Measuring the Performance of Nonprofit Entities

An Honors Thesis (ID 499)

by

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THE PROBLEM

There is a deficiency in the financial reporting of the nonprofit sector. Of performance measures found in practice, the "benefit measures [are] the least common" (Gordon, p. 15). Revenues and expenditures are effectively disclosed to external users, but the benefits and/or outcomes that the nonprofit agency generates through service efforts are not generally measured and disclosed to outside parties.

A nonprofit agency is an entity whose financial reporting is much different from that of a profit-seeking enterprise. The nonprofit's purpose is to allocate and manage scarce public resources for the public's benefit. Unfortunately, there are no "market prices" or common units to measure the benefits that nonprofit agencies produce (Gordon, p. 9). There is no monetary value to measure the generated benefits. The financial reports only disclose revenues and expenditures. How can the external user determine the outcomes or benefits that the nonprofit entities produce?

CONTRAST BETWEEN FOR-PROFIT AND NONPROFIT REPORTING

A profit-seeking entity can measure the benefits that it produces through revenues and expenses. The amount of profit achieved after subtracting expenses from revenues effectively measures the benefits of the company. In most cases, but not all, high profits mean successful products or services which means satisfied customers who benefit from the product or
service. On the other hand, the nonprofit entities cannot use profits as an effective measure of the benefits derived from the agency. Obviously, revenues for this type of entity are not generated from satisfied customers. These revenues are produced from contributions or government funding.

To illustrate, we can say that Company X may be successful because Product X has produced an increase in profits from the previous year, but we can't say that a welfare agency has been beneficial to "the needy" because of an increase in its revenues and/or a decrease in its expenditures. The difference between revenues and expenditures cannot measure the effectiveness or success of the care for the poor because this amount is not produced as a result of satisfied customers. This amount is merely derived from sources such as governmental funding or the United Way. How can the performance and accomplishments of the nonprofit agencies be measured and reported to external users?

PROPOSED MODEL

The following is a proposed process that can be used to measure and report the benefits produced by nonprofit entities. This procedure describes the basic technique which can be used for any nonprofit entity.

Determining the entity's mission is the first and most important step of the process. According to the committee members of the report on Measuring the Performance of Nonprofit
Organizations, the following entity characteristics and operating environment must be recognized when making a choice of performance measures for external reporting (Gordon, p.10):

1. To enhance public good without adverse impact on any private interests.
2. To enhance public good at the expense of some or all private interests.
3. To provide free or subsidized services that improve the quality of life in a community individually or collectively.
4. To transfer wealth from one set of stakeholders to another.

These characteristics and operating environment best exemplify the nature of the missions of nonprofit entities. Since these qualities are important when choosing performance measures, and these qualities exemplify the mission, the mission is important to keep in mind while developing the next aspect of the process: determination of performance measures.

In order to properly measure the benefits produced by nonprofit agencies, a set of factors, or performance measures, must be developed. This step of the process requires the determination of a list of factors that measure how well the agencies are fulfilling their missions. For example, a factor or performance measure for the Red Cross could be "number of pints of blood collected" (Gordon, p. 32). All factors should be positive-oriented. A positive-oriented factor states "percentage of people served," and doesn't state "percentage of people that weren't, but could have been served." This positive
orientation more clearly reflects the purpose of measuring the benefits since positively stated factors correspond to adhering to the mission.

After the list of factors is developed, the next step in the process is to rate each factor on a rating scale. As an example, the following scale could be used.

\[
\begin{array}{c|c|c}
0 & 5 & 10 \\
\end{array}
\]

A factor could be rated on a scale of 0 to 10 with 0 meaning that the factor is not satisfied or is of low quality.

Development of a formula is the next step in the process. The formula is derived by first, weighting each factor with a fraction of 100%, and then taking the sum of the weighted factors as follows:

\[
X = (\text{factor 1})(\text{weight 1}) + (\text{factor 2})(\text{weight 2}) + \ldots
\]

The weights must come to a total of 100%.

The final result is then presented to external users as a numerical constant with a corresponding scale. For example, a certain entity could have X equal to 8 out of a total scale of 10. External users now have a means by which to measure the performance of nonprofit entities: a simple numerical rating.

Each year, the entire process should be implemented in its entirety. The second year of implementation and beyond requires (1) considering any needed improvements from previous years or
SUMMARY OF THE PROPOSED MODEL

1. Determine the mission.
2. While keeping the mission in mind, determine the entity's important factors to success.
3. Rate each factor.
4. Determine a weight for each factor.
5. Develop the formula.
6. Each year, repeat all steps while considering changes in environment or needed improvements.

