

Cases in **Nonprofit** **MANAGEMENT**

A Hands-On Approach to Problem Solving

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10

Financial Management

INTRODUCTION

It seems fairly obvious to say that leaders entrusted with the fiscal oversight and leadership of a nonprofit organization should have a basic understanding of nonprofit finance. Equally understandable is the fact that unmanaged or unstable finances are a threat to the success of any organization. What is less obvious to some is the extent to which it is imperative to integrate financial strategy with organizational mission and desired outcomes. Any manager would be happy to say, “We have enough money to pay our bills today.” However, we would suggest that it is equally, if not more, important for those tasked with setting the strategic direction of the organization to also ask, “Are all the resources of the organization being deployed in a way that helps us to achieve our strategic objectives?” While the first statement demonstrates the basics of good accounting, the second question reflects a more holistic financial leadership approach needed to successfully operate and govern a nonprofit.

Transparency, especially financial transparency, is an important organizational practice for nonprofits. Many think that being transparent simply means making information available to the public. However, nonprofit finance expert Bob Beatty suggests that true transparency is more than a paper blizzard of information. To be transparent, Beatty suggests, requires a sophisticated understanding of goals, success drivers, and progress in an organization and an ability to clearly communicate about the substance of each. To achieve transparency under this definition requires nonprofit leaders to commit to a deeper understanding of the organization's program, fund-raising, and administrative activities (Beatty & Deitrick, 2014). Although financial management is unquestionably important, finance often intimidates even the most savvy nonprofit executives and board members. In an attempt to make financial management accessible to lay people, financial ratios are often used to define financial success or efficiency in a nonprofit.

The following are some common financial ratios used in nonprofit finance:

- Profitability—Does revenue exceed expense?
- Liquidity—How is our cash position compared to organizational need?
- Long-term solvency—What are our net assets?

In addition to ratios, staff and board members primarily use the following four reports to monitor the finances of a nonprofit:

- Statement of Financial Position (Balance Sheet)—Describes the capital structure of an organization
- Statement of Activity—Describes the operating structure
- Cash Flow—Describes sources and uses of cash
- Statement of Functional Expense—Details how expenses are allocated to one of three categories: (1) program, (2) fund-raising, and (3) management.

While ratios and financial statements are helpful to understanding aspects of an organization's financial standing and future outlook, they are by definition backward-looking, and, considered on their own or without context, do not provide a comprehensive financial picture of the organization.

Good governance practices, budgeting, and thorough financial policies all contribute to sound financial leadership at a nonprofit. When reporting and communicating about financial matters it is helpful to consider the following questions:

- Who needs what kinds of information and when? For example, board members will require different types of financial data than will be needed by a program manager.
- What kinds of financial controls need to be in place to ensure accountability?
- Who is responsible for creating and implementing budgets? What stakeholders need to be involved in the budgeting process? What criteria should be considered in the developing of a budget?

This chapter explores the financial leadership issues such as the following:

1. Budgeting
2. Misallocation of grant money
3. Transparency

REFERENCES

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CASE 10.1

DECISION MAKING: THE SPOILS OF A BUDGET SURPLUS

Amy Jefferson was enormously relieved. After a long meeting with Tim Schultz, her new finance and operations director, she knew for certain that Jersey County Protects (JCP) would have a budget surplus for the first time in 5 years. “Yep, we’re going to be \$207,000 in the black going into the new fiscal year” said Tim. “The county contract is back up to full funding, the United Way increased its support by \$35,000, the Society of Angels raised its gift to \$5,500, and the Jersey County Community Foundation increased its grant by \$65,000 and also identified a new donor for us. Profits from our thrift store are pretty much what they were the year before even though they are nowhere near what they were 5 years ago. Still, we can use that money, money from the new donor, and money from our annual dinner to create a nice little cushion for our \$1.1 million annual operating budget.”

Amy was surprised to feel tears welling up in her eyes. It was the first time in years that she felt assured the agency could meet its mission of protecting victims of domestic violence in their rural county without the having to do it with another round of layoffs. In the 15 years she had served as executive director of JCP, one third of it had been spent struggling to balance the budget without drastically reducing services to people who were in desperate need of help. Sure there had been a series of staff and program cuts over the years, but JCP had gotten through the worst of it, just like the people they served.

