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NFP ADVISOR

VOL. 19
SPRING 2019

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BRINGING A UNIQUE UNDERSTANDING OF KEY ISSUES FACING NOT-FOR-PROFIT ORGANIZATIONS

FROM THE EDITOR - KEN CERINI, CPA, CFP, FABFA

These are interesting times to be in nonprofit leadership. We are on the cutting edge of technology and the sector is identifying increasingly more innovative ways to use it to make a difference in the lives of people served. Take for instance **Developmental Disability Institute (DDI)** who is using virtual reality goggles and software to reduce the stress of everyday tasks (*such as shopping, dentist visits, etc.*) of individuals on the spectrum. A really cool idea that didn't exist a few short years ago, and we don't expect this type of innovation to stop. In addition, with the push towards managed care, we expect to see an increase in the integration of services across the continuum where nonprofit organizations serving the developmentally disabled and mental health populations will have the ability to influence more traditional healthcare costs.

The problem is, at times it feels like funders (*private and public*) are making it increasingly more difficult for nonprofits to be effective. Somewhere along the line administrative costs, executive compensation, and investing in infrastructure all became something evil. Adding to that, the level of regulatory and reporting requirements, documentation requirements, and statutory hoops that nonprofits have to jump through has left leadership dealing with crisis management instead of strategic thinking and organizational growth.

I apologize, but I get a little frustrated with how nonprofits are treated. You guys are out there every day trying to make a difference; short staffed, underfunded, and often overworked. You are dealing with some of the most vulnerable populations, giving them the basics they need to persevere and more importantly giving them a voice and compassion to heal and grow. There is so much good that can come from effective partnering if we can just bring all the sectors together with a common goal of solving the key issues that impact our society. This will not come from politicians pushing policy or people sitting around in a room discussing and re-discussing the same issues. It's going to come from the ground up; businesses and nonprofits working together to find ways to develop effective business models that work and are self-sustainable. This means different types of conversations with your business partners and finding innovative ways to approach new partners with business solutions that will really make an impact.

We are passionate about the sector, and we want to be right in the thick of the action … helping to propel the sector forward. We would love to hear what you're doing and see if there are ways that we can help. In addition, it is even more important today for nonprofits to develop strategic alliances and find ways to work together. To that end, we encourage you to attend the Imagine Awards on April 30, 2019 at the Crest Hollow Country Club and join with over 400 other individuals that are passionate about the sector to start making important contacts and linkages to drive your organization and the sector forward.

Enjoy our latest edition of the NFP Advisor and let us know how we can be a resource.

Thanks for listening (*drops mike*).

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DEVELOPMENTAL DISABILITIES INSTITUTE

ddi Developmental Disabilities Institute

Developmental Disabilities Institute (DDI) was founded in 1961 to address the special education needs of children with autism and other developmental disabilities and provide therapeutic intervention.

Today, DDI is a dynamic, non-profit, multi-site agency, each day serving hundreds of children and adults with autism and other developmental disabilities, providing educational, residential, habilitative, vocational, transportation, and service coordination support to the Long Island community.

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UNDERWATER ENDOWMENTS

FASB's Accounting Standards Update 2016-14 will be effective for calendar year-end entities in 2018 and fiscal year-end entities in 2019. Non-profit organizations will see changes in how they must present net assets on their statement of financial position. An important area of change will be the presentation and disclosure of underwater endowments.

Endowments are established funds of cash, securities, or other assets to provide on-going income for a non-profit organization. Endowment funds are generally established by gifts that are restricted by the donors. Donors may restrict an endowment in perpetuity to provide a permanent source of income for the non-profit, or they may restrict an endowment for only a specified time period. Income generated from endowment funds can either be with restriction (*to be used for a specific purpose, such as scholarships*) or without restriction. However, when an endowment fund falls below the original value restricted by the donor, it becomes an *"underwater"* endowment.

