Center for Nonprofit Strategy and Management

Baruch College School of Public Affairs

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Introduction

This report presents an analysis of the financial condition and fiscal management practices of nonprofit child welfare organizations in New York State. State governments are legally mandated to provide child protection and child welfare services. In New York, when the state determines that a child is experiencing or at risk of abuse or neglect, government workers will determine whether the child must be removed from the home, or if some other form of public intervention is required. Once that decision has been made, however, it is usually a private, nonprofit organization that delivers the indicated services. Indeed, child welfare nonprofits provide the considerable majority of New York's state-mandated child welfare services, including preventive services, foster care, residential placements and related forms of assistance. Through service contracts with child welfare nonprofits, state, county, and municipal governments provide substantial financial support for these nonprofit organizations: as documented later in this study, New York's average child welfare nonprofit receives 94 percent of its revenues from government.

The reality of this arrangement is that government and the nonprofit child welfare sector are mutually dependent. The child welfare nonprofits that are the subject of this study operate primarily with government funds. At the same time, without these nonprofit organizations, New York State would be unable to carry out its legal responsibility to support children whose needs mandate state protection. The capacity to do so simply does not exist within government.

The financial health of New York's child welfare nonprofits thus constitutes an important concern not only for the nonprofits themselves, but also for government and the general public. The issue takes on heightened importance within the recent context of child welfare policy changes and difficult fiscal conditions in the state. This study establishes a baseline understanding of the fiscal capacity of New York's child welfare nonprofits, with an eye towards informing future policies regarding critical issues such as: nonprofit governance related to fiscal health; financial support for organizational infrastructure; the relationship between fiscal health and quality of care; and related issues.

Goals of the Study

The Council of Family and Child Caring Agencies (COFCCA), New York's membership organization for child welfare nonprofits, commissioned this study of the financial health and governance practices of its member organizations. The study was conducted by the Baruch College Center for Nonprofit Strategy and Management (CNSM). The study had four primary goals:

1. To paint a picture of the breadth and depth of nonprofit child welfare organizations currently operating in New York State;
2. To provide an overview of the current funding environment of the nonprofit child welfare sector;

3. To help individual child welfare nonprofits understand their own financial health in relation to the overall health of the sector;
4. To document the state of fiscal and other governance practices among child welfare nonprofits.

Study Methodology

The study combined analysis of individual COFCCA members' public financial documents with a survey of members' governance and financial management practices.

1. Public financial documents: five years of data, 2006-2010
    a. Audited financial statements were collected either from the website of the New York State Attorney General, or directly from the COFCCA members;
    b. IRS Form 990s were also collected from the New York State Attorney General, privately held databases compiled from IRS filings (most notably, from the National Center for Charitable Statistics and GuideStar), or directly from the COFCCA members. In the case of organizations with multiple corporations with multiple 990s and audited financial statements, we combined the multiple public financial documents to analyze the nonprofit as a single consolidated entity.

2. Survey: 110-item survey developed in close collaboration with COFCCA
    a. Sampling frame: all COFCCA members that directly operate child welfare programs. N=82.[1]
    b. Response rate: 79 out of 82; 96%.
    c. Survey administration: In-person or telephone interviews with each organization's Chief Financial Officer or equivalent. Representatives of New York City organizations generally were interviewed in person, while representatives of upstate organizations were interviewed by telephone.
    d. Survey duration: Approximately 45 minutes. Actual interviews ranged from 35 to 75 minutes.
    e. Confidentiality of responses: All respondents to the survey were guaranteed, via a process of informed consent, that their responses would be kept confidential by the Baruch CNSM study team. Only de-identified aggregate data are made available to any audience, including the respondent's organization, any other COFCCA member organization, and COFCCA itself. The study was approved by the Baruch College Institutional Review Board.

[1] COFCCA has 89 member organizations. Sampling frame was reduced to 82 organizations, excluding three organizations that operate nationally, and four large multi-service organizations that operate very small child welfare programs. Only three organizations included in the sampling frame declined participation.

Summary of the Financial Condition of the Sector, 2006-2010

Figures 1, 2, and 3 show summary figures for the New York State nonprofit child welfare sector from 2006 to 2010. Each figure shows both the totals for all child welfare nonprofits, and a split for organizations serving New York City versus those serving the rest of New York State. Figure 1 shows that total revenues in the sector generally grew steadily from $2.3 billion to $2.9 billion over the five years, an increase of 26 percent (about twice as fast as general inflation). Revenues of organizations outside New York City grew more slowly than those of New York City organizations. Total expenses grew more quickly than revenues in the sector, from $2.3 billion in 2006 to nearly $3 billion in 2010, a 28 percent increase (Figure 2). The expenses of organizations outside the city generally exceeded and grew more quickly than their revenues (25 percent expenses growth versus 22 percent revenue growth over the 5 year period), while New York City organizations fared better, with expenses generally below revenues and growing at about the same rate (approximately 29 percent over the 5 year period).

It is important to note that while New York's child welfare nonprofits experienced revenue growth during the time period, these additional resources largely went towards increased expenses. This is at least partly due to the fact that publicly funded contracts do not allow nonprofit organizations to reserve portions of these contracts for future use (that is, as rainy day funds or operating reserves). In other words, one of the standard financial planning tools available to firms – setting aside current revenues for future use – is not available to child welfare nonprofits. The result is that the increased revenues generated by the organizations in our study during the 5-year period of observation were not accompanied by any appreciable growth in organizational reserves that might be used during future contractions in available resources.

Figure 1: Total Revenues, 2006-2010

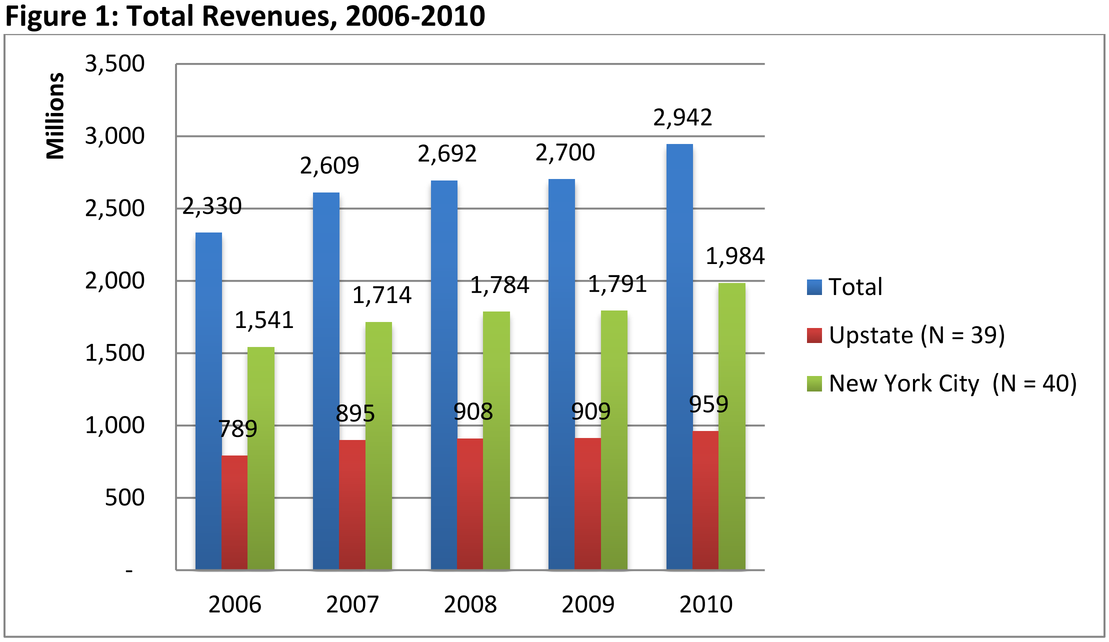
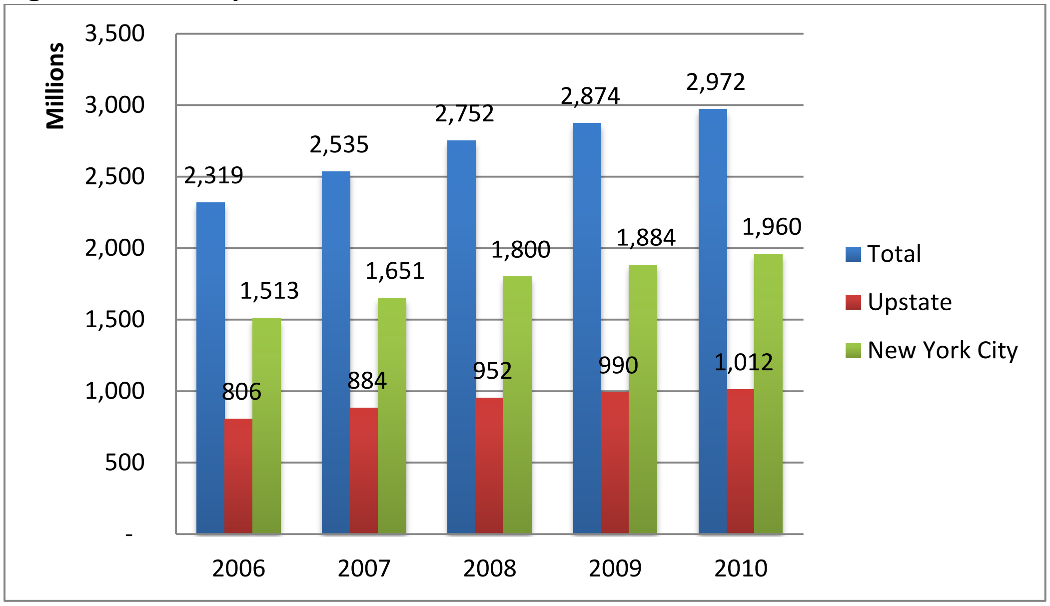