During the first few years of the bad economy, when the county, United Way, and the community foundation all reduced their support for the agency, Amy, along with the previous finance director, Camila Torres, made the difficult decision to recommend that the board vote to fully fund their operations using the agency’s reserves. They made that recommendation without hesitation, knowing that people’s lives depended on JCP. Amy will never forget the meeting when Camila presented those bleak financial statements to the board and together they made an impassioned plea for a vote to use the reserves to fund programs. As John Hughes, a local minister and longtime board member, said at the time, “This is a rainy-day fund, and by God it’s pouring out there. Domestic violence has

already gotten worse in this bad economy, and we have a moral obligation to do everything in our power to help those folks who need us.” The board voted swiftly and unanimously to spend down JCP’s safety net. There was enough money to make up for 2 years of cuts, after which time the board and staff were confident the economy would begin to recover.

Two years later, the reserves were gone, and JCP was faced with more difficult decisions as the county announced further cuts to social service programs. The community foundation, itself reeling from the financial crisis, told Amy that it, too, would have to reduce its annual grant to JCP by \$75,000.

Amy volunteered to take a 15% pay cut. Camila reduced her hours. She eventually left the agency for a better-paying job but joined the board as a way of expressing her commitment to the work of JCP. Silvia Ruiz, the director of programs and herself a former victim of domestic violence, told Amy that as it was she was barely making ends meet raising two kids as a single mother and couldn’t afford to take a pay cut. There was no choice left other than to reduce and eliminate programs.

The first programs to go were the anger management therapy groups JCP ran at the local high school and community college, along with a similar but separate program offered at the county jail. Deputy Sheriff Michael O’Rourke, a board member of JCP, said, “It’s a darn shame. I know for sure those therapy groups have had a tremendous impact on those guys who were an incident away from exploding in anger. Being able to talk about it and to learn how to handle their issues has made a big difference in our community—you can just see it in the statistics on violent crime in Jersey County.” O’Rourke appealed to the Rotary Club to fund the program, but it was unable to help. The board reluctantly agreed to eliminate the program and to lay off Marne Brooks, the social worker responsible for directing it. Marne also had case worker responsibilities at JCP, which had to be filled by other staff.

Also on the chopping block were the paid staff members for JCP’s thrift store. Even though the store produced a steady source of revenue for JCP, the board felt strongly that it could be staffed by volunteers. Reverend Hughes convinced the group that several women from the Society of Angels would be willing to step in to run it. Although Amy had serious doubts that the Society of Angels, mostly elderly church volunteers,

would have the expertise to run an effective retail operation (and one that was an important revenue generator for JCP), she was outvoted by the board. As a result, Jody Smith, the thrift store director, was laid off.

As the situation worsened, more social service staff had to be eliminated. Two full time social workers were laid off in the fourth year of the cuts. The remaining four case managers worked 60-hour weeks in heroic efforts to meet the steady demand for services.

Finally, the day they had all been hoping for had arrived. Their revenue stream, which was based on firm numbers, was showing a \$207,000 increase over the previous year. The question before the JCP staff and board was, what to do with the money?

Silvia approached Amy with an impassioned plea for a pay raise for herself and the four case managers. No one had gotten a raise in 5 years, and everyone was feeling the pinch. Silvia felt strongly, too, that she and the others should be rewarded for their extra effort during these past 3 years. She also told Amy that reinstating the two eliminated staff positions would go a long way toward helping alleviate burnout among the staff and to JCP being able to more effectively serve its client population. Silvia argued that even though JCP had been able to serve the same number of women and children each year for the past 5 years, the quality of the services provided to those families had decreased due to a lack of staff. For instance, there was no longer a special counseling group for the children, which Silvia felt was critically important for helping the kids address the trauma they were facing and, in particular, to make sure the boys were broken of the cycle of violence to women.

