

**FINANCIAL MANAGEMENT
FOR NONPROFIT HUMAN
SERVICE ORGANIZATIONS**

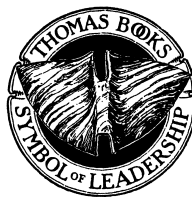
Second Edition

FINANCIAL MANAGEMENT FOR NONPROFIT HUMAN SERVICE ORGANIZATIONS

By

RAYMOND SANCHEZ MAYERS, PH.D.

*Rutgers, The State University of New Jersey
School of Social Work*



CHARLES C THOMAS • PUBLISHER, LTD.
Springfield • Illinois • U.S.A.

Published and Distributed Throughout the World by
CHARLES C THOMAS • PUBLISHER, LTD.
2600 South First Street
Springfield, Illinois, 62794-9265

This book is protected by copyright. No part of
it may be reproduced in any manner without
written permission from the publisher.

© 2004 by CHARLES C THOMAS • PUBLISHERS, LTD.

ISBN 0-398-07512-3 (hard)
ISBN 0-398-07513-1 (paper)

Library of Congress Catalog Card Number: 2004043798

With THOMAS BOOKS careful attention is given to all details of manufacturing and design. It is the Publisher's desire to present books that are satisfactory as to their physical qualities and artistic possibilities and appropriate for their particular use. THOMAS BOOKS will be true to those laws of quality that assure a good name and good will.

Printed in the United States of America
GS-R-3

Library of Congress Cataloging-in-Publication Data

Mayers, Raymond Sanchez

Financial management for nonprofit human service organizations / by
Raymond Sanchez Mayers.--3rd ed.

p. cm.

Rev ed. of: Financial management for nonprofit human service agencies. c1989.

Includes bibliographic references and index.

ISBN 0-398-07512-3 -- ISBN 0-398-07513-1 (pbk.)

1. Human services--United States--Finance. 2. Nonprofit organizations--
United States--Finance. I. Mayers, Raymond Sanchez. Financial manage-
ment for nonprofit human service agencies. II. Title

HV95.M33 2004
361'.0068'1--dc22

2004043798

**For Fontaine,
Jordan and Sara Caitlin,
and my parents, Esther and Arthur Bovero**

PREFACE TO SECOND EDITION

This book is an update of the previous edition, formerly titled *Financial Management for Nonprofit Human Service Agencies*. We are grateful for the continued warm reception to the first edition. But many events have transpired since then. At the time of the writing of that first edition, nonprofit human service agencies were not regulated to the degree they are now. During the last few years many pressures have been brought to bear on nonprofits, not the least of which is the drive to make them more “businesslike”, more “accountable”, and more understandable to those outside of the nonprofit field.

This book attempts to provide nonfinancial managers in the nonprofit field with the critical knowledge needed to communicate with the “experts” they depend upon for financial decision making. It is not intended to be an entry-level text in accounting for nonprofit organizations. Rather, it is to familiarize the reader with the financial terms, concepts, required forms and procedures to be used in the nonprofit human service agency.

The central organizing theme of this book is the acquisition, distribution, and reporting of agency resources within a systems framework. Human service organizations take in resources that they convert to goods and services. To be accountable, they must record and report on the distribution and use of the resources they receive. This book attempts to present key concepts and skills in each of the major areas of the financial management process. The book is divided into sections relating to those parts of the process.

Section I is an overview that covers the historical and sociopolitical context of nonprofit organizations and financing as well as the systems concept and unique characteristics of nonprofits. Section II covers the planning and acquisition of resources by human service organizations. This involves planning and budgeting as well as marketing and grantwriting skills. Section III covers distribution of the acquired resources through internal control, budgeting, and investments. Section IV covers the recording and reporting of organizational financial activities. Included here are basic accounting techniques, fund

accounting, financial reporting guidelines, and financial statement analysis.

Admittedly, there are some arbitrary distinctions made in the division of the topics. Real life is not so neat and tidy. Certainly those who work in nonprofit finance know that the activities of budgeting, recording, and fundraising go on simultaneously. The division of topics and the order in which they are presented are due to didactic attempts to show a logical flow from inputs (acquiring resources) to outputs (reporting of what happened to the resources), and to show the cyclical nature of the processes involved.