According to FASB, an underwater endowment fund is defined as: *"A donor-restricted fund for which the fair value of the fund at the reporting date is less than either the original gift amount or the amount required to be maintained by the donor or by law that extends donor restrictions."* Additionally, it should be noted that underwater endowments only apply to donor-restricted endowment funds. FASB's requirements for underwater endowment funds do not apply to board designated endowment funds or *"quasi-endowment funds."*

To explain the new changes for underwater endowments, we also need to clarify a change to the classification of net assets on the financial statements. With ASU 2016-14, net assets will be classified under two types; **with donor restriction** and **without donor restriction**. Temporarily restricted and permanently restricted net assets will no longer be presented on the financial statements. They are now classified as *"net assets with donor restriction."* Unrestricted net assets, including Board designated funds, are now classified as *"net assets without donor restriction."*

The presentation of underwater endowments will be as follows: the original amount of the endowment and the amount the endowment is underwater (*deficiency*) will both be included in net assets with donor restriction. In the past, the unrestricted net assets bore the risk of endowment losses.

Under the new standards, there are four disclosures that must be included in the notes to the financial statements for underwater endowments:

- *The fair value of the underwater endowment funds.*
- *The original gift amount of the endowment or level required to be maintained by donor stipulations or by law.*
- *The aggregate amount that endowment funds are underwater (deficiencies).*
- *Any governing board policy or decisions to spend, or not spend, from such funds.*

The problem for organizations with underwater endowments is the classification of the net assets, as with or without restriction requires retroactive treatment of any previous losses. In other words, you would need to analyze the history of your endowments to ensure that they are properly valued as previous losses on endowments went to assets without restrictions and the new ASU requires the restatement of net assets to reflect the historical investment results as part of the endowment.

JAMES LAINO, CPA
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STRENGTHENING YOUR MISSION: IS MERGING THE ANSWER?

With increased government regulations, decreased government funding, competition for donors, and difficulty in attracting and retaining staff and engaged board members, it may be time for nonprofits to decide if they can continue to operate on their own, or if they should consider merging with another organization. Mergers can occur where your organization takes over a smaller organization, you are taken over by a larger organization, or two similar sized organizations come together to form a new larger organization. If you are going through that thought process, it may be useful to understand how two Long Island-based organizations approach the process to effectuate an effective merger.

After three years of planning, Sandy Oliva, Executive Director of Nassau County Coalition Against Domestic Violence and Cynthia Scott, Executive Director of Coalition Against Child Abuse and Neglect, co-located their offices in 2010 and officially merged a few years later as The Safe Center LI, located in Bethpage, NY.

WHAT WERE THE KEY ISSUES THAT BROUGHT THESE TWO AGENCIES TOGETHER?

When deciding whether a merger makes sense, an organization needs to understand what they are trying to accomplish through a merger. If your organization is experiencing significant financial issues, it may be difficult to find an effective partner as there needs to be strategic value associated with a merger, and most organizations don't want to, or don't have the financial wherewithal to go deep into their pocket to bail your agency out. Typically, organizations are looking for either vertical or horizontal integration when they explore merger candidates. This means that organizations are looking to expand the types of services they offer (*vertical integration*) or they are looking to expand market share of the existing services they offer inclusive of expanding the territory/communities in which they operate (*horizontal integration*). In developing the Safe Center, Oliva and Scott believed that by bringing together domestic abuse and child abuse under one roof, they would be able to provide holistic, integrated trauma-informed services to victims of abuse. There was no overlap of services between the two organizations. For the Safe Center, bringing the two entities together to expand the overall continuum of care made sense. While they had some financial savings by merging the back-offices, that was not the primary driving factor of the merger. For Organizations dealing with managed care issues, increasing the bandwidth of your organization to be able to negotiate more competitive rates could be an impetus to start talking to potential partners.

WHAT ARE SOME OF THE KEY ISSUES/ CONSIDERATIONS THAT AROSE DURING THE MERGER?

