UNCLASSIFIED

United States Department of State
and the Broadcasting Board of Governors
Office of Inspector General

Office of Inspector General

Office of Audits

Independent Accountants' Report on the Application of Agreed-Upon Procedures on Financial Capability of AFS-USA, Inc.

Report Number AUD/CG-10-16, April 2010

~~IMPORTANT NOTICE~~

~~This report is intended solely for the official use of the Department of State or the Broadcasting Board of Governors, or any agency or organization receiving a copy directly from the Office of Inspector General. No secondary distribution may be made, in whole or in part, outside the Department of State or the Broadcasting Board of Governors, by them or by other agencies or organizations, without prior authorization by the Inspector General. Public availability of the document will be determined by the Inspector General under the U.S. Code, 5 U.S.C. 552. Improper disclosure of this report may result in criminal, civil, or administrative penalties.~~

UNCLASSIFIED

United States Department of State and the Broadcasting Board of Governors Office of Inspector General

Office of Audits

Independent Accountants' Report on the Application of Agreed-Upon Procedures on Financial Capability of AFS–USA, Inc.

Report Number AUD/CG-10-16, April 2010

L.F. Harris & Associates, CPA, P.A., performed the agreed-upon procedures under the Department of State, Office of Inspector General, Contract No. S-AQMPD-04-D-0044, and by acceptance the report becomes a product of the Inspector General.

Harold W. Geisel
Deputy Inspector General

_4/6/10__________________
Date

Summary

At the request of the Department of State, Office of Inspector General (OIG), L.F. Harris & Associates, CPA, P.A., performed certain agreed-upon procedures to determine whether AFS–USA, Inc., is financially capable of performing government grants in the current and near term.

The objective of the financial capability agreed-upon procedures was designed to examine AFS–USA's financial condition to determine whether the grantee has adequate financial resources to perform on Department grants currently and in the near-term future. To meet the objectives of the agreed-upon procedures, we performed the following actions:

- Examined AFS–USA's audited financial statements and interim statements from 2006–2008 and for the interim period ended September 30, 2009.
- Examined AFS–USA's cash flow projections.
- Determined whether AFS–USA was current in liquidating its accounts payable.
- Reviewed payroll tax payments.
- Examined net worth, working capital, and key financial ratios.
- Determined compliance with loan agreements.
- Examined changes in net worth.

The results of our analysis are detailed in the Results section of this report. Highlights of the results include the following:

- AFS–USA's net increase in cash from all sources rose from to during December 31, 2006, through September 30, 2009.
- AFS–USA projected adequate cash flows through January 31, 2010, and the projections appear to be reasonable.
- Key Financial Ratios computed using AFS–USA's financial statements data are favorable.
- AFS–USA's Unrestricted Assets and Total Assets increased during the period examined.
- AFS–USA's is current in paying its payroll taxes.
- AFS–USA appears to have sufficient working capital to support operations and liquidate current liabilities.

Background

AFS–USA, Inc., is a nongovernmental, not-for-profit organization incorporated under the laws of Illinois and is a tax-exempt organization under the Internal Revenue Code Section 501(c)(3) of the United States of America. Since 1993, AFS–USA has been operating under the Articles of Partnership—a signed agreement of cooperation between AFS–USA and AFS International, which essentially allows AFS–USA the exclusive right to operate AFS-branded programs in the United States as long as AFS–USA abides by the agreed-upon global standards. AFS's partner organizations are incorporated under the laws of the countries in which they are located, and they prepare financial statements and tax reports as required by the jurisdictions in their respective countries.

Each AFS partner undergoes an annual fiscal audit and presents AFS International a copy of the independent auditor's opinion, along with the financial statements. While rules and regulations vary among partner nations, audits generally follow standards that are consistent with auditing standards generally accepted in the United States of America.

According to AFS–USA, Inc.'s Web site,[1] partner organizations provide intercultural learning opportunities "to help people develop the knowledge, skills and understanding needed to create a more just and peaceful world."

Purpose, Scope, and Methodology

The primary purpose of this agreed-upon procedures engagement was to determine whether AFS–USA is financially capable to perform on government grants.

We performed our procedures engagement in accordance with attestation standards established by the American Institute of Certified Public Accountants and *Generally Accepted Government Auditing Standards* (July 2007 revision), promulgated by the Comptroller General of the United States. Our procedures included the following:

- Examining the grantee's audited financial statements and interim statements for 2006–2008 and the interim period ended September 30, 2009.
- Examining net worth, working capital, and key financial ratios.
- Determining whether AFS–USA was current in liquidating accounts payable.
- Determining AFS–USA's compliance with loan agreements and lines of credit.
- Determining whether AFS–USA was paying its payroll taxes timely.
- Examining AFS–USA's cash flow projections.
- Reviewing AFS–USA's related party transactions. (Per the representation of management, there was no off-balance sheet arrangement.)

