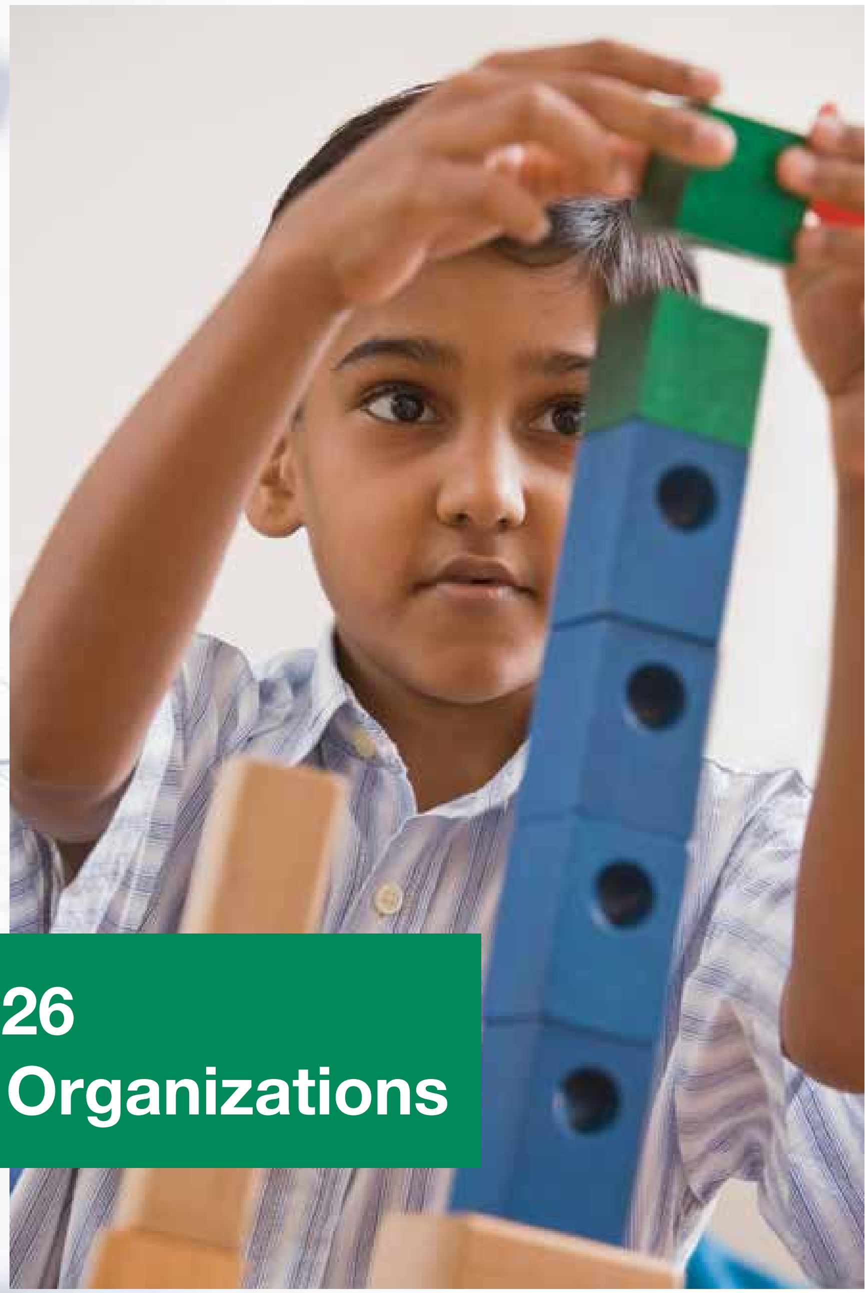
Building Stronger Nonprofits Through Better Financial Management

Lauren J. Kotloff with Nancy Burd

Executive Summary



Early Efforts in 26 Youth-Serving Organizations

P/PV Public/Private Ventures
INNOVATION. RESEARCH. ACTION.

