

FISCAL FITNESS

for **NONPROFITS**

Project Puts
Chicago After-School
Programs and Funders Through
a Financial Workout

By Anne Field

On a sunny day in July 2010, Maria Pesqueira sat at a conference table, ready to make her case. Armed with PowerPoint slides, the head of Mujeres Latinas en Acción, a Chicago-based nonprofit providing after-school and other services to Hispanic women and children, wanted to alert other nonprofit leaders to a looming threat. The financially strapped State of Illinois, she had learned, was postponing payments to nonprofits by up to six months. With close to 60 percent of Mujeres Latinas' funding coming from the state, Pesqueira knew these delays would devastate her organization and,



The Wallace Foundation

Supporting ideas.
Sharing solutions.
Expanding opportunities.

Maria Pesqueira
of Mujeres
Latinas



she reasoned, others, too. So she was here to rouse the Illinois Coalition for Immigrants and Refugee Rights, a collection of like-minded groups that gathered regularly to discuss common issues.

In the past, Pesqueira might have been complacent about slow payments, figuring she'd find a way to get by. But, for months she had been participating in a program to teach financial management skills to groups that run after-school programs. After hearing the news from the state, she had done a thorough cash flow analysis and made a disturbing discovery: A six-month delay meant Mujeres Latinas would have to wipe out its \$150,000 line of credit, and it still wouldn't be able to keep its head above water. "We didn't have enough for the electric bill," she says.

Concerned that her colleagues were so used to frequent payment delays that they would take the news in stride, she arrived at the meeting armed with a startling visual depiction of just how dire the impact would be on her organization's

cash flow. Her

presentation had

the desired effect. The coalition became so alarmed it promptly polled its 131 members about their cash situations and learned that only two groups would manage to keep the lights on.

That's when the coalition sprang into action, lobbying legislators, the governor's office and human services officials, and calling a packed press conference that generated a torrent of coverage. "Lo and behold, the state came through with some of the money," says Pesqueira.

*"We didn't have enough for
the electric bill."*

DIFFICULTIES IN NONPROFIT AND GOVERNMENT PRACTICES

Good financial management "is connected to every facet of the organization's operations – and it's essential to success."

As Pesqueira discovered, a nonprofit ignores financial management at its peril. Still, many nonprofit executives give short shrift to the financial underpinnings of their organizations. "There's a feeling that programming is important and finances are less important," says Elizabeth Boris, director of the Urban Institute's Center on

Nonprofits and Philanthropy. "These are not finance people. They're programming people, and they haven't been trained in financial skills."

Financial management is about a lot more than keeping the books, however. It's about creating a system through which the program and development offices and the financial staffs can work together to set priorities and agree on the most effective and efficient ways to further the group's objectives without breaking the bank. "It's connected to every facet of the organization's operations – and it's essential to success," says Hilda Polanco, managing director of Fiscal Management Associates, the New York- and Chicago-based consulting group conducting the sessions Pesqueira attended.

Indeed, poor financial management at nonprofits can cripple the ability of the groups that are a city's safety net to deliver quality programs or even to function at all.

Government funding practices make matters worse. State and city agencies generally work on a reimbursement system, through which nonprofits submit invoices for expenses related to funded programs and then are paid back what they have spent. But government funders often cause crises for nonprofits by practices including underpaying administrative costs, demanding burdensome, duplicative paperwork and delaying payment for services, according to a 2010 United States Government Accountability Office report.¹ "Organizations like ours bear the brunt of financing the state," says Pesqueira. "They hold onto their cash for as long as they can, while we pay interest on our lines of credit to keep our doors open."

A POSSIBLE SOLUTION?

Strengthening after-school programming for city youngsters has long been an objective of The Wallace Foundation, a national philanthropy based in New York City. In its work over the years, Wallace has found that weak financial management of the nonprofits running many high-quality programs hampers their ability to improve and expand. In 2009, Wallace introduced an initiative in one city, Chicago, to see if a combination of financial training and consulting for executives at after-school nonprofits and the introduction of friendlier government reimbursement policies could change that picture.