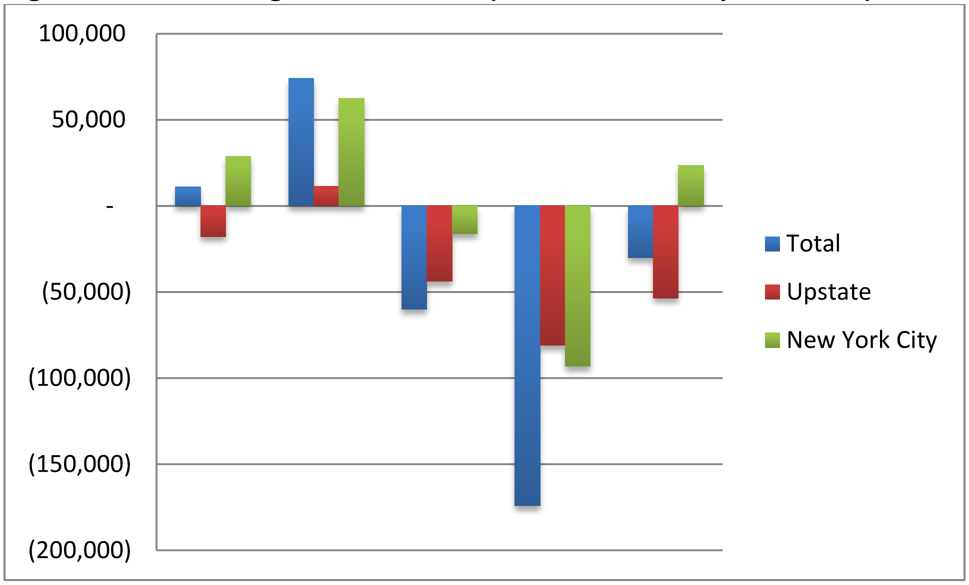
Figure 2: Total Expenditures, 2006-2010



As Figure 3 shows, the fiscal crisis that began in 2008 had a major impact on all child welfare nonprofits, producing deficits in 2008-2010 for the sector overall, with 2009 being the worst year. Prior to the financial crisis, however, organizations outside New York City were still operating at a deficit: in 2006 those organizations reported a total margin of minus-2 percent, and in 2007, they operated essentially at breakeven. In contrast, New York City organizations reported 2 percent and 4 percent average margins for 2006 and 2007, respectively. As a result, New York City organizations as a whole entered the fiscal crisis in a slightly better financial position than their counterparts outside the city. Figure 3 also suggests that the sector overall was not generating adequate surpluses even before the fiscal crisis, with total margins of 0 percent and 3 percent in 2006 and 2007, respectively. Since the fiscal crisis, as a group, New York's child welfare nonprofits have failed to break even, with total margins ranging from minus-6 percent in 2009 to minus-1 percent in 2010. We note that public funding for child welfare did not decline even in the presence of the significant fiscal contraction experienced nationally during this time period. However, the ongoing fiscal constraints facing governments at all levels makes it increasingly likely that child welfare nonprofits will face an uncertain future funding environment. In other words, past stability of public funding should not be taken as given in the future.[2]

[2] Some of the potential scenarios might include overall reductions in public child welfare funding; the renewal of contracts without cost of living adjustments; or new rules that make contract reimbursement more difficult for providers.

Figure 3: Total Change in Net Assets (Revenues less Expenditures)

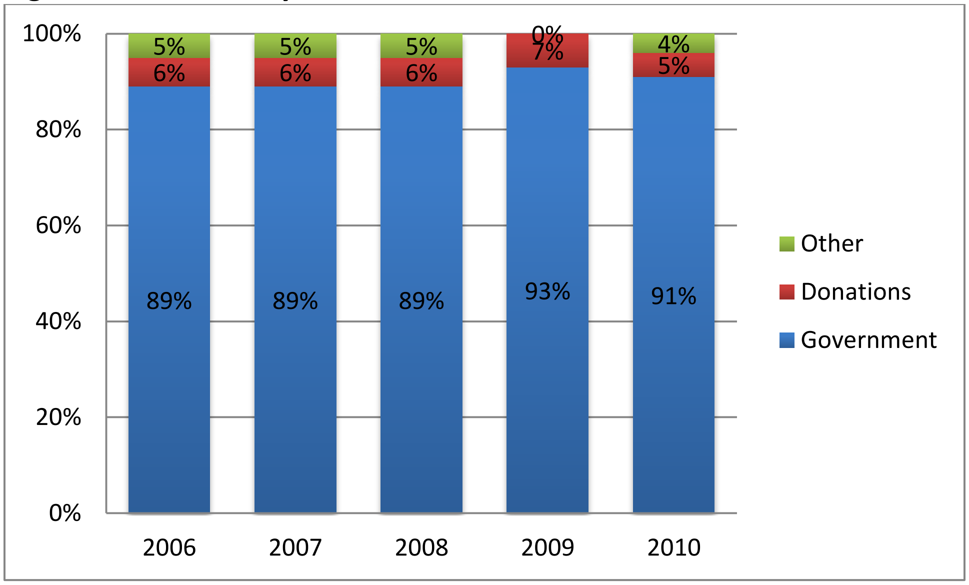


If we remove investment income from the calculations above and focus instead only on core operations, organizations outside New York City reported operating deficits for every year in our analysis: from minus-2 percent in 2008 to minus-3 percent in the other years (2006, 2007, 2009, and 2010). Similarly, New York City organizations do not report positive operating results when investment income is excluded, with operating losses ranging from minus-3 percent in 2007 to minus-1 percent in 2009 and 2010. Thus, if we exclude investment income – which only a handful of the study organizations have – the New York nonprofit child welfare sector failed to break even in any year during the 2006-2010 time period. We thus conclude that child welfare nonprofits were unable to support themselves – that is, revenues could not support the expenses of the organizations in total – without non-operational resources such as investment income.

Revenue Sources and Cost Centers

The vast majority of New York child welfare nonprofits' revenues come from government sources: between 2006 and 2010, on average, government funds constituted 89 percent of the sector's revenues (see Figure 4). 2009 was the most unusual year, when 93% of the sector's revenues came from government. Importantly, however, this upward tick was *not* the result of increased government funding; rather, government funds became a larger share of child welfare revenues due to a sharp dip in investment income in the wake of the fiscal crisis. Interestingly, private donations needed another year to start showing a decline: after four years at 6-7 percent of sector revenues, private donations fell to only 5 percent in 2010.

Figure 4: Revenues by Source



While the decline in investment returns was important for the sector overall, it affected some organizations much more than others. Indeed, a large segment of child welfare nonprofits were barely affected by declining investment income, because they have very little or no endowment funds. Figure 5 shows that 25 of the 79 organizations in the study (32%) had no endowment at all, while an additional 30 organizations had endowments of less than $5 million. In other words, nearly 70 percent of child welfare nonprofits have little hope of generating significant income from their own resource holdings.