We conducted the initial assessment from September 17–30, 2009, with an additional assessment conducted during November 11–17, 2009.

Results

The results of the financial capability review indicated that AFS–USA's financial condition was acceptable for performing on Government grants in the near-term, which is defined as one year from the date this report is given to the Department of State through September 30, 2010. However, AFS–USA is highly dependent on Department grants, without which the grantee's viability would be questionable. We recommend that the grantee be on a

[1] <linkedin.com/companies/afs-usa-inc>, accessed on January 10, 2010.

cost-reimbursement funding basis until its financial condition has improved. When the financial condition has improved, AFS–USA should notify the Department, which then could make a determination as to whether the grantee can return to the advance method of funding. If the grantee does not keep the Department apprised of its financial condition, the grantee should remain on the cost-reimbursement funding method as long as it continues to receive grants from the Department. We determined that AFS–USA is considered viable for the reasons as summarized.

The financial statements used to assess the viability of the grantee consisted of audited statements for the 3 years ended December 31, 2008, and the unaudited 9 months ended September 30, 2009. For the 3 past years audited (see note 1 on page 7 and Table A on page 8), net assets increased, but unrestricted net assets decreased. However, there was a shift to an increase of in unrestricted net assets for the unaudited 9 months ended September 30, 2009. Since the September 30 financial statements are unaudited and the shift in change in net assets is significant, the shift was questioned during our agreed-upon procedures. We ascertained the following:

- Based on our search for unrecorded liabilities, we found that invoices of for September 2009 were received late in October and were therefore not accrued at September 30, 2009. Considering this unrecorded liabilities amount, the change in unrestricted net assets would be
- Some of the participant costs that were not incurred at the start of the school year will be incurred by year end December 31, 2009. These costs had not been quantified as of September 30, 2009. As such, we further considered the projected statement of activities for year end December 31, 2009.
- The projected statement of activities for year end December 31, 2009, shows an increase in unrestricted net assets of $185,653, which appears reasonable. This shows an improvement in change in unrestricted net assets and also shows that AFS–USA will be in a break-even position compared with the losses incurred in prior years. We therefore consider AFS–USA to be viable.

Results of Agreed-Upon Procedures of Financial Capability

The analysis of each subject in the scope of the review is addressed as follows:

1. There is a consistent increase in total net assets (net worth) reported in the audited statements for the 3 years ended December 31, 2008, and the unaudited 9 months ended September 30, 2009.

   AFS–USA's net worth increased during the period examined. AFS–USA reported net worth (Total Net Assets) of $14,077,361, $16,887,748, and $17,902,015 as reported in AFS–USA's audited financial statements for fiscal years 2006, 2007, and 2008, respectively. The interim balance sheet at September 30, 2009, reported total net assets of (b) (4)(b) (4)

Temporarily restricted net assets is the largest component of the total net assets, and unrestricted net assets is the smallest component of the total net assets for the period examined. The breakdown of total net assets for each year is presented in Table 1.

Table 1. Summary of Net Assets

Net Assets	Audited Year Ended 12/31/2006	Audited Year Ended 12/31/2007	Audited Year Ended 12/31/2008	Unaudited Period Ended 9/30/2009
Unrestricted Net Assets:				
Beginning	$2,558,905	$2,339,747	$1,509,255	
Change in net assets	(219,158)	(830,492)	(438,020)	
Ending	$2,339,747	$1,509,255	$1,071,235	
Temporarily Restricted Net Assets:				
Beginning	$5,344,799	$7,386,585	$10,950,952	
Change in net assets	2,041,786	3,564,367	1,742,406	
Ending	$7,386,585	$10,950,952	$12,693,358	
Permanent Restricted Net Assets:				
Beginning	$3,935,138	$4,351,029	$4,427,541	
Change in Net Assets	415,891	76,512	(290,118)	
Ending	$4,351,029	$4,427,541	$4,137,423	
Total Net Assets:				
Beginning	$11,838,842	$14,077,361	$16,887,748	
Change in Net Assets	2,238,519	2,810,387	1,014,268	
Ending	$14,077,361	$16,887,748	$17,902,016	

During financial years 2006 to 2008, the change in total net assets ranged from $1,014,268 to $2,810,387. However, the change in total net assets for the 9 months ended September 30, 2009, amounted to (b) (4) The increase in net assets in the period ended September 30, 2009, resulted mainly from additional grants of awarded for expenses that have not been incurred. The net assets would decrease by (b) (4) if the grant was not received. This grant awarded but not yet drawn down is recorded in temporarily restricted net assets for the period. (Revenue recognition is discussed in note 4a.)