Tim felt strongly that a new rainy-day fund should be established. As a longtime nonprofit financial manager who worked for several organizations, he believed that responsible organizations should have 6 months of operating reserves in the bank. He argued that \$207,000 wasn't even equal to 2 months of reserves and that the entire amount should be placed in a high-yield investment account.

Camila had other ideas. She approached Amy to talk about the need to restore the position of a paid manager of the JCP thrift store. She argued that revenue from the thrift store had been in steady decline since Jody had been laid off as store manager. In fact, the store was looking a little

shabby and disorganized these days and had, on average, made \$60,000 less each year since Jody was gone. She knew the members of the Society of Angels were dedicated volunteers and appreciated their efforts but felt that a professional could increase the revenue with internet marketing and other merchandizing strategies. She also thought that Silvia and the case managers needed a small raise to boost their morale.

Sheriff O'Rourke met with Amy to talk about restoring the anger management therapy programs. He argued that the impact of not having those programs was evident in the increase in domestic violence in Jersey County. Since the programs had ended, the rate of domestic violence had soared 22%.

Amy's head was spinning as she considered what to do with the money. What seemed to be something wonderful was actually a huge dilemma. All of the suggestions were different, yet each person had valid reasons for why they thought the funds should be allocated in a certain way. All of the ideas presented had merit, but the fact was there was not enough money to meet all of the requests.

Case Questions

1. Silvia, Tim, Camila, and Sheriff O'Rourke all made proposal to Amy for how to allocate the surplus funds. In what ways do these various proposals advance the mission of the organization? What decision-making criteria would you use to prioritize the proposals?
2. Which proposals are most likely to have the greatest impact on clients?
3. What are the advantages to each proposal? What are the disadvantages each proposal?
4. What impact is each proposal likely to have on the effort contributed by the board and staff?
5. What solution or set of solutions will generate the most support from the board, staff, and community?
6. Where does the ultimate decision-making authority for allocating this funding rest?

CASE 10.2

MISALLOCATION OF GRANT MONEY: WHEN THE FIGURES DO NOT COMPUTE

Darren Herrod was proud to have landed at job at Technology for You (TfY), a nonprofit founded in 2005 for the purpose of making technology available and accessible to underserved populations by providing equipment, training, and support. This was his first job out of college, and he was excited to work for a nonprofit doing exactly what he loved most: teaching people how to use technology to improve their lives. Darren had interned at TfY during his final spring semester of college in the hope that a permanent position would open up by the time he graduated. The job perfectly combined his college major and minor: computer science and education.

TfY offered three core programs. The first was its *Trash to Treasure* program that accepted old computers that they refurbished and sold at cost to other nonprofit organizations and low-income people. That program included free technical support and low-cost computer repair services to any person or organization purchasing equipment from TfY. This program was largely self-supporting through the fees collected from those who purchased the equipment. The free technical support arm for anyone who purchased equipment was managed largely by volunteers that worked the hotline. *Trash to Treasure* was the first program started by TfY back when the organization was run entirely by volunteers.

Senior Tech, TfY's second core program, provided people 60 and older with free technical assistance on what to look for when purchasing a computer or cell phone as well as workshops on how to use that technology effectively. Workshops included topics such as understanding your keyboard, Web browsing, social media, Internet security, sending e-mail and photos, text messaging, and so on. This program was funded by the County Senior Service Grants Program and was the earliest staffed effort launched by TfY.

The third program was *Career-IT!*, an information technology (IT) training, certification, and job placement program that served military veterans, as well as unemployed and underemployed individuals, in the

general population. Those two efforts were respectively funded by the U.S. Department of Veteran Affairs (VA) and by the U.S. Department of Labor (DOL). TfY had been operating those programs for 7 and 5 years, respectively, and had an excellent track record with both programs, placing 80% to 85% of all students in good-quality entry-level jobs as help desk technicians or IT support technicians. These programs had signaled important growth in TfY's revenue and operations, requiring the organization to move to a larger space to accommodate a steady stream of students. Darren was hired as a full-time lead instructor for these programs, replacing a staff member who left to work in the private sector.