Figure 5: Number of Organizations by Endowment Range

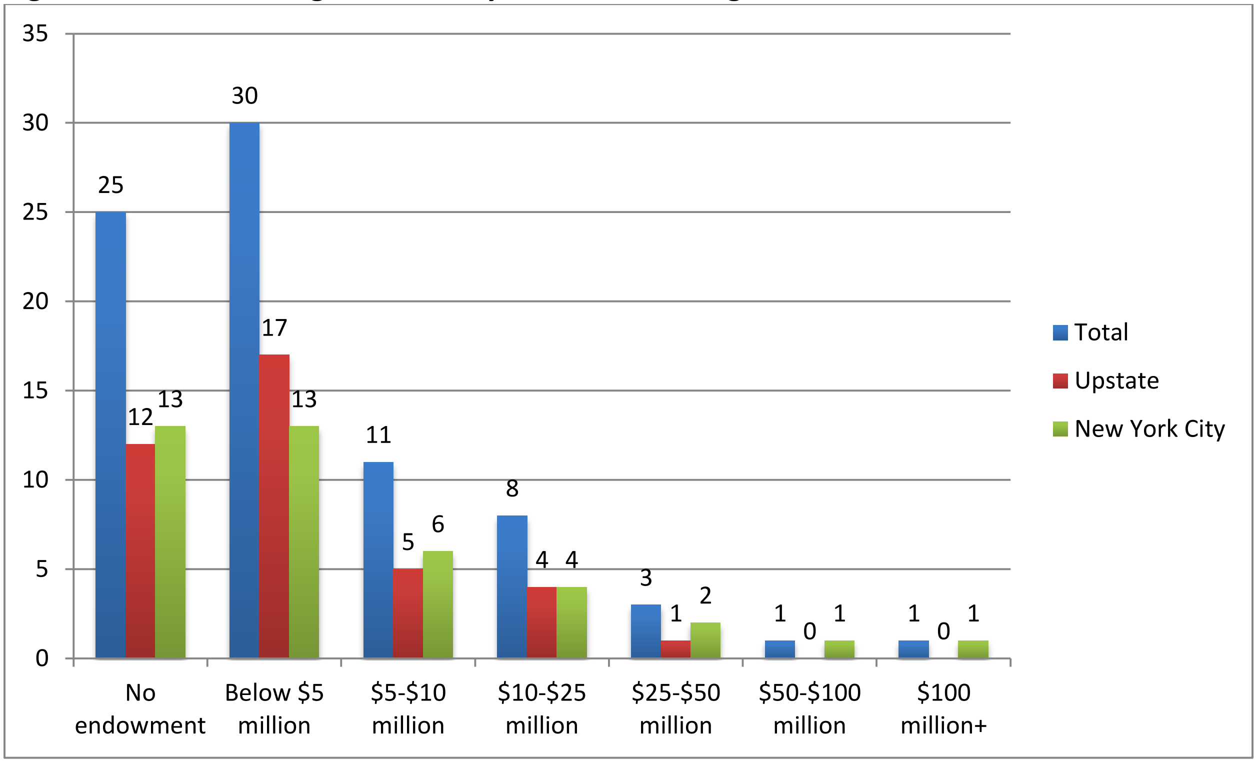


Figure 6: Number of Organizations by Endowment Divided by Annual Spending

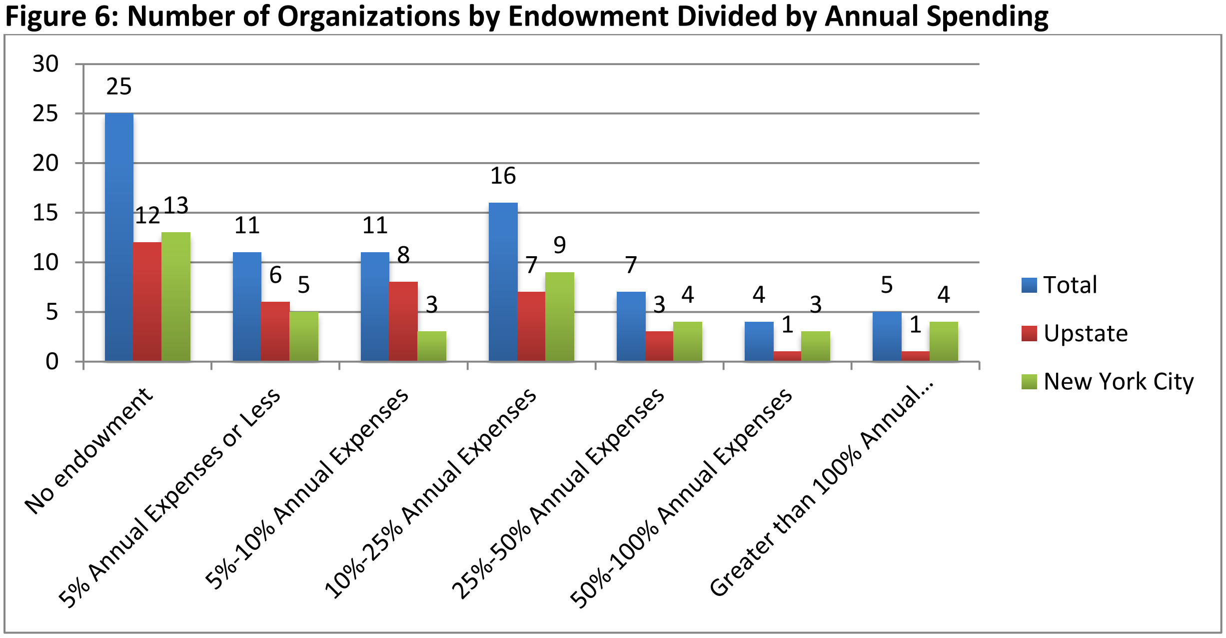


Figure 6 presents categories of endowment holdings in 2010 as percentages of child welfare nonprofits' annual spending. These categories show the endowment principal amounts relative to the amounts of total annual spending. Nearly one-half of the nonprofits have either no endowment or total endowment principal that can generate only about one day's worth of their annual spending: annual spendable endowment revenue should typically be limited to 5 or 6 percent of endowment principal. Only five organizations have endowments large enough to generate investment earnings that will finance as much as 18 days of operating costs.

Close to 90 percent of child welfare nonprofits' spending goes to program services. Only 12-13 percent is allocated to management, fundraising, and other administrative costs (see Figure 7). Organizations operating outside New York City consistently report slightly higher expenses on these latter items than do New York City organizations, but even organizations outside the city maintain about 87-88 percent of their expenses for programs. The higher administrative costs for the latter group of organizations may be the result of their higher levels of property ownership, which requires maintenance and management effort even when not fully utilized.

Figure 7: Management, General, and Development Expenses as Percent of Total Expenses

In any human service organization, the bulk of program-related costs go towards the personnel who deliver the organization's services. An important component of personnel costs is the cost of fringe benefits, such as health insurance and pensions. One of the major cost savings that New York governments reap from their current reliance on nonprofit child welfare providers is in the area of fringe benefits. While the average ratio of fringe benefits to salaries for New York State government workers is approximately 50 percent,[3] the average ratio of fringe to salaries among nonprofit child welfare organizations is 25 percent. All of the nonprofits in our sample

[3] New York State fringe rates were calculated using data obtained from the State's Comprehensive Annual Financial Reports (CAFRs) for the fiscal years 2006 – 2010. The data combine the "Pension" and "Other Fringe" and divide these total fringe expenditures by total Personnel Services expenditures.

have fringe benefit rates lower than those of New York State workers. Our study cannot address the non-fiscal implications of the significantly lower fringe benefit rates in the nonprofit sector – for example, the impact of lower fringe benefits on staff quality – but the difference is especially noteworthy given its large size.

Distribution of Program Services and Program Revenue Sources

Over the last thirty years, child welfare policy has emphasized keeping at-risk children with their families by offering preventive services that can protect children and avoid further incidents of neglect and abuse. In keeping with this approach, as shown in Table 1, over 80% of New York State's child welfare nonprofits offer preventive services, with even higher rates (90%) among New York City organizations. New York City organizations are more likely to offer family-based foster care (68%), while organizations outside the city continue their longstanding tradition of offering institutionally and other residentially based care to children who need this type of placement (90%). Medical services (including mental health services) have become an important part of child welfare practice, and are provided by three-quarters of the state's child welfare organizations.

