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CASE STUDY

FINANCIAL MANAGEMENT OF A NOTFOR PROFITORGANIZATION- A CASE STUDY

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INTRODUCTION

This case details a 10 year period of a not for profit organization located in New York City. During the first five years the agency had a tremendous growth period due in large measure to the efforts of the newly hired executive director. The next five years told a completely different story. The board of directors' inaction, an executive director's laid back management style and a fiscal director that did not take an active role in the financial management of the agency all contributed todrive a viable agency to the brink of bankruptcy. There were steps that the agency's board of directors could have taken to prevent this situation from happening. This article will explore those steps that the board of directors could and should have taken. Those measures would have improved the financial management of the agency and prevented this situation from escalating to the point that it did.

The organization, a 50l (c} 3, was incorporated in New York. The organization provided services to predominately low income and inner city patients. The agency's public support funding came from New York State and New York City.

The agency's revenues came from Medicaid, Medicare, Social Security Income and Self Pay.

The agency had an aggressive growth rate for the first five years, total public support and revenues grew by 61%. But while revenues grew, net income dropped by *55%* during that same time period. A pattern of over spending began to emerge. The management of the agency consisted of:an executive director, medical director, fiscal director, and three associate directors. The agency was able to keep afloat through several techniques even though net income was decreasing. The agency kept expanding revenues by taking on new programs. The money was then used to pay overdue expenses of the existing programs. The money from one program was lent to another by inter program loans. Even though the funding sources frowned upon inter program loans ifthose loans were repaid quickly then they did not object too strenuously. In the beginning the loans were repaid quickly but toward the end of the ten year period this was not the case. The executive director was on call 24 hours since the agency operated a 24 hour facility. In the beginning of his tenure the executive director spent the majority of his time at them ain office. After his fifth year, he developed a pattern of coming in to the office later and later intheday.It finally reached the point that he would not be seen in the main office for days at a time, but he would call in daily to see if he had any urgent messages. The agency had a deficit, coincidentally, the executive director took a less active role in the management of the agency. The fiscal director had a master's degree but was not a C.P.A. He was employed in a public accounting firm just prior to his coming to the agency.Under his tenure the books and records were standardized and kept up to date for all the programs. The book keepers were hired originally as clerks and were subsequently promoted even though they were not formally trained. The fiscal director had to closely supervise his staff and that left him little time for anything else. The fiscal director's time was spent being the chief accountant instead of being both the financial advisor and chief accountant of the agency. Check requests from all the different programs came to the accounting department.The accounting department would then generate the checks. The executive director and a board member would sign the checks after reviewing the documentation attached to the check requests. The signed checks and check requests would be returned to the accounting department where they would be released or mailed. Itwas not unusual for the fiscal director to hold on to the checks for one month until the money was available in the accounts. When the agency began to experience cash flow shortages the checks that were processed for payment were not released but held back for as long as four months.The agency was getting deeper and deeper in debt. The funding sources kept the revenues frozen for a three year periodyet the agency's expenses were not. Salary and fringe benefits accounted for the largest increase in the agency's expenses during that time period. The agency employed union personnel that negotiated a contract with the agency every two years. The

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agency hired an attorney to negotiate the contract on its behalf. The attorney negotiated a two year contract with a significant annual increase at the same time when the agency's revenues werefrozen. Unfortunately, the fiscal director was not a participant in the contract negotiations as he should have been. This set the stage for the deficit to grow and for the agency to experience severe cash flowshortages.

The agency operated several homes for disabled adults. The agency was offered two additional homes since they already operated profitably two homes. The program director left the agency and a new program director was appointed. The new program director also functioned as an associate director in the agency. Under the leadership of the new program director, program expenditures began to exceed revenues for the first time. The clients were taken on several vacations, as part of teaching the adult clients socialization skills. They were taken to Puerto Rico and Jamaica and, since the clients needed supervision staff members were included in the trip. Staff members received their regular salary in addition to having an all-expense paid trip. Some of the staff were even paid overtime salaries. Even though the four homes comprised one program, they werein reality operated as if they were individual programs. As an example, each house purchased goods as individual units and not as a member of a larger group. There was also rampant overtime by the staff members. In some instances there were times when a staff member worked well over 80 overtime hours during a two week period. Staff members were required towork 70hours in a two week period. The program director justified the need for over time because of existing personnel shortages during some of the shifts. The adults in the program needed 24 hour supervision by the staff. Overtime costs increased the personnel costs of this program and was the main reason why personnel costs exceeded the budget. A major expense of the program in addition to personnel costs was food. Each house had a $1, 100 petty cash food account that was replenished twice a month. In addition to this fund each house purchased food monthly from a whole saler.