During his internship, Darren had honed his skills as a teacher and had been trained on the record-keeping requirements pertaining to each of the enrolled trainees so that TfY could accurately report its results to the VA and DOL. Each agency had a separate contract and reporting requirements even though TfY classes contained a mix of both types of students. Darren loved seeing his pupils transformed from the first week of class to the last. They went from knowing next to nothing about computers and feeling insecure about whether or not they could master all they needed to know when they entered the program, to graduating with certifications in CompTIA A+, Network+, and Security. Students' body language often went from shy or hunched at the beginning of the program to confident and smiling as they graduated with their certifications. The program was truly transformational.

To accommodate the steady stream of students, Darren delivered the program alongside longtime TfY senior instructor, Tao Wong (who referred to himself as Ted). Ted was a Gulf War veteran who felt passionately about serving his fellow vets. Darren had enormous respect for Ted as a teacher and as a human being. He felt that Ted's teaching style was direct yet kind. He prodded when he needed to, provided encouragement at just the right moments, and engendered a sense of trust and caring among all of the students. Ted was one of the reasons why Darren was so excited to be working at TfY; he saw Ted as a gifted teacher who would be an excellent mentor and supervisor.

Eleven months into his job, Ted told Darren that TfY had landed a new grant that would allow the organization to train disabled adults for entry-level computer tech jobs. The grant was funded through a generous

grant from the Nancy M. Smithfield Foundation, a family foundation that was dedicated to improving the lives of people with physical and intellectual disabilities. TfY would promote the program in collaboration with the County Office of Persons with Disabilities whose office would also be a conduit for student referrals. Darren was excited about this new challenge and proud that TfY had chosen to expand its work with this population. The program would be called *Abil-IT*.

Six weeks later, the first clients began enrolling in the *Abil-IT* program. The program was designed such that these students, regardless of their disability type, would be incorporated into TfY's *Career-IT* program. Although the new students were interviewed and screened for aptitude, Darren had concerns (that he kept to himself) about how that model would work, whether it would be effective, and whether he personally had the skills to teach all of these different types of students in a single setting. However, he was open-minded about trying it out as he had deep personal beliefs about helping disadvantaged people live independent and productive lives.

During the first week of the new class session, Darren's worst fears were confirmed. He felt unprepared to assist students with such a wide array of disabilities (some physical, others intellectual), requiring specialized attention that he was unaccustomed to handling. Darren was further discouraged that he could not dedicate the time and care he was accustomed to providing to the *Career-IT* students as he had done with past classes. He was surprised, too, at how large the class had become. Previously, he had taught 15 to 20 students per session; now he and Ted were being asked to instruct 30 students, including those in the *Abil-IT* program. Although he had minored in education in college, nothing had prepared him for the challenges of working with these special populations. In addition, he found that each student disability required individualized instruction that made the TfY model of cohort-based instruction ineffective.

Several times during the first 2 weeks of class, Larry Bowling, TfY's executive director, stopped by to observe. He made a point of telling Darren that he was doing a great job teaching these blended classes. "I know it's not easy, Darren, but you're making it look like it is. You do such an amazing job connecting with the students." Darren was flattered by the attention; however, he was puzzled by the compliment. He didn't feel as

if he had command of the classroom and was concerned about meeting the benchmarks laid out in the VA and DOL contracts, let alone those that were part of this new grant.

By the fourth week of the new session, it was apparent to Darren that this new program wasn't working as planned. His traditional student population wasn't progressing nearly as quickly as they should through the curriculum (most were still trying to master the lessons they would usually have learned in week 2), and the *Abil-IT* students were even further behind the *Career-IT!* students. This was happening despite the fact that Darren found himself working much longer hours to provide more individual help to students. His girlfriend complained that he was more in love with his work than he was with her because she barely saw him before 9 p.m. on weeknights. He felt like a failure as a teacher, although he wasn't sure that it was entirely his fault. Shyly, he approached Ted to discuss the situation.