LIMITATIONS

The solution to this problem is not exactly the same for each type of nonprofit entity, but the basic process is the same. Entities that are of the same type may even find it necessary to implement different solutions due to environmental variables or available resources. Consequently, each agency must be analyzed to determine the most effective performance measures that will be the most cost efficient to use and that will allow the agency to determine if its goals are being accomplished.

Another limitation of the model is that individuals differ in their ability to rate factors (Guilford p. 278). People judge characteristics and aspects of all elements of life in a different manner. This will weaken the ability to use the final rating when making comparisons between entities. A solution to
this problem could be the formation of a committee for each type of nonprofit entity which would set measurement standards to follow when rating the activities. These standards could be much like those produced by the Financial Accounting Standards Board (FASB). This group of "standard-setters" would allow for a more objective rating when factor judgments take place. This would allow for comparability of the measurement results between nonprofit entities.

APPLICATION MODEL

To illustrate the analysis of a specific entity and formulation of a solution to determine a measurement system, the benefits generated by a medical social worker (MSW) of the Ball Memorial Hospital (BMH) Home Care Services Center will be measured.

The MSW's primary responsibility is to assist the staff of the BMH Home Care Services Center in providing care for the patient. This assistance is achieved through visiting patients and recognizing their needs "as they are influenced by psychosocial and community variables." This visit allows the MSW to determine the proper services which will benefit the patient in the most effective manner. The MSW then works "directly with the patients and their families to enable them to use these services." Basically, the MSW can be defined as a link between the patient, the patient's family, the community, and the
professional staff of the BMH Home Care Services Center (Wrege).

The mission of this job, stated previously, is a very important first step in determining the solution to the problem of effectively reporting the benefits of the BMH Home Care Services Center. During the next step of the process, the mission must be kept in mind in order to appropriately measure the benefits of the MSW since, obviously, the mission is the driving force to achieving goals which benefit the patients in need of home care.

Determination of the factors is the next step to be implemented. While keeping the mission in mind, the following factors can be derived to measure the generated benefits of the MSW.

- percentage of actions taken that are successful
  Use the attached sheet, SOCIAL WORK DISCHARGE SUMMARY, which has already been established by the Home Care Services Center as a "results-report," to find the percentage of actions taken that are successful. The number that will correspond to the percentage is designated as "A".

- interaction with health care team (eg. interaction with nurses) -- "H"

- interaction with the patient's family -- "F"

- knowledge of the community -- "C"

- additional studies/education -- "S"

- staff meetings attended by medical social worker -- "M"
  Determine the percentage attended out of the number of meetings that the MSW could have attended.

- patient and family satisfaction -- "P"

- percentage of patients whose cases were not reopened -- "N"
The next step is to rate the factors. The following scales can be used for rating depending upon the situation.

<table>
<thead>
<tr>
<th>0%</th>
<th>50%</th>
<th>100%</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>1</td>
<td>2</td>
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<tr>
<td>3</td>
<td>4</td>
<td>5</td>
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<td>6</td>
<td>7</td>
<td>8</td>
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<tr>
<td>9</td>
<td>10</td>
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poor interaction          moderate interaction          excellent interaction
<table>
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<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>1</td>
<td>2</td>
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</tbody>
</table>

no satisfaction          moderate satisfaction          total satisfaction
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<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td>0</td>
<td>1</td>
<td>2</td>
</tr>
</tbody>
</table>

no knowledge/education          intense knowledge/education
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<th></th>
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</thead>
<tbody>
<tr>
<td>0</td>
<td>1</td>
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</tbody>
</table>

Assume that the factors were rated as follows:

A -> 8  M -> 10
H -> 9  P -> 8
F -> 7  N -> 10
C -> 9
S -> 9

The next step in the process is the weighting of factors. The analyst should weight the factors according to their importance in achieving the mission of the MSW. Each weight should be a ratio or fraction of 100%. All ratios should equal 1 or 100%.
Assume that the factors were weighted as follows:

- A → .40
- H → .20
- F → .20
- C → .09
- S → .01
- M → .01
- P → .08
- N → .01
  1.00

Entering the numbers into the previously developed formula from the proposed model will finalize the process and allow for a final result that can be reported to external users.

"X" is derived as follows:

\[ X = 8(.40) + 9(.20) + 7(.20) + 9(.09) + 9(.01) + 10(.01) + 8(.08) + 10(.01) = 8.14 \]

If all factors were rated as a "10" then the final result would also be a "10". X can never be more than 10 since all scales used to rate the factors do not allow for a rating in excess of 10. Since the weighting takes a fraction of a whole (1 or 100%) for each factor, and these weights add up to the whole, the final result will never equal more than the whole of the continuum (10). If all scales or continuums only went as high as 8, then the final result, X, would never be higher than 8. This is true for any constant. This proves that the final result can be placed on a final scale which is the same as the scales used when rating the factors. The following is the final scale for external users to see where X falls on the continuum:

```
|------------------------|------------------|----------|
0                      5                  8.14     10
```
The accounting qualities which appear in Statement of Financial Accounting Concepts No. 2: Qualitative Characteristics of Accounting Information can be used to assess the proposed model used for performance measurement. Although most characteristics show that the model is beneficial, other characteristics show that the model presents problems.