Table 1: Percent of Organizations Providing Specific Child Welfare Services

	Total	*Outside NYC*	*New York City*
Preventive Services	81%	72%	90%
Medical Services	76%	82%	70%
Residential Care	71%	92%	50%
Family Foster Care	63%	59%	68%
Education Services	57%	62%	53%
Detention	24%	26%	23%

Actual spending on these different kinds of services follows a related pattern (see Table 2). New York City organizations spend most on family foster care and preventive services (34% and 31% of total child welfare program spending, respectively). Organizations outside the city concentrate about half their spending on residential care. Medical services are provided by most New York child welfare nonprofits to children in foster care, but spending on these services accounts for only about 10% of programmatic spending.

Table 2: Percent of Child Welfare Services Spending on:

	Total	*Outside NYC*	*New York City*
Residential Care	33%	51%	15%
Family Foster Care	22%	10%	34%
Preventive Services	22%	13%	31%
Education Services	10%	13%	6%
Medical Services	9%	8%	10%
Detention	2%	2%	1%

Some child welfare nonprofits have diversified into other areas of service. As Figure 8 shows, just under half of New York's child welfare nonprofits spend 75 percent or more of their budgets on child welfare services. Another 20 percent spend at least half their budgets on child welfare. Among child welfare nonprofits that offer programs in areas other than child welfare, Table 3 shows that the most common are services for the developmentally disabled (especially in New York City organizations) and mental health services for adults (especially in organizations outside the city).

Figure 8: Percent of Organizational Budgets Devoted to Child Welfare Spending

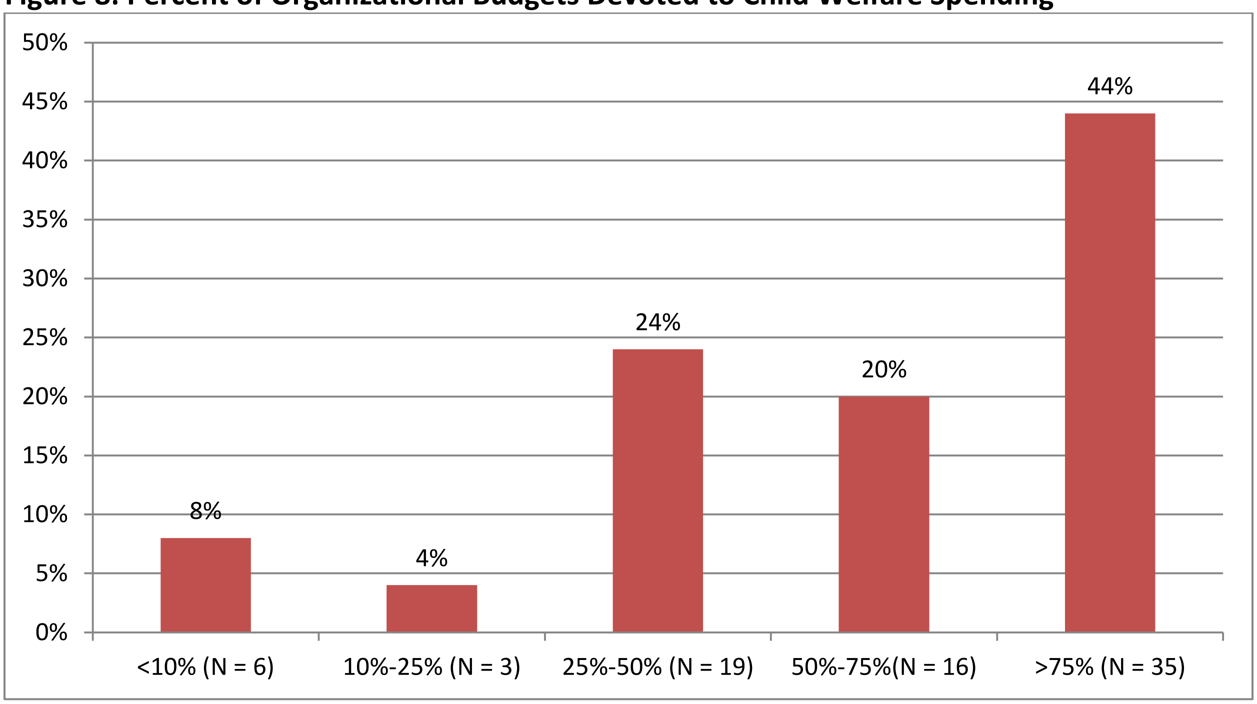


Table 3: Second-Largest Area of Service Expenditures, After Child Welfare Expenditures (Percent of Organizations in Each Category)

	Total	*Outside NYC*	*New York City*
Developmentally Disabled Services	16%	3%	30%
Mental Health, Other Than for Children	11%	18%	5%
Other Education Services	10%	10%	10%
After-School/Youth Development	5%	3%	8%
Day Care	3%	0%	5%
Housing	3%	5%	0%
Medical, Other Than for Children	3%	0%	5%

A large set of government agencies provides funding for the various services offered by child welfare nonprofits (see Table 4). All of the organizations in the study have contracts with one or more of the governmental child welfare agencies: the state's Office of Children and Family Services, county Departments of Social Services, or New York City's Administration for Children's Services. In addition, over 70 percent of the organizations have contracts or funding from state or city health agencies, and about half of the organizations have contracts with state, city, or county education departments. New York City organizations also tend to work closely with the city's youth development agency. Finally, close to half of New York City child welfare nonprofits have contracts with the state developmental disabilities agency, and are much more likely to contract with this agency than are organizations located outside the city.

Table 4: Percent of Organizations with Contracts from Specific Government Agencies

Funding Source	*Statewide*	*Outside NYC*	*New York City*
State Agencies			
OCFS	72%	74%	70%
DOH	71%	72%	70%
OMH	57%	56%	58%
NYSED	51%	59%	43%
OPWDD	38%	28%	48%
OASAS	20%	23%	18%
NYC Agencies			
ACS	59%	18%	100%
DYCD	38%	3%	73%
DOE	34%	18%	50%
DOHMH	32%	3%	60%
HRA	10%	0%	20%
DSBS	3%	0%	5%
County Agencies & School Districts			
DSS	68%	97%	40%
CSE	39%	56%	23%

Quantitative Indicators of Financial Health

One aspect of our analysis of the financial health of New York's child welfare nonprofits uses a set of quantitative indicators calculated from information drawn from the organizations' audited financial statements. Indicators include available short-term borrowing, receivables management, revenue diversity, active fundraising and development, and overhead vs. program spending. Some of these indicators have standard "rules of thumb" that suggest fiscal health, while others do not. In the latter case, we have indicated standards for financially healthy organizations that are largely based upon comparisons to the entire child welfare sector in our sample. It is a common practice in fiscal analysis to compare organizational performance to an entire industry, and we use this approach especially where no clear cutoff for fiscal health exists. Table 5 provides a summary of these indicators, showing what percentage of New York child welfare nonprofits meets the standard to be considered financially healthy in a particular area. We discuss the definitions and specific indicators below, and also present additional tables for the individual indicators.

Table 5: Quantitative Indicators of Organizational Financial Health

	Standard for a Financially Healthy Organization	Percent of Organizations Meeting Standard
Available Line of Credit	30-60 days	41
Average Collection Period, Accounts Receivable	60 days	56
Donations Ratio	Covers Management and General expenses	11
Overhead vs. Program Costs	>65%	100
Operating Margin:		
a) No deficit	Breakeven	52
b) Rate of inflation	2.25%	24
Cash Reserve Ratio	30-60 days	28
Current Ratio	2.0	53
Quick Ratio, excluding Receivables	1.0	21
Financial Debt Ratio:		
a) Average for sample	19%	57
b) More equity than debt	50%	90
Total Debt Ratio:		
a) Average for sample	55%	48
b) More equity than debt	50%	41

Available short-term borrowing. Organizations need to be prepared for times of cash shortfall by having short-term borrowing strategies in place. Among nonprofits, a line of credit is common for addressing such situations. Best practices indicate that a line of credit should be able to cover a minimum of one to two months of organizational expenses – about 8 to 16 percent of annual expenses. Only 41 percent of New York's child welfare nonprofits meet this standard, with organizations outside New York City slightly better positioned than New York City groups. About half of all the organizations actually used their line of credit in 2010, the most recent fiscal year for which we have data. These figures suggest that many organizations may be borrowing against insufficient lines of credit and/or drawing down their reserves.

