NYNP New York Nonprofit Press

Feeling Poorly The Financial Health of Child Welfare Nonprofits

Written by Fred Scaglione

Monday, 25 February 2013 05:02

Nonprofit child welfare provider agencies are not doing well…at least financially. That is the diagnosis which was delivered following a recent check-up and battery of tests conducted on the sector by Baruch College School of Public Affairs' Center for Nonprofit Strategy and Management.
On average, child welfare agencies lose money on the vital, mandated services they provide for State and local governments – and they have been losing money consistently, posting negative core net operating margins of -2% to -3% every year from 2006 through 2010.

"If we exclude investment income – which only a handful of the study organizations have, the New York child welfare sector failed to break even in any year during the 2006-2010 time period," says the report. "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."

Since New York's 80 nonprofit child welfare agencies expend approximately $3 billion annually on their programs, these losses add up to serious money. Overall, in 2008, 2009, and 2010, these agencies absorbed losses of $60 million, $74 million and $30 million, for a staggering total loss of $164 million.

As a result, it is not surprising that the majority of voluntary agencies have little in the way of financial resources to withstand further cuts in funding, failure of government payments to cover cost increases, or even just the normal bumps in the road that come with the provision of any complex set of government-funded human services.

"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," says the Baruch study. "Annual spendable endowment revenue should typically be limited to 5% to 6% 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."

Much of the sector also falls short in terms of other key measures of financial health.
When it comes to available short-term borrowing, the Baruch study notes that "best practices indicate that a line of credit should be able to cover a minimum of one-to-two months of organizational expenses – about 8-16 percent of annual expenses. Only 41% of New York's child welfare nonprofits meet this standard."

Even fewer agencies meet other benchmark levels for financial liquidity.

Best practice standards call for an agency to be able to operate for one-to-two months with its existing cash reserves. Only 28% of agencies have sufficient cash to carry themselves for that length of time. "The average child welfare nonprofit could finance less than 25 days of its operations with cash on hand," says the Baruch report. When balances on lines of credit are excluded from this analysis, the situation becomes even more dire. "The average Cash Reserve Ratio drops to below 4% of annual expenses, or less than 14 days of operations." In other words, the average agency would be able to meet just one bi-weekly payroll with the cash it currently has on hand.

"This suggests that any hiccups in contract payments could have very immediate deleterious effects on the organizations' fiscal health," says the Baruch team - Nicole P. Marwell, Thad Calabrese, and James Krauskoph. "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."

What do these financial difficulties mean in terms of the quality of services agencies provide for children and families? A lot! At least, that is what the Baruch study suggests based on an analysis of Administration for Children's Services (ACS) Scorecard Performance Ratings for 27 agencies providing family foster care services in New York City. The ACS Scorecards rates agencies performance in four areas: child safety, permanency, child and family well-being, and the recruitment of qualified foster families.

"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," the Baruch team explains. "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 ration are associated with higher grades on two performance measures."

The Baruch analysts caution 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."

The report goes on to note that these findings "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."

Generally speaking, however, the Baruch study found that child welfare nonprofits run with relatively little administrative overhead. "Only 12-13 percent is allocated to management, fundraising and other administrative expenses," says the report, leaving little "fat" available for trimming in response to government funding cuts.

The report also found that agencies and their boards of directors generally followed good financial management and governance practices.

"The indicators that 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," the study concluded.

"There really is nothing surprising here," says Jim Purcell, CEO of the Council of Family and Child Caring Agencies (COFCCA) which commissioned the Baruch study of its membership. "It simply confirms what we in the field have known for years."

If anything, says Purcell, the situation has probably grown even worse over the two year period since 2010, the last year for which Baruch had financial data in its study. Since then, there have been no Cost of Living Adjustments (COLAs) or "trend" factors in the State's child welfare program budgets or rate mechanisms.

Purcell points to the negative impact which these financial challenges are having on nonprofit agency staff – the men and women who actually deliver child welfare services to children and families. "Our salaries are very low," he says. "And, as the report states, our fringe benefit levels –25% of salary -- are half the fringe benefit rate government pays to its own workers." As a result, says Purcell, child welfare agencies are continuing to experience extraordinary caseworker turnover. In 2010, average agency turnover for caseworkers in preventive and residential programs was 18% and 19%, while for foster boarding home programs, the turnover reached a staggering 41%. "That was during the height of the worst job market in living memory, when just having a job was the thing most people cared about," says Purcell. "It is an indication of just how difficult these jobs are, relative to the salary levels the agencies are able to pay."
The Baruch study should serve as a serious warning to government policy makers and to nonprofit agency boards of directors, says Purcell.

"Government needs to recognize just how fragile this system is," he explains. "At the very least, we need to receive COLAs in our programs and rates. We can't afford to lose any more ground. The State may not have a lot of money right now, but these agencies have less."

And, nonprofit board members need to understand their responsibility to step up their own private fundraising efforts. "The report's analysis showing that greater private fundraising and stronger financial reserves are associated with higher scores on performance indicators should serve as a lesson to boards," says Purcell. "If you want to be at the top of the heap, you have to go out and raise some private money for your programs."

Addressing the financial weaknesses of nonprofit child welfare agencies is a critical public policy issue for government, argues the Baruch report.

"Government and the nonprofit child welfare sector are mutually dependent," the report states. "The child welfare nonprofits… 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."