"I know it's tough," said Ted, "and maybe you and I can make a few tweaks to the schedule to separate out some of the more promising students from the rest of the group so that we can at least help a few of them. After all, we have to keep our numbers up for the VA and DOL contracts no matter what, and to be completely honest, we have crossed the line in double-counting heads on more than one occasion, checking boxes for both programs when a longtime unemployed vet is hired, for example. But here's the deal: the rent for the office went up this year at the same time that the county grant went down. On top of that, TfY has been losing money on the *Trash for Treasure* program for the past couple of years because we don't have enough volunteers to help refurbish the equipment or answer the technical assistance hotline so we have to pay people to do that. That's hurt us, especially since that's what we're known for out in the community. When we were a new organization, everyone wanted to be part of us. Now that we've been around awhile, volunteers are scarce, and the county has moved on to funding other things. Larry told me that this grant money is making the difference between being able to support our operations and having us go out of business."

Darren nodded in response to Ted. He knew that nonprofit work was hard, but he never imagined something like this would happen.

Case Questions

1. If what Ted says is correct, is TfY's use of the Smithfield funds illegal, unethical, or both?
2. What are the consequences, legal and ethical, of comingling government money with private foundation funds?
3. What are the legal and ethical consequences of double-counting clients for separate government contracts?
4. What recourse does Darren have? What should be his response or next steps?
5. What could Larry have done, if anything, to avoid this situation?
6. Do you think situations like this are common in nonprofit organizations?
7. What practices and strategies can nonprofits use to avoid this type of situation?

CASE 10.3

TRANSPARENCY: THE RISK OF SILENCE

The Historical Society of Evansville was abuzz with excitement. They had just learned that their town had been selected to host a film festival and commemoration ceremony celebrating the history of silent films. This made perfect sense since several of the first silent films ever produced were filmed in and around Evansville. Additionally, the city's historic main street and train station made a perfect backdrop for the event since they had each retained much of their original character from the times the films were made.

The Historical Society was led by a part-time executive director, Charlotte Simms, a native of Evansville. When she received word of the selection, Charlotte called together a meeting of the board and its key volunteers. "This is very exciting for us," Charlotte told the assembled group. "It's a huge opportunity for Evansville. I'm tickled!"

"What will this mean for us?" asked Jack Su, a newer member of the board. "What kinds of resources are we going to have to commit to the effort?"

"Well, as I understand it, the event production group, called What's Up Productions, manages all of the festival activities," Charlotte answered. "They ask that we help them get the city permits needed, host the opening night party, and provide volunteers over the 3 days of the festival. When they do these things, they usually look for a local nonprofit to partner with so we can collect any tax deductible donations associated with the event. Or we can even look for grants."

According to the letter from the event company, it was expected that the festival could draw close to 15,000 people to town for the weekend, including some current movie stars and film producers. The idea of celebrities coming to Evansville heightened the excitement of many in the room.

"An event like this can really boost tourism, which all the shopkeepers on Main Street can tell you has been dropping off these past 2 years," Jack noted.

"You may recall, when they came here for the site visit they talked a lot about the economic impact of the event in terms of generating local tax revenue," Charlotte reminded the group.

"All the more reason for us to promote the heck out of this," interjected Jenna Rogers, board chair for the society and a professional event planner by trade. "I think there are several things we could do to add to the celebration," she said. "Just think, we could have a very elegant party right in the middle of Main Street. We could bring in spotlights, really decorate around the old-time Hollywood theme," she said. Before long, Jenna had the majority of the group enthusiastically throwing out ideas for ways they could promote Evansville, and the ideas kept coming. "We could host a director's guild cocktail party and maybe even a red carpet type of awards ceremony," someone chimed in.

"This seems like it could require us to lay out a lot of cash," Jack pointed out.

"Oh, don't be a party pooper Jack," Jenna chided. "We'll use a lot of my company connections and we'll make it great. We may have to think of this more like a friend raiser than an actual fund-raiser, but it's going to be so important for Evansville. I'm going to hit up the city council for some support," Jenna said.

"Let's make sure we at least break even," Jack asserted.