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Public/Private Ventures
P/PV is a national nonprofit whose mission is to improve the effectiveness of social programs, particularly those that aim to help young people from high-poverty communities successfully transition to adulthood. Working in close partnership with organizations and their leaders, P/PV aims to:

- Promote the broad adoption of appropriate evaluation methods;
- Advance knowledge in several specific areas in which we have long-standing experience: juvenile and criminal justice, youth development (particularly out-of-school time and mentoring) and labor market transitions for young people; and
- Enable practitioners and organizations to use their own data, as well as evidence in these fields, to develop and improve their programs.

Ultimately, we believe this work will lead to more programs that make a positive difference for youth in high-poverty communities.

For more information, please visit: www.ppv.org.

The Wallace Foundation
The Wallace Foundation is a national philanthropy that supports and shares effective ideas and practices to expand learning and enrichment for disadvantaged children. The foundation maintains an online library of research reports and other publications at www.wallacefoundation.org. Included are lessons and information stemming from the foundation's current efforts in: strengthening school leadership to improve student achievement; creating more time for learning during the summer and school year; enhancing after-school opportunities; improving arts education; and developing audiences for the arts.

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We are indebted to many individuals who helped make this study possible. First and foremost, we would like to thank the CEOs, executive directors and lead finance staff of the 26 organizations participating in the Strengthening Financial Management in Out-of-School Time initiative. They graciously accommodated the many demands of the research despite their extremely busy schedules.

A special thanks to Jean Grossman, whose vast knowledge of the out-of-school-time (OST) field helped us identify the key issues that drove the research and framed the report.

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The study benefited greatly from input of the talented staff of Fiscal Management Associates. Sarah Walker, Andrew Fuller and Amy Gudgeon shared extremely helpful insights about the financial management challenges confronting the SFM organizations. Amy Gudgeon and John Summers provided thoughtful comments on early drafts of the report.

The Wallace Foundation's long-standing commitment to improve the quality of OST programs so that more children, especially those with the highest needs, can benefit led to this study. We are especially grateful to Edward Pauly and Polly Singh for their guidance and advice throughout the study and to Edward Pauly and Lucas Held for their useful feedback on the report.

Nonprofit organizations are rarely judged solely by their financial bottom line; instead, their worth is gauged by the effectiveness of their services and how successfully they achieve their mission. Accordingly, recent efforts to improve the quality of out-of-school-time (OST) services have centered on various aspects of programming (e.g., applying "best practices," increasing professional development, tracking outcomes, etc.) and have largely ignored building the capacity of the organizations themselves. Yet, for most organizations, the ability to deliver effective services is dependent on sound management practices, of which financial management is an essential piece.[1]

Unfortunately, past research has shown that even high-performing nonprofit organizations have serious gaps and inefficiencies in their financial and other core management systems.[2] In an effort to maximize the resources that go to serving clients,[3] public and private funders have traditionally set very low limits on administrative, management and other "overhead" expenses not directly related to programming.[4] There is now widespread agreement among nonprofit leaders and those who study them that the percentage of funds from grants and contracts that can be used to cover overhead is, as a rule, unrealistically low.[5] In addition, nonprofits often find that managing their many grants and contracts and complying with the reporting requirements of various funders is enormously time consuming, especially for the sizable proportion of organizations that rely on government funds.[6]

This situation leaves nonprofit organizations vulnerable. Many lack cash reserves, making it difficult for them to build a safety net for periods of low revenues.[7] Organizations often struggle to manage their finances effectively—challenged by the basic, day-to-day demands of paying bills, submitting vouchers and responding to funder requests. In these situations, leadership is forced to focus on survival and crisis management, rather than long-term strategic planning and development or improving program quality.[8] Inadequate investment in core management systems, including financial management, has led to what one expert describes as a "continued and persistent hollowing out of organizational infrastructure" across the nonprofit sector.[9]