The change in Unrestricted Net Assets for the audited periods of December 31, 2006, 2007, and 2008, amounted to ($219,158), ($830,492), and ($438,020), respectively, and increased by (b) (4) for the 9 months ended September 30, 2009. The increase for the 9 months resulted mainly from the partial implementation of a new hosting transfer price schedule and a reduction in non-grant operating expenses.

The change in Temporarily Restricted Net Assets for the audited periods of 2006, 2007, and 2008 amounted to $2,041,786, $3,564,367, and $1,742,406, respectively, and increased by for the 9 months ended September 30, 2009. The increase at September 30, 2009, resulted mainly from the receipt of additional grants of which were recognized as temporarily restricted revenue, and the release from restriction of of net assets previously reported as temporarily restricted assets.

The grantee also projected for December 31, 2009, total change in net assets of compared with December 31, 2008, actual change in net assets of $1,014,268. The projected change in net assets of consisted of of unrestricted net assets, of temporarily restricted net assets, and of permanently restricted net assets.

2. Based on the audited financial statements for the 3 financial years of December 31, 2006, 2007, and 2008, and the unaudited 9 months ended September 30, 2009, we believe that AFS–USA appears to have sufficient working capital to support operations and liquidate current liabilities in the near term.

3. As summarized in Table 2, AFS–USA reported net increase/(decrease) in cash from operations, investing, and financing of ($778,330), ($533,164), $145,877, and in its audited financial statements for fiscal years 2006, 2007, 2008, and interim financial statement for the 9 months ended September 30, 2009, respectively. AFS–USA's net cash balance at September 30, 2009, was

Table 2. Cash Balances

	Audited Year Ended 12/31/2006	Audited Year Ended 12/31/2007	Audited Year Ended 12/31/2008	Unaudited Period Ended 9/30/2009
Cash Beginning Balance	$2,794,716	$2,016,386	$1,483,222	
Net Cash Flow from:				
Operations	(12,668)	455,904	(461,023)	
Investing	(1,038,052)	(981,317)	51,275	
Financing	272,390	(7,751)	555,625	
Net Increase/(decrease)	(778,330)	(533,164)	145,877	
Cash Ending Balance	**$2,016,386**	**$1,483,222**	**$1,629,099**	

AFS–USA projected adequate cash flow through January 2010. The projection ends in January 2010 because that is when the final revenues for 2009 will be received and when final payments for 2008 expenses will be made. The total net cash for the current fiscal year ended December 31, 2009, is projected to be and for January 31, 2010, is projected to be (b) (4) The projected revenues and other contributions are based on existing grants and recurring donations only. We considered the overall cash flow projections to be reasonable.

AFS–USA management officials said, to improve cash flow, that they had secured a $1.5 million loan from AFS International for 10 years at zero percent interest. AFS–USA intends to pay off its line of credit of $950,000 and will use the remaining $550,000 for operating expenses. Payment under the terms of the loan is not due until a threshold reserve level is reached when unrestricted net assets exceed 10 percent, at which time 50 percent of the amount above 10 percent is due as a loan payment.

4. The Key Financial Ratios computed using AFS–USA's audited financial statement data are mostly favorable, with the following exceptions:

   a) AFS–USA's current ratio (which indicates adequate current assets to cover current obligations) and the quick ratio (which indicates the ability to meet all short-term obligations with assets readily convertible to cash) are both considered to be favorable indicators of AFS–USA's financial condition.

      The liquidity position appears strong for the organization. However, the organization's receivable days ratio[2] is high for the sector, which is a result of AFS–USA's revenue recognition procedure as described. The receivables days are 124 days, 156 days, 167 days, and days compared with industry averages of 40 days for 2006, 2007, 2008, and the 9 months ended September 30, 2009, respectively.

      During our procedures engagement, we noted that AFS–USA considers the Department's grants as non-exchange transactions. AFS–USA recognizes revenue when the Department awards a grant to the agency by recording a receivable and temporarily restricted revenue. We are of the opinion that the Department's grants are not unconditional contributions, as defined by paragraph 23 of Statement of Financial Accounting Standards (SFAS) No. 116, "Accounting for Contributions Received and Contributions Made." Therefore, revenue should be recognized when earned and not when awarded. The effect of AFS–USA's treatment is to overstate receivables and net assets. This effect was considered during our analysis to further evaluate the high receivable days ratio, accounts receivable, and the change in net assets.

   b) For year end 2008, the organization improved operating margins and significantly improved the results of operations for unrestricted activities. The net operating loss improved by 68.77 percent, which was achieved mainly by maintaining flat revenues while reducing program expenses.

[2] "Receivable days ratio" is the average number of days an organization takes to collect payments for goods and services.

For the 9 months ended September 30, 2009, the results of operations for unrestricted activities also improved from a loss position to a net operating gain. The net operating gain recorded for this period was as compared with net operating losses of $162,403 for FY 2008 and $519,959 for FY 2007. This improvement resulted mainly from the partial implementation of a new hosting transfer price schedule and a reduction in non-grant operating expenses.