The foundation funded Fiscal Management Associates, better known as FMA, to provide financial management training to the CEO's and CFO's of 25 Chicago-area nonprofits that provide after-school services. Participating organizations were also given financial incentives that varied depending on the training they received: \$40,000 or \$115,000 for initial financial management improvements, and, for those completing the program, \$25,000 for administrative infrastructure or \$125,000 for operating reserves. Wallace also supported a forum bringing together representatives of government, advocacy groups, private funders, academics and service providers to recommend new contracting practices.

The results of the Strengthening Financial Management initiative thus far suggest that, with sufficient grounding in the basics of financial analysis, nonprofits that run after-school programs can learn to navigate difficult challenges to their organizations more adeptly, even in the face of a troubled economy. The forum (in which several Wallace grantees participate) has led to a closer partnership among government, nonprofits and funders – an achievement in itself given the state's chaotic funding landscape – and early steps toward streamlining contracting practices with nonprofits.

Nonprofits face a host of thorny financial management problems.

AN OLD PROBLEM, MORE PRESSING TODAY

Certainly, the problem of poor financial management at nonprofits isn't new. But it's particularly urgent in today's climate of widespread cutbacks. Consider a 2008 Wallace-commissioned FMA study of 16 nonprofits.² It found that most funders seldom pay for all of an organization's costs of

Anne Field is an award-winning freelance writer who specializes in social enterprise, small business and management. She's contributed to a variety of publications, including The New York Times, Bloomberg Businessweek, Crain's New York Business and Businessinsider.com.

¹ *Treatment and Reimbursement of Indirect Costs Vary among Grants, and Depend Significantly on Federal, State, and Local Government Practice*, GAO, 2010, 19. The report also suggested that "building nonprofits' capacity to manage" could help them better handle problems caused by slow government reimbursement and high grant administration costs. <http://www.gao.gov/new.items/d10477.pdf>

² John Summers and Lana Price, *Administrative Management Capacity in Out-of-School Time Organizations: An Exploratory Study*, Fiscal Management Associates and The Wallace Foundation, 2008. <http://www.wallacefoundation.org/KnowledgeCenter/KnowledgeTopics/CurrentAreasofFocus/Out-Of-School-Learning/Pages/administrative-management-capacity-in-out-of-school-time-organizations.aspx>

delivering contracted services, making it imperative for the nonprofit to get additional financing elsewhere. Doing so requires a thorough understanding of costs, however, something many nonprofits lack. Now, in an environment where resources are scarce, that gap in understanding can make it even harder to find the necessary funds. “[The] development [office] has difficulty telling a story about what they need if they can’t explain” what they plan to accomplish over the course of a year, what programs they need to meet the goals and what the programs cost in full, says Polanco. The study found a host of other thorny financial management problems specific to nonprofits. For example, there’s the issue of budgets built around the contracts the organizations receive as opposed to the programs and services the groups provide. As a result, it’s virtually impossible to evaluate the real costs of providing programs. What’s more, without an understanding of the relationship between specific expenses and organizational goals, nonprofits can’t make informed, productive financial decisions.

This was a lesson Celena Roldan learned the hard way. In 2010, not long after she became executive director of Erie Neighborhood House, which provides educational and other social services primarily to Latino families, she was faced with a \$1 million deficit and the task of reducing spending by 20 percent. Her initial response was to make across-the-board cuts, including reducing marketing staff. More recently, Roldan realized that such cutbacks were crippling the board’s goal of boosting the group’s social media presence and overall public awareness of Erie’s services. She now plans to fill the position in 2012.

In addition, many nonprofits also chronically operate on only a thin margin of cash, raising the stakes of sound money management. In fact, most organizations in the FMA study had less than the rule-of-thumb three months cash on hand for satisfying general operating expenses. Half of

*Arthur
Mollenhauer
and Johanna
Sigurdardottir
of Big Brothers
Big Sisters of
Metropolitan
Chicago*



the groups had less than one month on hand. Then there's the matter of staffing limitations – a short supply of professionals skilled in nonprofit finance and an abundance of program employees with little expertise in finance. Organizations also often don't spend nearly enough on administrative costs; the FMA study found that the groups it examined spent on average about 11 percent of total expenses on administration. That's less than half of what businesses typically pay for overhead.³

These problems can cripple nonprofits' ability to take the steps needed to grow. Many groups have the capacity to address such day-to-day operational activities as paying bills and processing payroll, according to FMA. Few have the time, available staff, and record-keeping and reporting systems to do high level strategic planning, which entails, among other things, assessing what resources are needed to support expansion and figuring out how they could be obtained.