The Current Study

The Strengthening Financial Management in Out-of-School Time initiative (SFM) grew out of The Wallace Foundation's long-standing commitment to improving the quality of services for youth during nonschool hours and the realization that even successful nonprofits face financial management challenges that have an impact on their ability to achieve their missions. The four-year initiative seeks to improve the financial management systems of 26 well-respected OST-providing nonprofit organizations in Chicago. It is offering their key staff training and support, while also working to reform funder (both public and private) practices that strain OST organizations' financial management capacity. Participating organizations are receiving financial management training and peer-networking opportunities, using one of two models that vary in intensity and in the balance of individual vs. group-based training and support.

The following pages summarize a report by Public/Private Ventures (P/PV) that describes the financial management challenges of participating organizations at the start of SFM, as well as their progress to date. It also suggests early lessons for OST funders and nonprofit leaders that have emerged from SFM's first 12 to 18 months. A second report that focuses on the implementation, cost and effectiveness of the initiative will be published in 2014.

The current report is based on information from the following sources:

- ***Baseline and nine-month follow-up surveys*** of the CEO and lead financial officer (or equivalent) in each of the 26 participating organizations.
- ***Formal assessments*** of the financial management practices of each organization, conducted by Fiscal Management Associates (FMA), which provided financial management training and capacity building for the initiative.

- ***Interviews*** with the CEOs, lead financial officers and, in some cases, program managers of 12 SFM organizations.
- ***Interviews*** with FMA staff and reviews of FMA documents and annual reports.

Summary of Findings

From interviews with experts on nonprofit financial management, we identified three practices essential to a nonprofit organization's ability to be financially strong and effective:

1. Understanding the true costs of all programs to develop accurate, realistic budgets;
2. Monitoring the financial status of individual programs and the organization as a whole on an ongoing basis; and
3. Meeting expenses in a timely manner.

To implement these key practices, an organization needs:

1. Strong financial management resources, both human and material;
2. Procedures and methodologies to generate key indicators of its financial status, account for overhead costs and alert staff about available cash as well as shortfalls; and
3. Systems to effectively communicate financial information among financial and nonfinancial staff.

However, the SFM organizations faced significant challenges in each of these areas:

The organizations' finance offices were hindered by having too few staff to deal with too much work, staff with less-than-optimal analytical and strategic skills, and staff configurations that created inefficiencies and slowed work flow. The staffing of the SFM organizations' financial offices had not kept pace with their rapid growth and the increasing complexity of funding requirements. Generally, finance office staff were able to carry out tasks necessary for maintaining their organization's daily operations, but their strategic and oversight functions were performed in a very limited way. Lead financial officers had to devote too much of their time to basic operational tasks and contract/grants administration, leaving little opportunity for big-picture analysis and long-term planning. Many offices needed to broaden the expertise and skills of staff and reconfigure duties and lines of authority to perform the full spectrum of financial activities effectively.

The majority of the organizations either needed to update or better utilize their financial software so that they could reduce inefficiencies and generate more accurate and reliable financial information. While some organizations needed to upgrade to more sophisticated software because they had outgrown their existing program, the majority of the organizations had appropriate software but were not using it to its full capacity—most likely because staff lacked the training needed to do so. As a result, the organizations' ability to produce critical financial reports was limited.

The organizations needed better procedures to ensure that organization-wide and individual program budgets reflect true and full costs of operations. Budgets are critical for good fiscal management—but only to the extent that they are based on accurate information about the true cost of running an organization's programs and services. The budget for any single program must include a share of the overhead costs of the organization that runs and houses the program, as well as the "direct" costs associated with delivering the program's services. About a third of the SFM organizations (9 of the 26) needed to develop a more accurate and automated method for capturing and allocating overhead costs and incorporating them into program budgets.