5. Based on our review of the accounts payable aging schedules for December 31, 2008, June 30, 2009, and September 30, 2009, we determined that AFS–USA was liquidating its accounts payable on a timely basis. We evaluated the number of days outstanding in the accounts payable aging schedules and did not find any significant payables over 90 days or deviations from accounts payable procedures for the periods reviewed.

   Additionally, we reviewed the check register for July and August 2009 for unrecorded liabilities. The review was updated to include October 2009 because of the roll forward of the review to September 2009. Of the balances reviewed, we found that invoices of $70,268 for June 30, 2008, and for September 30, 2009, were not accrued until the following month. However, they were paid timely.

6. Lines-of-credit balances outstanding consisted of a balance of $250,000 from UBS and $700,000 from Bank of America.

   Lines-of-credit balances remained the same after AFS–USA obtained a new line of credit for $300,000 in April 2009 and subsequent repayment of equivalent balance in June 2009.

   AFS–USA has been making interest payments on its existing debt on a timely basis. Of the liabilities examined for the 7-month period of December 2008 to June 2009, we found that two of the months reviewed for the UBS line of credit for January and March payments were made the following months. That is, the January and March liabilities were paid in March and May, respectively. From discussions with management officials and reviews of the line-of-credit agreement, we found that interest payments were due monthly but that allowances were made for payments to be deferred, provided the collateral was adequate. The payments made in the following months were not the result of cash shortages.

7. We traced the tax liabilities recorded in the payroll register to bank statements. Payroll was processed by an outside servicer, and deposits were made electronically.

   AFS–USA was generally current in paying its payroll taxes. Based on our tests of Federal and state taxes for the last quarter of 2008 to the second quarter of 2009, we found that 5 weeks of federal taxes and 3 weeks of state taxes were paid 1 to 2 days late. These were not long overdue, and penalties were not levied.

8. From March 2008 to April 2009, 25 board members resigned and 15 new members had joined AFS–USA. Management officials said that a resolution was made to have a total of 18 board members and that the new board members had been more engaged in operation and were very active volunteer representatives. The officials also said that the new board members had been effective in running the business and that not having fully replaced the board members had not jeopardized the business.

9. Management officials said that there was no off balance sheet arrangement to be examined. Funds held on behalf of Participating Chapters, investments held in trusts, and beneficial interest in perpetual trusts did not reflect any irregularities.

We discussed the results of our audit with AFS–USA officials during exit conferences on September 30 and November 16, 2009. The grantee officials concurred with the results of this agreed-upon engagement.

L.F. Harris & Associates, CPA, P.A.
Certified Public Accountants

Independent Accountants' Report on Application of Agreed-Upon Procedures

U.S. Department of State
Office of Inspector General
Office of Audits
1700 North Moore Street
Arlington, VA 22209

We have performed certain agreed-upon procedures (Procedures), as summarized in the Purpose, Scope, and Methodology section of this report. The Procedures, which were agreed to by the Office of Inspector General, U.S. State Department, were performed solely to assist the Office of Inspector General, U.S. Department of State, in evaluating AFS–USA's financial capability to perform government grants in the near-term, which is defined as one year from the date of this report.

This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants, Generally Accepted Governmental Auditing Standards, and guidance from the Office of Management and Budget.

The sufficiency of these Procedures is solely the responsibility of those parties specified in this report. Consequently, we make no representations regarding the sufficiency of the Procedures as described in the Purpose, Scope, and Methodology section of this report, either for the purpose for which this report has been requested or for any other purpose. The results of our procedures are presented in the Results section of this report.

We were not engaged to, and did not perform, an audit, the objective of which would be the expression of an opinion on the specified elements, accounts, or items. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the use of the United States Department of State, Office of Inspector General, and should not be used by those who have not agreed to the Procedures and taken responsibility for the sufficiency of the Procedures for their purposes.

L.F. Harris & Associates

L.F. Harris & Associates, CPA, P.A.
November 16, 2009

3012 E. Robinson St. • Orlando, Florida 32803 • 407-228-0560 • Fax 407-228-0166 • www.lfharris.com

FRAUD, WASTE, ABUSE, OR MISMANAGEMENT
of Federal programs
and resources hurts everyone.

Call the Office of Inspector General
HOTLINE
202-647-3320
or 1-800-409-9926
or email oighotline@state.gov
to report illegal or wasteful activities.

You may also write to:
Office of Inspector General
U.S. Department of State
Post Office Box 9778
Arlington, VA 22219
Please visit our Web site at:
http://oig.state.gov

Cables to the Inspector General
should be slugged "OIG Channel"
to ensure confidentiality.