True to her word, the very next day Jenna made her way into the office of a local realtor named Carl Peters. Peters was one of five local council people elected to govern the city of Evansville. He and Jenna had attended the same high school and had been family friends for years. Peters loved the ideas Jenna was throwing out. "Do you think we could get some city funding to underwrite some of this?" she asked him.

"I don't think that will be a problem. We have funds set aside to use to support nonprofits. Usually you have to make a grant request, but in this case, I think I can make the request on your behalf. Then it will have to be approved by the entire council. We could get it done in the next few weeks."

"Perfect!" Jenna replied.

At the next meeting of the city council, the councilmembers, at Peter's behest, voted unanimously to make two grants for \$25,000 each to the Historical Society. The first grant was funded through the special fund mentioned by Peters, and the second was made from the city's general fund. As they left the meeting, Peters leaned over and whispered to Jenna, "Go forth and plan a big party. Make us proud."

When all was said and done, the festival was deemed by most to be a big success. "I admit I went a little over the top, but it was everything we could have hoped for," Jenna said in the debrief meeting following the event, "glittery, opulent, and fun!"

However, the next week, enthusiasm for the event was dampened when a letter to the editor of the local paper was published calling into question the Historical Society's use of public funds for the purpose of, as the writer put it, "throwing a party, when there are people with more important needs going unserved in our community." The issue resonated with others, and more letters to the editor followed. Soon a local blogger took up the issue demanding that the Historical Society provide a full public accounting for every penny spent. Council member Peters received the following note:

Dear Mr. Peters and members of the City Council:

Since both of you saw it fitting and necessary to give \$50,000 in taxpayer money to throw a party, I am formally requesting a line item statement of all expenditures that said money was used for, along with receipts, a statement of how much money is left over, and an explanation of what happens to it.

I assume that you had the foresight to request that such records be kept for auditing purposes. Taxpayers and citizens are entitled by law to know where every dime of their money goes. If such an accounting cannot be produced, then I would request a full audit of the Historical Society's books.

Thank you.

Jay Roberts

Mr. Peter's reply was posted on the blog:

Dear Mr. Roberts,

As you know, the Historical Society is an established and respected nonprofit doing good work in our community. I see no reason to ask for an accounting of these funds from such a trustworthy organization. Anyone who can't see the benefits of the film festival is shortsighted and isn't looking at the common good.

Mr. Roberts posted this response to his blog:

Councilmember Peters and the board of directors of the Historical Society of Evansville,

Ms. Jenna Rogers, president of the board of the Historical Society and a professional event planner, was easily granted \$50,000 from two city funds for entertainment purposes related to the Evansville Film Festival, which occurred this past week. In the wake of this event, it has proven quite difficult to find out what taxpayer money was used specifically for. How do we know that her company did not benefit financially from this transaction? It's about transparency, not whether we like or trust someone. Please provide a public accounting of these funds.

Jenna was hurt and incensed by the negative comments and ongoing public scrutiny. She asked Charlotte for a meeting.

"While I really think most people don't care, some persistent members of the public are demanding answers," Charlotte reported. "I suggest we open up the books and provide a full accounting of how you spent that city money, Jenna."

"I am not giving them the satisfaction of an answer," Jenna said. "By law, we only have to provide them with audited financial statements not line item expenditures. I don't need those jerks adding up every penny I spent on glitter and red carpet. They'll have a heyday with that information and make me look like a fool. They don't see the bigger picture of how this was good for the community. And, as for making

money personally? Ha! If anything, this event cost my company big in terms of all the favors I had to call in.”

“Put them off and hopefully this will just go away,” Jenna concluded. “And get that blogger Jay Roberts off my back!”

Case Questions

1. What kinds of information are nonprofits required to legally provide to the public when public funding is granted?
2. What kinds of information should nonprofits provide to the public (e.g., beyond what may be legally required)? Is following the letter of the law enough?
3. What level of transparency is or isn't required for large-scale events that impact an entire community?
4. How might a situation like this impact future giving to the Historical Society?
5. Was there a conflict of interest with having Jenna plan the event?
6. Special events such as galas, golf tournaments, and large races can be costly to put on. What are some ways that nonprofits can evaluate the effectiveness and efficiency of raising money through events?