In some cases, organizations are able to grow even with weaker-than-ideal financial management. However they, too, face continual roadblocks. Consider Instituto Del Progreso Latino, a 33-year-old nonprofit offering a host of workforce development, adult education and after-school programs, and a participant in the initiative. Despite explosive growth, with a budget that skyrocketed from \$1 million to \$8 million in 10 years, the group had neither a CPA on staff, nor a comprehensive budgeting system, nor a handle on cash flow, according to CEO Juan Salgado. Just one result was an inability to produce accurate financial reports for auditors on time. That meant slowing down important decisions, anything from hiring a new employee to determining the number of books to buy for students enrolled in the organization's various programs. "When you're way behind on your audit, you can't get on with the new year," Salgado says. "You're constantly behind."



Michael Loehrke, a Big Brother, with his "Little," Chris Garcia, and Chris' mother, Robyn Garcia

A FINANCIAL WORKOUT FOR 25 OF CHICAGO'S LEADING AFTER-SCHOOL PROGRAMS

The Wallace-supported FMA program aimed to address the problem by providing the nonprofits with financial know-how. First, Wallace, with help from people who are familiar with the after-school scene in Chicago, chose 25 local nonprofits functioning well enough to benefit from the work, i.e. groups considered to offer high-quality services and to be in sound financial shape. All the organizations offered after-school services, although, like Mujeres Latinas en Acción and Instituto Del Progreso Latino, some provided other programs as well.

Then, the nonprofits were divided into two groups. Organizations in the group Pesqueira belonged to had an initial one-on-one assessment with FMA specialists. Then their CEO's, along with their heads of finance, and perhaps development or programming directors, attended classes on such topics as appropriate staffing structure or budgeting. In the morning, participants took part in a class that was part discussion, part lecture; in the afternoon, members of each organization broke down into groups to work on exercises to reinforce the day's lessons.

³ Ann Goggins Gregory and Don Howard, "The Nonprofit Starvation Cycle," *Stanford Social Innovation Review*, Stanford University, Fall 2009, 50. http://www.ssireview.org/articles/entry/the_nonprofit_starvation_cycle/

Barbara Castellan
of Gads Hill



GADS HILL CENTER ADOPTS A NEW APPROACH TO BUDGETING

One budgeting and planning transformation that occurred as a result of the Strengthening Financial Management initiative took place at Gads Hill Center, a nonprofit providing after-school and other services to low-income families on Chicago's Lower West Side. Two years before CEO Barbara Castellan and CFO Ernesto De La Torre joined the project, the organization had built up a \$300,000 deficit after unsuccessfully trying to expand its after-school programs, which usually were held at the group's own facility or leased space, into Chicago public schools. Gads Hill had tapped out its line of credit and laid off much of the expanded staff, and was just getting back on its feet when the initiative started.

Over two years, using the lessons learned from the program, Castellan and De La Torre revamped their budgeting procedures from top to bottom. While previously the two had produced a budget with little input from anyone else, they turned the activity into a collaborative affair involving almost the entire supervisory staff. "This way, we know what our basic programming needs are and whether we have the revenue to make them happen," says De La Torre. "And we can make adjustments before we run into trouble."

*"We budget conservatively
instead of hopefully."*

How does it work? First, the eight-person leadership team, as well as 10 program coordinators, all received training from a member of the board's finance committee, with assistance from Fiscal Management Associates, the consulting group running the financial management initiative for The Wallace Foundation. After that, they introduced a new process through which program managers create their

own budgets, which are then reviewed by their supervisors and sent to De La Torre, who puts them all together into one plan. The final budget is then presented to the leadership team, which either works on changes or sends it to the board for approval.

There's also a monthly leadership meeting where De La Torre presents a financial report detailing a breakdown of costs by program and for the organization as a whole. Included is a summary of both program and financial measurements. Based on that review, the team can make necessary adjustments and avoid running low on cash. For example, after the team noticed large overtime costs in some departments, procedures for approving overtime were revamped.