Each home had 10lived in clients, yet no analysis or portion control was performed on the quantity of food purchased. Was the food purchased used exclusively by the clients or was someof the food used or taken by the staff? The program director did not seemed to be overly concern about overspending. There are circumstances when you cannot plan for all expenditures, but them a jority of the time purchases can be coordinated to take advantage of volume discounts.It is also important that the agency implement portion control as a means to control food costs. The program should be scrutinized to make sure that it is properly staffed to keep the use of on call personnel to a minimum. It is suggested that the personnel director have a list of on call staff that can be utilized when a position needs to be filled on short notice. The agency will then keep overtime by regular fulltime eemployees to a minimum. By lowering personnel costs the corresponding fringe benefits a real so kept reasonable. The on call list reduces personnel costs and can be utilized by all of the agency's programs.

At the monthly board meetings the fiscal director prepared and distributed reports for each program. The accounts payable was growing with no way to pay for it unless some additional money was generated immediately. This was the dilemma facing the board of directors. Some of the questions asked by board members were: “how was this situation allowed to escalate to this point" and secondly, “could any of this have been prevented". There were steps that could have been taken to prevent this situation from happening. The board of directors is responsible for overseeing them management of the agency. The management team is hired by the board and reports to them. The executive director as part of that team should not be exempt. In this case the board should have kept a closer eye on his activities. A useful tool that could have been used to accomplish this was a daily log of his activities. The log would breakdown each management personnel's day into specifically what client or program he worked on, what functions were performed and for how long.In this fashion management personnel would not have blocks of unaccounted time,particularly, the executive director. These logs also serve as a vehicle for finding out how management personnel spend their time and therefore, could be used as a basis for allocating administrative costs to the different programs the agency manages. Blocks of unaccounted time can be subject to abuse and is a temptation that is hard for any person to resist. In this case the executive director spent a lot of time outside the central office where he could not be reached by anyone. The reason he gave for his long and repeated absences was that he was fundraising, yet no contributions ever materialized nor did he supply any names of the people or companies he contacted. The board of directors should be able to contact the executive director during working hours. Granted, part of an executive director's day could include meetings outside the office, but there should be some way to contact himor her when away from the office. The board of directors should have insisted that a number or location should be given to someone in the agency whenever there are meetings outside of the main office. The board of directors should have also questioned the executive director’s unsuccessful attempts at raising additional revenues.

The board of directors should have made sure that part of the fiscal director's responsibilities included monitoring to insure that programs did not exceed budgeted expenditures. The program directors were held responsible for making sure that their programs adhered to applicable program regulations and/or laws but not for running the programs within budgets. It is important that the fiscal director be given the authority to approve or disapprove program spending in conjunction with his monitoring responsibility. All of the programs had either restricted or unrestricted revenues and some of the programs had both. The board of directors should evaluate senior management annually. It is important that financial management of programs be an area that is included in senior management’s annual evaluation.

The program directors and the fiscal director should therefore, work together as a team to make sure that programs are not only operationally but fiscally sound. To this end, it is important that program directors have input in budget negotiations and that they fully understand the entire budget process of their programs. The fiscal director has to make sure that the records are current so that program directors have timely and useful information. An example of timely and useful information would be for program directors to know how much they have available in each expense category before the budget year ends. This information would allow management to take any corrective actions before it is toolate. The board of directors should have requested a detail listing of the accounts payable by vendors and date order. This would have alerted them that the accounts payable were growing and signaling that there was a problem with the agency's cash flows. The board of directors by requesting a detailed list of the outstanding checks would have seen that the signed checks were being held for a longer and longerperiod of time, another signalof the agency's worsening cash flows. The board of **directors** should have required that they approve any inter program borrowings above a specified dollar amount. The board of directors by requiring a monthly list of outstanding inter program borrowings make sure that any inter program borrowing is limited and repaid in a timely fashion.

The executive director kept the agency going by substantial useof inter program borrowings which not only delayed the inevitable, but enabled him to hide from the board of directors the truth about how dire the situation really was.

It is the author's hope that this article serves to convey some valuable information that can be useful to both board of directors and management in the financial management of not for profits organizations.

1. Should the fiscal director approach the executive director about the pattern of absence from the central office and express his concern about how his behavior has had a detrimental effect on the management of the agency?
2. Should the fiscal director inform the board of directors of the executive director's erratic behavior regardless of the outcome of his meeting with the executive director?
3. Should the board of directors have been aware of the executivedirector's erratic behavior as well as the financial position of the agency without the fiscal director informing them directly?
4. Has the agency committed fraud by claiming expenses that were not actually paid. If fraud has been committed, who should be held liable?
5. The agency needs to find ways to live within its means. If revenues can't be increased, what other avenues are available to the agency?

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