Many of the organizations were struggling with financial monitoring and forecasting. Most SFM organizations (80 percent) were producing financial reports, referred to as "budget-to-actual" reports, that present the variance between the amount that has been budgeted and the amount actually spent at specific points in time. Reviewing these reports helps ensure that actual expenditures do not exceed what was planned. Unfortunately for the SFM organizations, these reports did not always help program staff make informed decisions about how to manage their budgets. One reason is that many organizations were not generating program-level budgets and thus could not create budget-to-actual reports for individual programs. In addition, program managers did not always have the skills needed to understand and act on the financial information they received.

Finally, cash flow projections were not being generated often enough or projected out far enough to help the organizations predict and plan for cash shortfalls. More frequent and extended projections are especially important in the current economic context, in which late state payments and low cash reserves often make it necessary for organizations to open lines of credit to meet their expenses.

Communicating financial information to program staff was a significant challenge. Budget development should be a team effort, based on input from staff from finance, programs, development and human resources.[10] Because they have direct knowledge of the resources needed to implement program activities, program managers are especially important members of the team. P/PV's data indicate that program staff were participating in developing annual budgets. However, program managers and finance staff were not routinely meeting to discuss any variances between a program's budgeted and actual costs, leaving program managers without the information they needed to carefully plan how to use discretionary funds to achieve the maximum impact for youth.

Responding to these challenges, the SFM organizations made encouraging progress during the first 12 to 18 months of training.

As a group, the 26 SFM organizations have responded enthusiastically to the SFM initiative and have made some promising early progress toward their goals. Lead financial officers' ratings of the skills of the financial office staff improved between the baseline and nine-month follow-up surveys. Data from these surveys also indicate that, on average, the organizations made modest gains in generating key financial reports more frequently, and were moving closer to the recommended benchmark of monthly reports. In particular, organizations' use of cash flow projection methods were on the rise. Finally, as a group, the program managers' ability to develop and/or understand budgets and financial reports improved over time.

Recommendations

Changes in the larger funding environment are needed to produce deep and sustained improvements in nonprofits' financial management capacity—and thus their ability to fulfill their organizational missions. Public and private funders should consider the following reforms:

Invest in nonprofits' core administrative infrastructure, especially financial management. Without sufficient funds to invest in software, training and technical assistance, and—perhaps most important—staff and managerial time, nonprofit organizations will not be able to improve their financial management practices at any kind of scale. In practical terms, this means funders should consider raising the level of overhead they allow in their grants and contracts, recognizing the importance of a strong organizational infrastructure for the delivery of quality services.

Reduce administrative and financial burdens that result from current funding practices. Meaningful change in this area cannot be accomplished by any single funder alone, but rather requires the collaboration of a significant proportion of public and private funders across a given sector.

Invest in financial-management capacity building. This study suggests that nonprofits are in need of and open to such assistance. Early SFM data indicate that peer learning opportunities (like its quarterly meetings for CEOs) may be particularly valuable. Funders should invest in these kinds of capacity-building efforts, including evaluations to document successful approaches.

Final Thoughts

The SFM organizations are some of the most well-established youth-serving organizations in Chicago, and yet they all are struggling to manage their finances effectively. If financial management problems are hampering their ability to achieve their missions, it is quite likely that weak financial management resources, communication systems and practices are hampering many other youth-serving organizations across the nation. And as a result, young people are not being served as well as they could be.

Improving the quality of OST programs—indeed of all social programs—can be achieved only if the leaders are not consumed with the very survival of their programs. Thus, efforts to improve program quality will need to be combined with efforts to strengthen organizations' financial management capacity.

In the current economic climate, it is more urgent than ever for organizations to adopt effective and strategic financial management practices. Findings from the start-up phase of the SFM initiative suggest that these organizations are very receptive to training designed to build their financial management capacity and are willing to devote staff time to carry out an ambitious change agenda. The ultimate success of these efforts, and what level of intervention will prove to be most cost effective, remains to be seen.

Executive Summary Endnotes

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