The first characteristic, timeliness, is present in the model. Since the entire process is performed on a yearly basis, it is always of a current nature. Predictive value and feedback value are also achieved through the use of the model since external users can use the end result to predict how the nonprofit entities may perform in the future and to decide the actions they (external users) will take in response to the information. Since these three qualities are present in the model, the model exhibits relevancy (see attached chart, A HIERARCHY OF ACCOUNTING QUALITIES, FASB p. 4).

The next set of characteristics prove that the model does have inadequacies because these characteristics rely on the entity itself. Since the entity is responsible for generation of the factors and rating of the factors, bias may occur. An entity may set the factors and formula up to make the end result more favorable than it should be. Whether or not the model exhibits representational faithfulness, neutrality, and verifiability depends on the implementors of the model; therefore, the reliability of the model depends on the implementors. This
problem could be less severe if the entity performed the rating of factors by following a set of standards developed by the previously mentioned committee (LIMITATIONS paragraph). This committee could deter a biased rating of factors to a limited extent.

Statement of Financial Accounting Concepts No. 4: Objectives of Financial Reporting by Nonbusiness Organizations states that "financial reporting should provide information about the performance of an organization during a period." This information on service efforts and accomplishments represents information most useful in assessing performance (FASB, p. 147). Since these performance measures generally cannot be reported to external users in monetary terms, what can be reported are the outputs of the entity (FASB, p. 168). In essence, performance measurement information should be reported whether it is in a monetary form or not. The proposed model allows for the reporting of nonmonetary information on the performance of nonprofit entities.

MAINTENANCE AND IMPROVEMENT OF THE SOLUTION

Environmental factors and sources of funding are constantly changing, and the need for improvements will obviously be determined through continued use of the system. Maintaining and improving the accuracy of the factors and the formula in response to these changes and new understandings is important. In order to maintain accuracy, the system should be reviewed by a
professional on a yearly basis. This review includes an interview with the medical social worker. The objective of the interview is not to assess the performance of the MSW. The objective is to determine if the measurement system is reliable or if it should be improved by assessing the activities and aspects of the MSW's job.
SOCIAL WORK DISCHARGE SUMMARY

Name: ___________________ ID #: ___________________

Date referral received: ____________________________________________ 

Dates visited: __________________ __________________ __________________ 

GOAL PROGRESS AT DISCHARGE:

Goal # ___ ____________________________

Intervention: ____________________________________________________

Results: ________________________________________________________

Goal # ___ ____________________________

Intervention: ____________________________________________________

Results: ________________________________________________________

Goal # ___ ____________________________

Intervention: ____________________________________________________

Results: ________________________________________________________

NARRATIVE: patient status at discharge. Impact of social work intervention on social/emotional conditions effecting medical condition and plan of care:

______________________________________________________________________________

______________________________________________________________________________

______________________________________________________________________________

______________________________________________________________________________

ESTIMATE OF FUTURE FUNCTIONING:

______________________________________________________________________________

______________________________________________________________________________

______________________________________________________________________________

______________________________________________________________________________

Signature, Social Worker ___________________ Signature, M.S.W. ___________________
A HIERARCHY OF ACCOUNTING QUALITIES

DECISION MAKERS
AND THEIR CHARACTERISTICS
(FOR EXAMPLE, UNDERSTANDING OR PRIOR KNOWLEDGE)

BENEFITS > COSTS

UNDERSTANDABILITY

DECISION USEFULNESS

RELEVANCE ← RELIABILITY

PREDECTIVE VALUE
FEEDBACK VALUE

TIMELINESS
VERIFIABILITY

REPRESENTATIONAL FAITHFULNESS

COMPARABILITY
(INCLUDING CONSISTENCY)

NEUTRALITY

MATERIALITY

THRESHOLD FOR RECOGNITION

SECONDARY AND INTERACTIVE QUALITIES

INGREDIENTS OF PRIMARY QUALITIES

PRIMARY DECISION SPECIFIC QUALITIES

USER SPECIFIC QUALITIES

PERVASIVE CONSTRAINT

USERS OF ACCOUNTING INFORMATION


Wrege, Carol. medical social worker of the Ball Memorial Hospital Home Care Services Center, Muncie, Indiana (personal interview) June 18, 1991.