As important, says Castellan, "we budget conservatively instead of hopefully." Government contracts, which account for 70 percent of the group's funding, generally are based on fee for service per enrollee. In the old days, Gads Hill budgeted for maximum enrollment, even though programs rarely reached that level, for reasons including increased worry among immigrants about participation in publicly funded programs. Now, Castellan and her team budget based on historical enrollment patterns.

In addition, previously, according to Castellan, the leadership team would approve new projects if they fit the organization's mission, but without seriously considering financial issues that might get in the way. Under the new system, they make decisions with considerably more care – and, in fact, have rejected programs that they might have once approved. For example, the group recently came close to working on a project with a partner organization expanding a Head Start program. But after analyzing the details, Castellan and her colleagues realized it would incur much higher costs than would be covered by the funding contract. Outcome? Project nixed.

Improved financial management has enabled Big Brothers Big Sisters of Metropolitan Chicago to “hire better quality staff, raise compensation to the top third of the market, invest in managerial positions” and take other steps.

The second group, which Roldan and Salgado participated in, also started with an assessment by FMA specialists, who produced a work plan for each nonprofit recommending activities necessary for that organization to get its financial house in order, with milestones and timelines for completing each task. The first step usually was to put in more efficient accounting systems. Then, the organization’s CEO and CFO checked in periodically with FMA staff while they tackled each phase in their plans.

To learn more – and swap insights they wouldn’t otherwise have been able to share – members of the group were asked to attend quarterly meetings at FMA’s office on La Salle Street in downtown Chicago. On an April morning in 2011, 14 members of the group met to discuss, among other things, an analysis of how the group had fared according to a few key financial metrics. One executive director talked about his group’s struggle to rebuild its reserves. Maria Wynne, CEO of Girl Scouts of Chicago, reported an uptick in cookie sales, partly thanks to improved volunteer training and new membership recruitment. And Erie House’s Roldan discussed the need to educate the board about the seasonal nature of the organization’s revenues.



Maria Pesqueira of Mujeres Latinas

For Arthur Mollenhauer, CEO of Big Brothers Big Sisters of Metropolitan Chicago, the initiative's timing couldn't have been better. The organization began taking part when it was in the middle of an expansion that would merge four Chicago-area Big Brothers Big Sisters affiliates and increase

the group's budget and number of children served by 20 percent. Mollenhauer knew that for the merger to work the back office operations of the organizations had to be consolidated and that meant strengthening their financial systems. "We needed a strong core in order to grow," he says.

So, he volunteered to be a guinea pig, one of the first in the group to be assessed by FMA and receive a work plan. That 19-page document included recommendations under four categories: financial planning and monitoring, fiscal management staffing structure, internal controls and

efficiencies, and other considerations. Recommendations included upgrading to a more advanced accounting software program that would allow for more efficient allocation of expenses; adding a new junior accountant to give the director of finance more time to work on higher level analysis; providing the entire staff with financial literacy training; and streamlining and automating work flow, such tasks as bill payment and payroll.

Now, two years later, Mollenhauer and director of finance Johanna Sigurdardottir eagerly reel off the results of introducing these changes. It takes two and a half months to produce an annual audit compared to five months before; thanks to the introduction of new software, the time to produce monthly financial reports has been reduced by several hours each month, also decreasing the number of errors, for an annual savings of about \$2,700. Even with the addition of a part-time junior accountant in March 2011, finance team costs have declined from 3.9 percent to 3.2 percent of revenue, with annual savings of \$28,000. Moreover, the merger has been completed, with a smooth transition.

Perhaps the most significant change at Big Brothers Big Sisters of Metropolitan Chicago was in budgeting, previously done by the finance staff and the board once a year. It's now a continuous process in which, every three months, budgets for each of the organization's 46 programs are reviewed. One result: Program staff members clearly understand their expenses and cash flow, and they have the

*The Donors Forum convened
41 experts to recommend
changes in Illinois
reimbursement practices.*