Receivables management. A primary reason for organizational borrowing is a delay in the collection of funds that an organization is owed. Best practices suggest that accounts should be collected within 60 days of the invoice being sent to the client or customer. Just over half of New York's child welfare organizations meet this standard, with basically no difference between organizations inside or outside New York City. For all organizations, the average collection period is 64 days, above the 60-day standard. This suggests that a number of organizations could meet this best practice standard with (likely) minor improvements in receivables management.[4]

Donations Ratio and overhead costs. Private donations generally provide nonprofit organizations with more flexibility in spending than do revenues that come from other sources for specific purposes. By necessity, these flexible dollars often serve as a key strategy for nonprofits to finance costs beyond those covered in public contracts – such as program expansion, quality improvements, or capital investments. Respondents noted that unrestricted revenues – primarily from donations – were used in these ways. As shown in Table 6, 62 percent of New York's child welfare nonprofits use unrestricted donations for new program development, 86 percent for improving the quality of existing services, and more than half for capital expansion. Less than 40 percent indicated that unrestricted dollars were reinvested into investment portfolios, and nearly 90 percent used them to offset operating deficits in current programs. In other words, New York's child welfare nonprofits consistently devote some unrestricted resources to additional capacity or quality improvement in programmatic areas, while also needing private donations to supplement public contracts.

Table 6: Uses of Unrestricted Revenues

Develop New Program Services	62%
Improve Quality of Existing Services	86%
Capital Expansion	51%
Portfolio Reinvestment	38%
Offset Operating Deficits	86%

The Donations Ratio shows private contributions as a percentage of total organizational revenue. On average, private donations to New York's child welfare nonprofits make up about 6 percent of total revenues (see Table 7). The standard used here to assess organizational fiscal health is whether private contributions can cover overhead costs, which are frequently insufficiently funded through the public contracts that make up the vast majority of child welfare nonprofits' revenues. Table 7 shows that private donations account for about 12 percent of the budgets of child welfare nonprofits. Based on this standard, very few of the organizations can count on private donations that will match or exceed their overhead costs: only 11 percent obtain this level of private contributions, with slightly better results for New York City organizations than those outside the city. Thus, despite the fact that nearly all of the state's child welfare nonprofits meet the best practice standard for overhead costs as a percentage of the total organizational budget, private donations fall far short of meeting their needs in this area.

[4] Such improvements might include (but are not limited to) electronic submissions of invoices, increasing the frequency of invoicing, tracking receivables through an aging schedule, and using this aging schedule to target delinquent payers.

Table 7: Donations and Overhead

	Total	*Outside NYC*	*New York City*
Average Ratio of Donations to Operating Revenues	6%	4%	7%
Overhead Costs (M&G) as Percentage of Expenses	12%	12%	11%
Percent of Organizations with Donations at Least Equal to Overhead Costs	11%	4%	18%
Percent of Organizations Meeting Best Practice for Overhead Costs	100%	100%	100%

Operating margin. Basic organizational fiscal health demands that operational revenues and expenses be in balance. Occasional annual deficits are not uncommon, and are routinely made up in subsequent years; for this reason, it is particularly important to assess operating margins over multiple years, as we do. A conservative definition of best practice for operating margin is that expenses should not exceed revenues: organizations should "break even." As Table 8 shows, about half of New York's child welfare nonprofits do so, with New York City organizations slightly more likely to meet this standard. A more appropriate definition of best practice would require operating margins to at least cover the costs of inflation, thereby allowing organizations to maintain their purchasing power over time. Using the Consumer Price Index average rate of inflation of 2.25% for the years of our analysis, we find that less than one-third of New York's child welfare nonprofits had operating margins that allowed them to maintain their purchasing power between 2006 and 2010.[5]

Table 8: Operating Margin

	Total	*Outside NYC*	*New York City*
Percent of Organizations with Operating Margin of Zero ("break even")	56%	52%	60%
Percent of Organizations with Operating Margin Greater Than 2.25%	31%	30%	32%

Liquidity. Table 9 presents three measures of liquidity: measures that examine an organization's ability to meet its obligations in the coming year. The Cash Reserve Ratio measures the number of days an organization could finance its operations with the cash it currently has on hand. This ratio is calculated as the amount of cash and short-term savings an

[5] We exclude investment income from our definition of operational revenues. It is important to note that even if we included this type of revenue, the number of organizations meeting the break even standard would only increase from 52 percent to 60 percent, and the number meeting the inflation rate standard would only increase from 24 percent to 33 percent.

organization has at the end of the fiscal year divided by annual expenses; this number is then multiplied by 365 days.[6] The best practice standard is 1-2 months, or 8-16 percent of annual expenses. Only 28 percent of New York's child welfare nonprofits meet this standard. The average child welfare nonprofit could finance less than 25 days of its operations with cash on hand. When we removed the balances on lines of credit (which would increase the cash on hand of an organization), the results are even more telling. The average Cash Reserve Ratio drops to below 4 percent of annual expenses, or less than 14 days of operations (i.e., one payroll).

A second measure of liquidity, the Current Ratio, is designed to measure the availability of short-term assets to pay liabilities coming due. The best practice standard is that organizations should have two dollars of short-term assets on hand for each dollar of current liabilities. Only about one-half of New York's child welfare nonprofits meet this standard. One criticism of the Current Ratio is that it includes fewer liquid assets, such as inventory and receivables in the calculation. In fact, because of the prevalence of government contracts in the New York child welfare sector, the bulk of the receivables are related to money owed nonprofits from governments. Recently, several states (California and Illinois, as two examples) have slowed or stopped payments owed to child welfare providers. Therefore, we also were interested in looking at a modified liquidity standard that includes only cash and savings as current assets to pay current liabilities. Our calculations of this "Modified Quick Ratio" show clearly that the majority of New York child welfare nonprofits' current assets are comprised of money owed by governments. While the average Current Ratio is a healthy 2.65 for the 2006-2010 time period, the Modified Quick Ratio averages only 0.78 – meaning that child welfare nonprofits maintain, on average, approximately 78 cents of liquid assets for every dollar of current liabilities. This suggests that any hiccups in contract payments could have very immediate deleterious effects on the organizations' fiscal health.

[6] Our calculations also excluded depreciation (a noncash expense) in total expenses. The results were generally unaffected whether it was included or not.

Table 9: Liquidity Measures

	Total	*Outside NYC*	*New York City*
Percent of Organizations Meeting Cash Reserve Ratio Standard	28%	29%	26%
Average Cash Reserve Ratio (percent of annual expenses on hand)	7%	7%	7%
Percent of Organizations Meeting Current Ratio Standard	53%	59%	47%
Average Current Ratio (funds available per dollar in current liabilities)	2.65	2.67	2.63
Percent of Organizations Meeting Quick Ratio without Receivables Standard	21%	22%	19%
Average Quick Ratio without Receivables (liquid funds available per dollar in current liabilities)	.78	.74	.82

Overall, these measures suggest that child welfare nonprofits in New York State do not hold very liquid assets. Organizations that suffer from illiquidity might be forced to delay payments to vendors and employees, which in turn can affect program service quantity and quality. At the very least, poor liquidity forces organizational managers to spend more time managing cash flow than overseeing programs. Furthermore, the indicators we analyzed suggest that future government budget crunches have the potential to cause very serious harm to the financial operations of child welfare nonprofits throughout the state. Future attempts to extend payables by governments will have serious and immediate implications for a sector that is already starved of liquid (cash) resources. This risk is no longer merely a hypothetical, as it has already happened in some parts of the country.

Debt. Debt is an important financial indicator because leverage increases risk to the organization, and debt requires interest and principal repayments that are fixed and generally beyond the control of an organization. Whereas liquidity is focused on an organization's short-term financial prospects, debt is focused on its long-term solvency. Table 10 presents five measures of organizational debt.

Table 10: Debt Measures

	Total	*Outside NYC*	*New York City*
Average Financial Debt Ratio (percent of assets financed by debt)	.19	.24	.15
Percent of Organizations with Financial Debt Ratio < 50%	90%	85%	95%
Percent of Organizations Meeting Financial Debt Ratio Standard	57%	47%	67%
Average Debt Ratio (percent of assets financed by debt, incl. short-term debt)	.55	.50	.59
Percent of Organizations with Debt Ratio < 50%	41%	46%	36%
Percent of Organizations Meeting Debt Ratio Standard	48%	54%	43%

The Financial Debt Ratio indicates what proportion of financial debt a nonprofit has relative to its assets. Financial debt is limited to formal borrowing instruments such as mortgages, bonds, notes, and so on. Assets include current assets owned by the nonprofit, such as cash and inventory, as well as long-term capital assets such as facilities, equipment, and buildings. Importantly, this ratio is indicative of an organization's leverage (that is, use of debt), which is directly related to the riskiness of the organization. A generally accepted rule of thumb is that financial debt should not finance more than 50 percent of any organization's assets. Levels in excess of this figure indicate that, if required to do so, an organization would be unable to pay off such debt with the assets it owns. Additionally, increasing financial debt beyond this level typically comes with higher interest costs, and ties up an increasing amount of an organization's operating budget in debt service. Ninety percent of New York's child welfare nonprofits meet the 50 percent standard. However, it is difficult to know if this rule of thumb is appropriate for nonprofit service providers like the ones studied here. Thus, we also examined what percentage of New York child welfare nonprofits had financial debt equal to or less than the sector's *average* level of financial debt. About 60 percent fall into this category, with New York City organizations much more likely to have average (or less) financial debt than organizations outside the city.