Per discussion with Cynthia Scott, some of the key issues/ considerations that the Safe Center dealt with during the merger were:

- Everything took a lot longer than expected. Expect things to take significantly more than you planned.
- Leave your egos at the door. Focus on what's best for the organization and clients you serve. There will be some level of fall-out at all levels, board, management, staff, etc.
- Culture is important. If you're coming from completely different organizational cultures, it's going to be hard to bring the organizations together harmoniously. Leadership will spend a significant amount of attention surrounding this issue.
  - Review policies and benefits for consistency. There may be added cost associated with bringing benefits and policies in-line.
  - Survey the staff surrounding the merger.
  - Consider dating first (*joint admin, joint fundraising, joint programs*).
- There are a lot of administrative aspects that need to be considered.
  - Contracts with government funders may need to be modified and you need to determine what impact that will have on operations.
  - Debt agreement and leases may need to be modified. If you have a favorable lease, this could be problematic if the landlord is unwilling to modify the lease.
  - If there is a name change involved, there could be a significant cost associated with reprinting of new collateral materials and new signage.
- Fundraising/Funding issues may arise.
  - Speak to your donors to ensure that there won't be a negative impact on funding.
  - Certain government funders may look to decrease funding if two separate agencies become one.
- You need to have a high level of transparency between partners. The key is trust and openness that everyone is focused on what's best for the merged entities.

WHAT ADVICE CAN YOU GIVE TO PEOPLE GOING THROUGH A MERGER?

Mergers are not easy. Cynthia Scott offered the following advice for organizations considering a merger:

- Consider using a consultant to help you through the process (*you don't know what you don't know*). Bring in an expert to help guide you through the process.
- Look for synergies in your merger partner. The combined entity should be stronger than the sum of its parts.
- Create a formal merger plan that outlines the process so that time-frames and tasks can be determined, assigned, and effectively monitored.
- Focus on the cultural aspects of the merger. This is probably the most important aspect of the merger process.

THE WRAP-UP:

Organizations really need to consider whether they should consider the possibility of a merger as part of their strategic thought process. A merger, like marriage, is a process. You have to find a partner you're attracted to and have things in common with; you need date to see if you are compatible; you need to share your visions and goals to see if you want the same things in the future; you need to potentially move in with each other to see if you can effectively cohabitate; you need to plan the merger to make sure you are fully prepared for the big day; and finally you need to consummate the merger. Like a marriage of two people, the merging of two entities takes openness, honesty, the ability to bend, and the desire to do what's necessary for the merger to flourish. The road is sometimes bumpy, but at the end of the day, everyone can win if done correctly.

ERIC GONZALEZ, CPA
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ANALYZING DATA MORE EFFECTIVELY

Measuring an organization's performance goes far beyond the debits and credits and the two-dimensional numbers reflected on a financial statement. Especially for nonprofit organizations. While, it is essential for continuing operations to be profitable, the real goal is to find a way to tie profit and purpose to be able to both effectively fulfill your mission, while developing the resources necessary for organizational stability and growth. The question is, *how do you know if your organization is healthy?*

There are many factors that go into an organization's health including financial reserves, liquidity, cash flows, expendable net assets, and operational effectiveness. Too often we have seen organizations with robust financial statement net assets, but when you look behind the numbers you realize the organization has plenty of illiquid assets, so it can't pay its bills.

Looking at trends in numbers (*sales over the last 5 years*), benchmarking your organization against other organizations (*what is your labor cost as compared to other organization's labor costs*), and looking at the interrelationship of numbers (*days in cash vs days in receivable to determine if adequate cash flow levels exist*), are all important in understanding how your organization is functioning. These provide a lot of insight into operational effectiveness and provide an organization with an understanding of potential risks and inefficiencies.

Certain analyticals that you should be reviewing monthly, in addition to understanding deviations from your established budget, are:

