying a strong commitment to its core mission.

## CONCLUSION

The assessment suggests a positive trajectory for St. Terry's University's financial health for several reasons: improved liquidity, signs of improved solvency and stable efficiency. A critical factor for any institution's financial health is its ability to cover short-term obligations. The improvement in liquidity, especially between 2021 and 2022, indicates the university's enhanced capacity to meet these obligations, which can be crucial for ongoing operations and unforeseen financial demands. While there had been a trend of increasing reliance on debt financing, fiscal year 2022 showcased improvement. This suggests that the university may be reducing its debt or increasing its assets, both of which can be positive indicators of financial health. Consistency in efficiency indicates that the university is managing its resources effectively year after year. Efficient operations can lead to cost savings and ensure that the maximum amount of resources is being directed towards the primary mission of the institution. While certain aspects, notably the contrasting indicators in profitability, do raise some concerns, the overarching narrative remains optimistic. The evident enhancements in both liquidity and solvency underscore a positive trajectory for St. Terry's University's financial health.

While the financial statement analysis of St. Terry's University paints an optimistic picture of its financial health, it's crucial to recognize the inherent limitations of this approach. Financial statement analysis based on historical data, might not necessarily reflect the future potential or challenges of an organization because economic conditions, industry trends, and regulatory changes can all influence an institution's future financial health in ways that past data cannot capture. Furthermore, the analysis is primarily quantitative, overlooking qualitative factors like reputation, student satisfaction, or the quality of education, which may play a significant role in evaluating institution's long-term success and delivering on their mission. Besides understanding the university's performance overtime, it is also important to understand how it compares with similar organizations. Comparing ratios with peer institutions or industry averages can be misleading. Each institution might have unique strategic goals, student demographics, employee size, location, or funding sources that influence their financial metrics. In addition, external factors like regional economic downturns, changes in government funding for education, or global events (like pandemics) can dramatically influence the finances of an educational institution are not always evident in the financial statements.

## TEACHING NOTES

This case offers students the chance to adopt the mindset of a consultant tasked with recommending whether a \$100 million donation should be made to a not-for-profit organization. While many universities may not offer not-for-profit accounting as an undergraduate elective, students can readily apply principles from other accounting courses to this context. However, they may require guidance on the key disparities between for-profit and not-for-profit accounting, such as efficiency ratios, net assets, the absence of shareholders, and variations in financial statements, among other factors. Particularly challenging is the absence of a single performance measure like earnings per share (EPS), which complicates financial analysis in the

not-for-profit sector. Instructors teaching not-for-profit accounting can supplement their lessons with relevant papers on financial statement analysis, using this case as a prime example for classroom discussion on analytical approaches.



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