While the Financial Debt Ratio only examines long-term borrowing secured through a lender, the Total Debt Ratio examines all organizational liabilities – short-term and long-term – and is arguably more comprehensive a measure of debt. As Table 10 reports, the Debt Ratio for New York's child welfare nonprofits is much higher than its Financial Debt Ratio: an average of 55 percent. This data may indicate that short-term, unsecured debt is a necessary strategy for financing operations in the child welfare sector. Indeed, only 41 percent of New York child welfare nonprofits are in accordance with the rule of thumb that total organizational debt should be under 50 percent, with New York City organizations much less likely to meet this standard than organizations in the rest of the state. Again, since it is unclear whether this rule of thumb is appropriate for nonprofit service providers, we also examined what percentage of New York child welfare nonprofits has total debt that is equal to or less than the sector's average level of debt. About half of the organizations do so, and again New York City organizations clearly are much higher users of short-term debt than organizations outside the city.

Relationship of Government Funding and Private Donations to Quantitative Indicators

As nonprofits seek stronger financial positions in a difficult economy, there has been much discussion of appropriate strategies. Across the sector, two strategies have achieved the status of conventional wisdom: diversifying funding sources and increasing private donations. In New York, support for child welfare nonprofits comes from a relatively large number of government agencies at the municipal, state, and federal levels. Figure 9 examines how having a diversity of government funding sources is related to the financial health of child welfare nonprofits. As the figure shows, on average, organizations with a larger number of public funders have *lower* liquidity and *higher* debt than organizations with fewer public funders. Also, the modified quick ratio (not shown) declines from 1.33 for organizations with 4 or fewer contracts to 0.35 for those with 9 or more contracts. This result suggests that a diversity of funding sources does not in fact produce better fiscal outcomes – at least in terms of seeking out diverse sources of government support. An alternative explanation might be that child welfare organizations with worse fiscal health increase government funding, perhaps in the hope of turning around their financial prospects. However, Figure 9 suggests that this strategy may be flawed. In contrast, Figure 10 shows good evidence that at organizations where private donations represent a larger proportion of their revenues, there are better fiscal outcomes. In addition, organizations with 10% or more donations have higher modified quick ratios (0.94) compared to other organizations (0.50). This suggests that the benefits of funding diversity are more likely to accrue from non-governmental sources.

Figure 9: Relationship of Government Funding Diversity to Indicators of Financial Health

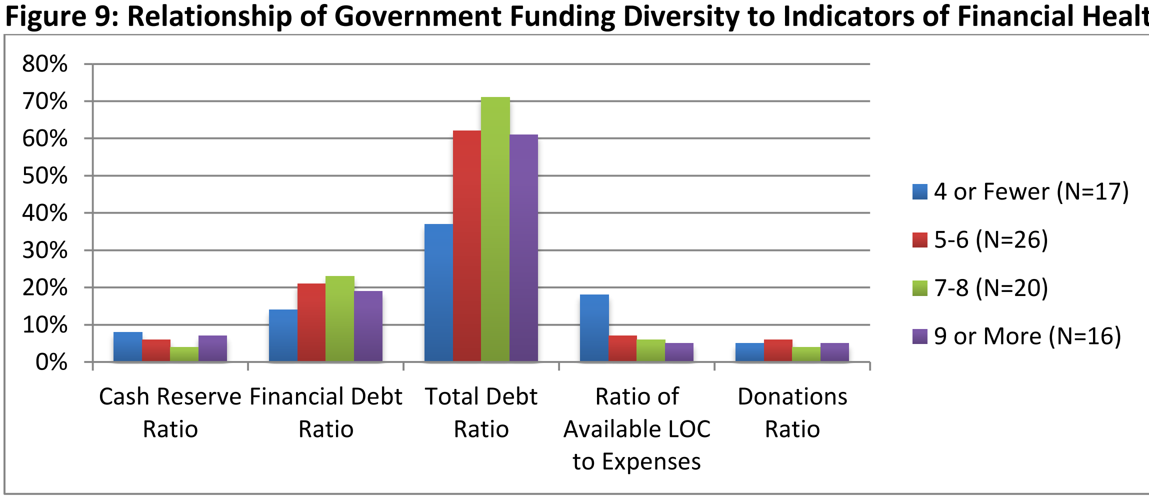
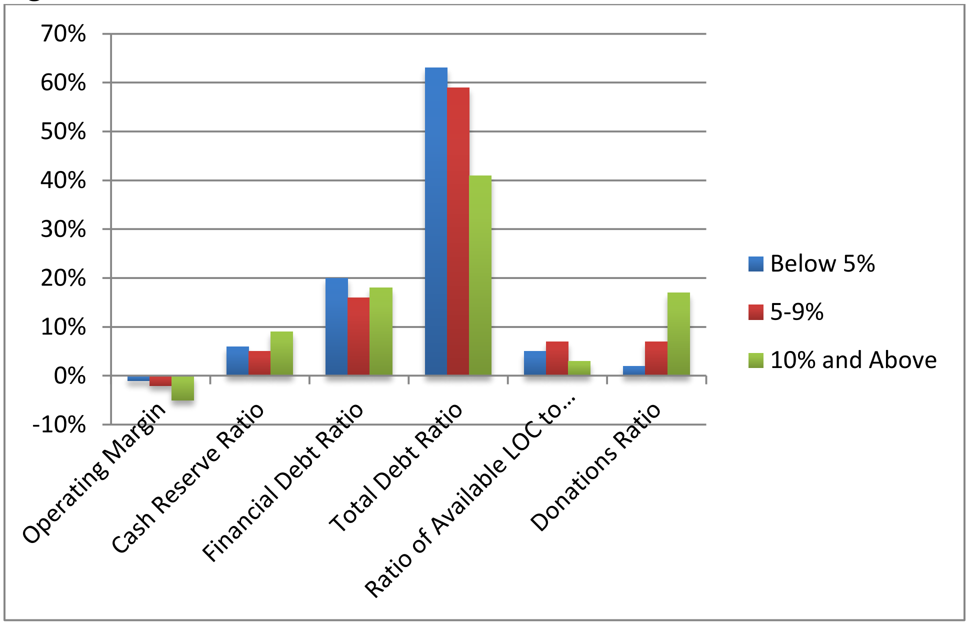
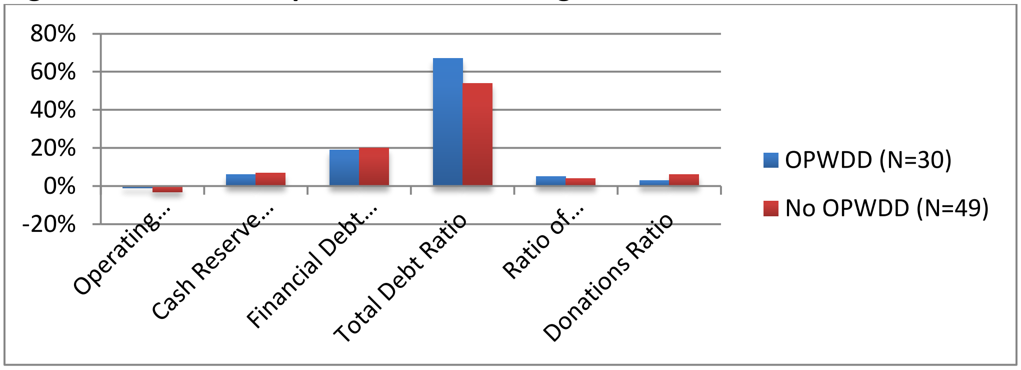


Figure 10: Private Donations as % of Revenues Related to Indicators of Financial Health



Among child welfare nonprofits in New York State, one additional piece of conventional wisdom prevails: that the state Office for People with Developmental Disabilities (OPWDD) provides more generous support than other governmental agencies that fund child welfare nonprofits. The conclusion drawn often is that securing contracts from OPWDD will put an organization on stronger financial footing because of the generally higher rates it provides. Given this strong sense among providers, we included an analysis of this question. Figure 11 shows the results of this analysis, leading us to conclude that OPWDD funding is not consistently related to better fiscal outcomes among New York child welfare nonprofits. However, this analysis examines the impact of OPWDD funding on the average child welfare nonprofit's financial health; results may differ for organizations that, for example, receive more than a certain proportion of their total revenues from OPWDD.