PARTICIPANTS IN WALLACE'S STRENGTHENING FINANCIAL MANAGEMENT INITIATIVE

After School Matters	Gads Hill Center
Albany Park Community Center	Girl Scouts of Chicago
Alternatives, Inc.	Girls in the Game
Association House of Chicago	Howard Area Community Center
Better Boys Foundation	Instituto Del Progreso Latino
Big Brothers Big Sisters of Metropolitan Chicago	Logan Square Neighborhood Association
BUILD, Inc	Metropolitan Family Services
Carole Robertson Center for Learning	Mujeres Latinas en Acción
Casa Central Social Services Corporation	Neighborhood Boys & Girls Club
Center on Halsted	South Shore Drill Team
Chicago Youth Centers	Southwest Youth Services Collaborative
Chinese American Service League	Youth Guidance Centers
Erie Neighborhood House	

ability to make more informed decisions on their own. “They used to come to me all the time and ask whether they could, say, buy something or arrange for an outing,” says Sigurdardottir. “Now they can determine that without me.”

No one can say yet with certainty whether these developments are rippling through the organization to help it achieve the ultimate goal of its financial management improvement efforts: to better serve children. But Mollenhauer suspects just such a connection. He notes that since the group made the changes the organization has gone from the top 20 percent to the top 5 percent of Big Brother Big Sister agencies in the United States in program performance, meaning it is having greater success in things like the length of time a Big Brother or Sister stays with a “matched” child. Improved financial management, Mollenhauer says, has freed the organization to: “hire better quality staff and raise our compensation levels to the top third of the market, invest in managerial positions and properly train the managers and team, improve our metric and performance management to allow for better monitoring and decision making, and allow us to shift more future investments to fund development and program areas. And it also increased donor confidence.”



*Ernesto De La Torre
of Gads Hill Center*

MAKING GOVERNMENT REIMBURSEMENT LESS BURDENSOME

For many nonprofits providing social services, including after-school programs, government agencies provide an essential source of funding – 52 percent of financing, according to the Independent Sector, a coalition of charities, foundations and corporate giving programs based in Washington, D.C. But those agencies don’t make it easy. There’s no standard reporting format, so organizations often have to comply with and manage a crazy quilt of different time-consuming, labor-intensive reporting forms and requirements, sometimes for dozens of contracts, each with different deadlines. And each funding agency generally requires an annual audit involving rigorous documentation and months of preparation. Many philanthropies, with their own set of funding rules, increase the complications.

At the same time, government contracts typically allow reimbursement of administrative expenses and other indirect costs at a Scrooge-like rate of about 10 percent of total expenses, according to FMA. That’s a far cry

from the practices of the for-profit sector, where overhead rates range from 13 to 50 percent, according to one analysis.⁴ In fact, the funders’ parsimony in administrative-cost reimbursement is likely a major culprit in the nonprofit practice of under-spending on financial management.

*One of the six principles of contracting:
government should stick to agreed-on
repayment schedules.*

⁴ William Bedsworth, Ann Goggins Gregory and Don Howard, *Nonprofit Overhead Costs: Breaking the Vicious Cycle of Misleading Reporting, Unrealistic Expectations, and Pressure to Conform*, The Bridgespan Group, 2008, 10-11. <http://www.bridgespan.org/nonprofit-overhead-costs-2008.aspx?Resource=All>



*Maria Pesqueira of
Mujeres Latinas*

As important, payment is often delayed and, at its best, moves slowly. Consider the experience of Instituto Del Progreso Latino's Salgado. About five years ago, his fast-growing organization faced a cash crunch while it waited the usual 60 to 90 days to receive reimbursement from a state agency. To pay the bills, Salgado was forced to refinance the group's building.

To address these problems, Donors Forum, a Chicago-based organization representing foundations, nonprofits and others, with backing from Wallace, convened a group of 41 experts in 2009 to devise and recommend changes in reimbursement practices in Illinois, focusing on human services. Participants represented a wide range of government agencies, foundations, advocacy groups, for-profit companies, service providers and universities, ranging from the McCormick Foundation to the real estate company Jones Lang LaSalle. "We're working on a macro level," says Laurel O'Sullivan, vice president, public policy, at Donors Forum. "Our goal is to change policy." In 2010, the group published a series of six principles aimed at improving the system.⁵ Example: To ensure that nonprofit providers don't bear the financial risk of delays, government agencies should stick to agreed-upon timeframes for reimbursement and pay interest on late payments.