- **Days in cash:** Days in cash is an analysis that divides your cash balance by your daily cash expenditures (*total expenditures less depreciation, bad debt, and in-kind expenses*). The resultant is how many days of operations that an organization has on hand. This is useful in analyzing cash flow. A low days in cash could indicate: *a need for a line of credit or other financing; that your staff is incurring significant time in cash management and vendor relations;* or *that you have a problem with receivables collection or lack of discretionary resources.*
- **Liquidity:** This looks at the bankability of your organization. It divides current assets by current liabilities and it effectively measures how liquid you are … do you have the current resources available to pay your current obligations. Most banks want to see a current ratio of 1.35 to 1.5 to 1, in order to extend credit to your organization. That doesn't mean that they won't fund you if you are below these thresholds, it just means more effort, explanation, and potentially higher interest rates will be needed.
- **Expendable Net Assets:** The level of unrestricted net assets that are not tied up in long-term investment (*e.g. property and equipment, intangibles, security deposits, etc.*). Many organizations only focus on their net assets, but you can't pay your bills with bricks. By understanding what portion of your net assets are expendable you can better understand the level of resources you have to fund operations. This is extremely important for an organization that is losing money, because you can determine how many years of operations you have left to determine how much time you have to effectuate change.
- **Profit and Loss by Program:** Many organizations review operations on a global basis, but it is important to look at information on a program by program basis. This will help to understand how much each program is contributing to the overall operations and allow management and the Board to assess whether programs should be maintained or closed down.
- **Cost of Fundraising:** This looks at the effectiveness of your fundraising activities. You divide total contribution revenue by your fundraising costs (*direct and non-direct*) to understand the multiple you are receiving. Most nonprofit rating organizations require a minimum return of 3 to 4 times your cost.

In addition to the standard analytics, you should also identify the key performance indicators that are the drivers for your organization. Since all organizations are different, and have different missions, it is most likely that each organization's metrics are going to vary. For instance, a school is going to be interested in number of students enrolled, scholarships provided, and student/teacher ratios while a clinic is interested in such things as payor mix, units of service, and diagnosis. It is important for organizations to understand which factors provide insight into organizational effectiveness, so they can drive positive results or mitigate losses. Indicators can be either external or internal. External indicators would be factors that are out of the organization's control, for example, budget cuts for government funded programs. Internal indicators are factors that are controlled by the organization and are in line with their mission. For example, the decreasing trend in donations, the volume, the average dollar amount per donation. *Why are donations decreasing? Is there more competition? Or is it because the message is not reaching enough people?*

There is no cookie cutter approach that an organization can use to determine which indicators to measure, because all organization operate in different environments, have different funders, and different missions. Leading indicators can provide insight to help drive future performance and, due to changes in the sector, are becoming extremely valuable tools for forward thinking agencies.

CHRIS MAHER
STAFF ACCOUNTANT

~~WINTER~~ MANAGED CARE IS COMING

Managed care is coming. What it will exactly look like, or how it will impact the nonprofit sector isn't clear yet. Managed care will most likely result in significant consolidation among OPWDD, OASAS, and OMH providers. The problem is unlike other areas of healthcare; these funding streams involve more chronic or long-term healthcare needs. Chronic care doesn't always lend itself well to managed care and capitation. Managed care companies want to see cost savings and impact, but how do providers create such savings when the individuals they serve need services on a continuous basis? Too often, when providers are looking at their value proposition, they focus on their small piece of the pie; the little sliver that deals with developmental disabilities or mental health or whatever. Unfortunately, this is not where the real cost savings and impact necessary lies. Nonprofits have the ability to significantly alter the continuum of health care. The real benefit is in understanding what are the drivers that your organization can influence that will result in real cost savings in the areas outside of developmental disability, mental health, or addiction.

For example, in serving the mental health population, if you can ensure that the individuals you serve are eating properly and healthy, are taking their medications, have appropriate shelter, are involved in wellness programs, and are accessing the health care system at the appropriate points (*clinics vs. hospitals*), you could significantly decrease the cost of their non-mental health care, creating value to the whole system. Since your organization has the direct contact with the consumer on a more regular basis, you have the greatest ability to effectuate change in how they incur healthcare dollars. I understand that this is not an easy process and it is not always easy to quantify but consider the real value you can deliver to managed care outside of delivering quality mental health or other services.

The challenge is to determine what the drivers that create additional health care costs are and determine what you can do to be part of the change process, resulting in less overall cost to managed care companies. That type of value and messaging is easier to sell to managed care executives than the concept that they will need to pay your organization forever for the care of an individual with mental health. It behooves you to identify the key drivers and measure the impact that your actions are having, so that you can develop a business case in your negotiations with managed care companies for higher rates or incentives.

As I said, *managed care is coming...* there is no doubt about it. How you embrace this challenge and find ways to creatively bring the understanding of your value to the negotiation table will really determine whether you have a say in your rates or you don't.

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