Figure 11: Relationship of OPWDD Funding to Indicators of Financial Health



Financial Health and Organizational Performance

For nonprofits in all human service fields, perhaps the most critical question of all is whether good organizational financial health is associated with better organizational performance. New York City's child welfare agency (the Administration for Children's Services) collects basic data to grade many of its nonprofit providers on four specific outcomes in family foster care: child safety, permanency of child placement, children's well-being, and recruitment of foster parents. The first three of these are federally-mandated outcomes for child welfare. *Child safety* means that children are protected from abuse and neglect, and safely maintained in their own homes whenever possible. *Permanency* means that when children must be removed from their homes, foster care is a short-term placement while a safe, permanent living situation is found for the child, either with the birth parent(s) when it is safe or, if that is not possible, with relatives, adoptive parents or kinship guardians who make a permanent commitment to the child. *Child and family well-being* is a broad outcome that involves families being better able to provide for their children's needs, and children being provided with services that meet their educational, physical health and mental health needs. The City also tracks the ability of child welfare nonprofits to *recruit qualified families to provide foster care* for children.

Performance grades range from A to F for each category, and were available for 27 of the 40 New York City organizations in our study. New York State's Office of Children and Family Services does not collect any similar data on performance, so we have no data on the performance of the 39 organizations in our study that operate outside New York City. Thus, the results we present below on the question of the relationship between organizational financial health and organizational performance in family foster care is based on data from only a third of the child welfare nonprofits in our study, all of them located in New York City. We therefore consider this analysis suggestive, rather than conclusive.

The analysis examined all of the study's quantitative indicators of organizational financial health. We grouped family foster care providers in each of the four performance categories by whether they had earned a high grade (A or B) or a low grade (C, D, or F). We then compared the financial indicators of these two groups to determine if there was a statistically-significant difference between them. We found that larger cash reserves and more private donations are associated with higher grades on three performance measures; total margins, increased overhead, and the quick ratio are associated with higher grades on two performance measures; and recruitment grades are unrelated to the other three grades in terms of financial indicators.

Table 11 summarizes the findings of our analysis. It is important to keep in mind that these results do *not* imply a causal relationship between organizational financial health and organizational performance, i.e., that raising more private donations inevitably will cause better performance. Rather, we show only that greater private donations, higher liquidity, increased profitability, and more overhead are characteristic of better-performing child welfare nonprofits in New York City. Importantly, while the results of this analysis are only suggestive, they do question two major pieces of conventional wisdom regarding nonprofit finances: (1) that the best interest of the public is always served by reducing nonprofit organizational overhead; and (2) that generating operating profits somehow short-changes current recipients of nonprofit services. While further analysis is needed, our results may indicate that higher overhead and greater profitability may in fact be important contributors to nonprofit organizational performance.

Table 11: Association Between Financial Indicators and Performance Measures

Safety Grade	Permanency Grade	Well-Being Grade
Overhead (1.96)		Overhead (1.42)
Total Margin (1.42)	Total Margin (1.53)	
Cash Reserve Ratio (1.87)	Cash Reserve Ratio (1.46)	Cash Reserve Ratio (1.39)
	Current Ratio (1.80)	
	Modified Quick Ratio (1.72)	Modified Quick Ratio (1.48)
Donation Ratio (3.00)	Donation Ratio (2.13)	Donation Ratio (2.94)
Numbers in parentheses are the t-test results for these financial indicators. All are significant at the 10% level or better.		

Best Practices in Financial Management

Many observers argue that the financial problems of nonprofit organizations can be traced to their lack of skill in organizational and financial management. In order to examine this hypothesis, we constructed and administered a 110-item questionnaire about the regular financial management and governance practices of New York child welfare nonprofits[7]. In addition to providing some of the information discussed in prior sections, the survey included an examination of: role of the board of directors, creation of internal financial transparency,

[7] The survey instrument is available from CNSM upon request.

operation of fiscal infrastructure systems, and access to technical expertise for rate-setting and contract management. We present key results from the survey below.

Role of the Board of Directors in financial management. A well-managed nonprofit has a separate Board committee charged with financial matters. Its responsibilities include overseeing investments, cash management, and ensuring proper financial controls are in place. It also is considered best practice for nonprofits to have a separate Audit Committee, which is responsible for overseeing auditor selection, scope of service, and ensuring that management implements suggested procedural changes from the auditors.

Over 90 percent of New York's child welfare nonprofits have a Board Finance Committee. About a third of these committees meet monthly, and 80 percent meet at least quarterly, which is considered the standard interval (see Table 12). Only 10 percent meet less than quarterly. In addition, 56 percent of New York's child welfare nonprofits have a stand-alone Audit Committee, while an additional 25 percent specifically engage the audit function in their Finance Committee. All told, then, 80 percent of the study organizations have specific Board oversight of the organization's annual audit.

Table 12: Frequency of Board of Directors Finance Committee Meetings

Monthly	32%
Every Other Month	18%
Quarterly	39%
Less Frequently	11%
Note: percentages refer to the 90% of organizations that have a Finance Committee	

In order to properly exercise its fiduciary responsibilities, a Board Finance Committee must be kept properly informed of the organization's current financial position. Table 13 shows the percentage of New York child welfare nonprofits that regularly provide their Board finance committees with key financial management documents. About 90 percent of finance committees receive operating statements and variance analyses (comparison of projected expenses with actual expenses). 85 percent also receive organizational budgets and balance sheets. Less common are cash flow analyses and program-level (as opposed to organization-level) budgets: 73 percent and 67 percent, respectively.

Table 13: Percent of Finance Committees Receiving Key Financial Management Documents

Organizational Budget	85%
Program Budgets	67%
Operating Statement	91%
Balance Sheet	84%
Cash Flow Statement or Projection	73%
Variance Analysis (Budget-to-Actuals)	87%

As shown in Table 14, about half of New York's child welfare nonprofits provide these financial documents to their Board Finance Committees every month, and 90 percent provide these documents on at least a quarterly basis. Overall, then, New York's child welfare nonprofits regularly provide their Board finance committees with important financial management documents, though improvement may be warranted in the provision of cash flow analyses. We note that the lower level of program budget scrutiny by Board Finance Committees may be because multi-million dollar child welfare nonprofits deem program-level budgets too low-level for their Finance Committee's attention.

Table 14: Frequency of Finance Committee Receipt of Key Financial Management Documents

Monthly	35%
Bimonthly	19%
Quarterly	43%
Less Frequently than Quarterly	3%

Internal financial transparency. While communication between staff and Board about financial management issues is critical to organizational financial health, so too is internal organizational communication on this issue. This is because staff members with different functions often are intimately involved in how program spending is managed, and in making decisions about how money is allocated. We thus inquired about the extent of such communication both within the executive ranks, and between executive and program staff. Among New York child welfare nonprofits, 96 percent of Chief Financial Officers (or equivalent) provide regular organizational financial reports to their Executive Directors. 85 percent do so on a monthly basis, and 11 percent on a quarterly basis. Communication between the fiscal office and the program staff is important in order to keep close watch on how actual program spending is tracking with projected expenses. At New York's child welfare nonprofits, 71 percent of fiscal offices provide program managers with monthly variance analyses that contain this information. As Table 15 shows, these variance reports generally are provided in a timely manner: nearly three-quarters of these reports are in program managers' hands within four weeks.