Since then, the Illinois state legislature has passed a measure with recommendations for how to streamline contracting practices and calling for the formation of a committee to implement those recommendations. And the Illinois Human Services Commission has agreed to come up with a plan for coordinating funding more efficiently among agencies. Donors Forum now is spearheading a new group of government agencies, foundations, academics and nonprofits to create an assessment tool for evaluating how effective those agencies are at reforming their contracting policies.

In the meantime, improved financial management can go a long way toward helping nonprofits deal with slow, inefficient reimbursement. Facing a cash crunch in 2010, the State of Illinois began to

⁵ *Fair and Accountable: Partnership Principles for a Sustainable Human Services System*, Donors Forum, 2010. http://www.donorsforum.org/s_donorsforum/bin.asp?CID=14836&DID=33993&DOC=FILE.PDF

drag its feet, according to Instituto's Salgado, taking 150 to 180 days to come through with reimbursements for operational expenses. To get by, Instituto did everything from delaying building improvements to rescheduling payments to vendors. As the group drew "dangerously close to not meeting our payroll," however, Salgado attempted something that might have seemed like tilting at windmills at another time. He approached Harris Bank for a line of credit.

With FMA's work plan in hand, he showed the bank his detailed blueprint for new budgeting, staffing and cash flow management systems. He was also able to tell the bank that the organization would be able to slash the amount of time it took to complete its annual financial audit from about 210 days after the end of the fiscal year to about 120 days. Thanks in part to the plan and new practices, Instituto was approved for a \$1 million credit line.

For her part, Pesqueira continues to deal with the effects of slow state reimbursements. On more than one occasion, she's had to call the appropriate government official to warn that her organization wouldn't be able to make payroll without payment. But, like Salgado, her nonprofit now has the kind of financial management muscle more typical of the for-profit sector – and, with it, a new ability to tackle the challenges it faces in making better after-school programs a reality for kids who really need them.

WALLACE'S WORK IN AFTER-SCHOOL PROGRAMMING

Typically in the world of after-school programming, the many varied youth programs and the government agencies and private organizations that fund them all operate in isolation from one another. In 2003, Wallace began working in Boston, Chicago, New York City, Providence and Washington, D.C., to help coordinate the after-school workings of these institutions, in the hope this would lead to systems supporting better programs and increased access to them citywide. In late 2010, a RAND Corporation report said the cities' efforts had provided "a proof of principle" that after-school systems hold promise.

Our after-school strategy is three-pronged:

- Inform city decision-makers nationwide about after-school systems and how to build them.
- Develop Web materials to help city leaders in system-building efforts.
- Help cities strengthen their after-school systems.

In a Chicago initiative, Wallace is trying to assist after-school providers and funders in dismantling a little-recognized barrier to offering more and better services – weak financial management. The initiative is being evaluated by the nonprofit research organization Public/Private Ventures, which expects to issue the first of several reports by early 2012. The study will be available at: www.wallacefoundation.org.

RELATED WALLACE PUBLICATIONS

Hours of Opportunity, RAND Corporation, 2010

A Place to Grow and Learn, The Wallace Foundation, 2008

The Cost of Quality Out-of-School-Time Programs, Public/Private Ventures, The Finance Project, 2009

Administrative Management Capacity in Out-of-School Time Organizations: An Exploratory Study, Fiscal Management Associates, The Wallace Foundation, 2008

Strengthening Out-of-School Time Organizations: Three Views, The Wallace Foundation, 2008

In Boosting After-School, Money Management Matters, The Wallace Foundation, 2010

At www.wallacefoundation.org, users can find a free online cost calculator to help figure out the costs of a variety of high-quality out-of-school time programs.



Based in New York City, The Wallace Foundation is a national philanthropy that seeks to improve education and enrichment for disadvantaged children. The foundation has an unusual approach: funding projects to test innovative ideas for solving important public problems, conducting research to find out what works and what doesn't and to fill key knowledge gaps – and then communicating the results to help others.

Wallace has five major initiatives under way:

- School leadership: Strengthening education leadership to improve student achievement.
- After-school: Helping selected cities make good out-of-school time programs available to many more children.
- Audience development for the arts: Making the arts a part of many more people's lives by working with arts organizations to broaden, deepen and diversify audiences.
- Arts education: Expanding arts learning opportunities for children and teens.
- Summer and expanded learning time: Giving children more hours to devote to learning.

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