Table 15: Timeliness of Variance Reports Provided to Program Managers

Within 4 Weeks	69%
Between 4 and 8 Weeks	15%
More than 8 Weeks	12%

Fiscal infrastructure. Good organizational financial management requires certain organizational practices occur routinely. One of the most important is maintaining timely awareness of cash flow, thereby ensuring that regular financial obligations such as payroll and vendor payments are always met. Nearly 80 percent of New York's child welfare nonprofits have an annual cash flow projection model, which projects receipts and disbursements to determine monthly cash flows and balances, thereby helping managers understand when cash shortfalls might develop, and prepare for these possibilities either through short-term borrowing or from internal balances. Following from this, another key piece of organizational fiscal infrastructure is access to a line of credit or other form of short-term borrowing. This allows organizations to bridge predicted cash flow shortages. As reported earlier, almost 80 percent of New York's child welfare nonprofits have an available strategy for short-term borrowing. Finally, we were interested in whether the organizations in our study used electronic communication – an internal network or even email – for the distribution of key financial management documents. About 60 percent did use electronic means to circulate variance reports, which are one of the most important tools of daily financial management, and should be distributed and accessed as quickly as possible.

Accessing expertise for contract management. In New York, one of the most important determinants of government funding of child welfare nonprofits is the per diem rate received by the nonprofit for each child in its care. Per diem rates, which vary among child welfare nonprofits, are calculated using a complex formula that responds to the exit and entry of children into care throughout the year, and is based on previous actual spending. As such, a key element of child welfare nonprofits' financial health is based how well they control and report their daily expenses. Importantly, the per diem rates are composites of different organizational spending targets and allowances by the State, including both current spending and capital investment. The rates are designed so that child welfare nonprofits can evaluate their own spending and adjust accordingly during the fiscal year.

Given this aspect of child welfare nonprofit budgeting, our survey inquired about the per diem rate-setting expertise of the organizations in our study. 80 percent of New York's child welfare nonprofits project their per diem rates as part of their annual budgeting process. Most of these organizations (70 percent) assign in-house staff to this task, with about half delegating the task to their Chief Financial Officer. As Table 16 shows, however, organizations vary substantially in their ability to monitor and adjust spending so as to ensure that per diem rates provide sufficient resources to support children in care. Only about 20 percent of New York child welfare nonprofits regularly engage in this level of budgetary oversight and planning. In contrast, close to half of the organizations rarely monitor expenditures and revenues in this way. This has important potential long-term impacts on organizational financial health.

Table 16: Percent of Organizations that Monitor and Adjust Expenditures and Per Diem Rates

Adjust Spending Often	20%
Adjust Spending Sometimes	25%
Adjust Spending Occasionally	34%
Never Adjust Spending	11%

Conclusions

The analysis contained in this report draws on two unique financial data sources that cover over 90 percent of nonprofit child welfare organizations in New York State. No previous study has provided such an in-depth and comprehensive picture of the financial health of these organizations, which the state entrusts as the primary providers of assistance for vulnerable children and their families. We draw the following conclusions:

- Child welfare nonprofits constitute an important sector in both social services and economic impact in New York State. They provide vital services to vulnerable children and families throughout the State and, collectively, constitute a large segment of expenditures and employment.
- Child welfare nonprofits are heavily dependent on government revenues, with the average organization receiving 94 percent of its revenues from government.
- Child welfare nonprofits operate on very tight financial margins, placing these organizations, and they children they serve, on precarious fiscal terrain.
- In general, child welfare nonprofits apply sound fiscal management practices, though there is room for improvement in a few organizations.
- State, county, and city governments in New York are funding child welfare nonprofits at a deficit, depending upon these organizations to raise additional revenues to adequately finance legally mandated child welfare services.

Our survey data show that lack of skill at managing finances is not the basic problem for the child welfare nonprofits we studied. Over the last twenty years, significant professionalization of nonprofit organizations has occurred in all aspects of their operations, including financial management. Indeed, as our survey shows, child welfare organizations generally have sound financial practices. Most of these organizations maintain proper Board oversight and adequate internal fiscal transparency. Our analysis thus leads us to conclude that solutions to the financial problems of the nonprofit child welfare sector will *not* be found through better financial management, although certain practices and perhaps some outlier agencies could be improved.

Instead, the source of these organizations' financial difficulties is far more pedestrian: not enough revenue. Revenue shortages mean many of the organizations in our study fall short of meeting standard rules of thumb for a variety of quantitative indicators of financial health. This finding is despite the fact that child welfare nonprofits keep two key cost drivers – overhead and fringe benefits – very low. In addition, it is noteworthy that, in our limited analysis of the relationship between financial health and organizational performance, we see some evidence that *higher* overhead costs are associated with better performance grades. Based on these findings, we think it very likely that increased revenues to child welfare nonprofits would improve many of their financial indicators, leading to more stable organizations that can better safeguard the interests of vulnerable children. Furthermore, given the New York Governor's recent Executive Order to limit public funding of overhead to no more than 15 percent of funds by 2015, it is critically important to track the influence of this policy change on the quality of services child welfare nonprofits are able to provide.

Given that child protection is a legally mandated function of government, it is worth asking whether increased government support of the child welfare nonprofits on which government depends may be the most appropriate solution to these organizations' revenue problems. We recognize that government budgets are in crisis, and that replacing recent cuts – to say nothing of appropriating new funds – will prove politically difficult. However, it does not seem unreasonable that public contracts for the provision of these public goods and services should cover the full cost of the contracts – especially for government mandated services – and not require private subsidies.

Additionally, it might be fitting to ask child welfare nonprofits to increase the proportion of their budgets that come from private donations. While a few of the organizations in our study have had relatively good success in attracting contributions, the large majority of New York child welfare nonprofits have little or no support from private sources. We note, however, that the present economic climate compounds the difficulty of seeking out increased private contributions.

Overall, our analysis concludes that additional public and private investment in child welfare nonprofits is likely to enhance these important organizations' financial stability in ways that will not lead to excessive administrative overhead and could produce improvements in program performance. With few exceptions, there is a sound base of financial management on which to build in the child welfare sector.

Appendix

This appendix defines and interprets the ratios used throughout this report.

Average collection period = 365/(Total Revenues-Investment Income)/Accounts Receivable at Year-End. Measures how quickly (in days) an agency collects money owed to it from government agencies, donors, or other clients. Investment income is not included in the calculation because it is not invoiced as other revenues are. A goal should be that money is collected within 60 days of invoicing.

Cash reserve ratio = Cash and Short-Term Savings at Year-End/Total Expenses. Estimates the percentage of annual spending the agency has available in cash (at year-end). A more intuitive interpretation is to use the cash reserve ratio to calculate the Days of Cash on Hand. The days of cash on hand of the Agency can be calculated by taking the percentage reported above and multiplying it by 365 days. For example, 0.05X365 days = 18.25 days of available cash on hand. It is reasonable that agencies should have 30 – 60 days of cash on hand for emergencies and general operating purposes.

Current ratio = (Cash and Savings at Year-End + Total Receivables + Inventory + Prepaid Expenses)/Current Liabilities. Measures the ability of an agency to meet obligations as they come due. The current ratio limits the assets (in the numerator) to those that are already cash or can be converted to cash relatively quickly within the next fiscal year. A current ratio of 2.0 is desirable, which means that an agency has $2 of current assets for every $1 of short-term liabilities that will be paid within the next fiscal year.

Financial debt ratio = (Mortgages + Bonds + Notes)/Total Assets. Measures the extent to which agency activities are supported by financial debt – that is, debt that is borrowed formally from a lender. This ratio essentially measures how much of an agency's assets have been financed by borrowing from lenders.

Modified quick ratio = Cash and Savings at Year-End/Current Liabilities. Measures the ability of an agency to meet obligations as they come due. A traditional quick ratio excludes inventory and prepaid expenses from current assets. However, because an agency may have limited control over converting some of its receivables (usually owed by governments to the agency) to cash, the modified quick ratio focuses only on resources that are already cash and is a very conservative measure of liquidity.

Operating margin = Change in Net Assets – Investment Income/Total Revenues – Investment Income. Assesses how much of each operating dollar earned is retained by the agency for future usage. Because investment income is not based on output, it is excluded from the calculation.

Overhead ratio = (Management and General Expenses + Fundraising Expenses)/Total Expenses. This ratio measures the amount of spending devoted to agency overhead, defined as management, general, and fundraising.

Total debt ratio = Total Liabilities/Total Assets. Measures the extent to which agency activities are supported by financial debt – that is, debt that is borrowed formally from a lender. However, this ratio recognizes that agencies may also borrow using unsecured means - such as accounts payable.

Total margin = Change in Net Assets/Total Revenues. Assesses how much of every dollar earned is retained by the agency for future usage. For example, a total margin of 2% (0.02) indicates that the agency earns 2 cents of total profits for every dollar of revenues generated.