This book is still intended for students and practitioners in the human services, and new topics have been added to update the continual changes in nonprofit management. In addition to new topics, all of the sections have been revised and new features have been added:

Added Topics

New topics added in this edition include:

- Fees for services
- Purchase of service contracting
- Breakeven analysis for costing services and activities
- Third-party payments
- Internet resources
- A glossary

Revised Sections

There are updated sections to reflect changes in practice as well as in law. Major revisions are in the areas of:

- Financial Statements: The new Statement of Cash Flows, Statement of Financial Accounting Standards Nos. 116 and 117
- Audits and Financial Statement Analysis: Ratio analysis for Cash Flow Statements, audits for nonprofits receiving federal awards
- Fundraising: New guidelines for joint activities, unrelated business income tax
- Internal Control: COSO standards for internal control
- Investments: Socially responsible investing, Statement of Financial Accounting Standard No. 124.
- Grants: grants management and OMB Circulars A-110 and A-122

New Features

In order to serve the needs of both practitioners and students, the cases and exercises have been removed. Cases and exercises are now in a student workbook available from the publisher. This was done so the text could more readily serve as a reference tool for practitioners. The separate workbook allows students to complete exercises that facilitate a working knowledge of financial management principles. In addition, an instructor's manual is available from the author at the address listed below. Since this is a beginning text for the nonfinancial manager and others interested in aspects of financial management, those familiar with the more technical aspects of financial management such as accountants, Certified Public Accountants (CPA's), attorneys, and financial planners should always be consulted for technical expertise and the particular legal requirements of an organization's home state.

Raymond Sanchez Mayers
Rutgers University
School of Social Work
536 George Street
New Brunswick, NJ 08901

ACKNOWLEDGMENTS

I wish to thank all those who gave feedback and comments regarding the material in this book. Most of all, I wish to thank the many students in my fiscal procedures, financial management, grantwriting and fundraising classes who gave their views on each chapter. They helped make the topics covered here understandable to nonfinancial managers. I especially owe deep gratitude to Fontaine Fulghum who read and edited every chapter and gave important feedback and insights as an experienced human service administrator. Some of the illustrations were done by Darlene Mendez, others by the author. S.C. “Cat” Sanchez Mayers, Erin O’Brien, and Cathy Duzenski served as able research assistants. My heartfelt thanks also to those who reviewed certain sections of the book:

Philip Crunk, University of Alabama
David Hardcastle, University of Maryland
Richard Hoefer, University of Texas at Arlington
Jordan E. Mayers, Investment Banker
John McNutt, University of South Carolina
John Stretch, St. Louis University

Lastly, there are those who inspire us to professional excellence. I thank Dean Mary Davidson and Professor Paul Glasser of Rutgers University School of Social Work for their guidance, loyal support, and friendship.

I would appreciate any comments, suggestions, or other feedback from readers. Please e-mail me at: mayers@rci.rutgers.edu or visit my website at: <http://crab.rutgers.edu/~mayers>.

Faculty who would like an instructor’s manual may send a letter on college/university letterhead to me at:

Rutgers University School of Social Work
536 George Street
New Brunswick, New Jersey 08901

To all those who gave their time, support, and ideas, I thank you, knowing that any errors or omissions are my own responsibility.

CONTENTS

	<i>Page</i>
Preface to the Second Edition	vii

I. OVERVIEW

Chapter

1. **The Social Context of Human Services Financing 3**
Human Services: An Old Endeavor; The Human Service Organization as a System: The Suprasystem; Characteristics of Open Systems; Subsystems.
2. **The Financial Management Process 19**
Financial Management Defined; The Financial Management Process; Nonprofit and For-Profit Organizations; Similarities Between Profit-Oriented and Nonprofit Organizations; Characteristics of Nonprofit Human Service Organizations; Funding of Nonprofits: Funding Streams for Nonprofits; Sources of Funds for Nonprofits; Accountability of Nonprofits and Their Regulation.

II. RESOURCE ACQUISITION

3. **The Role of Planning in Budgeting 41**
Budgetary Processes: Incremental Budgeting, Zero-Base Budgeting, Planning Programming Budgeting System (PPBS); Planning: Designing Planned Budgeting Structure, Organizational analysis, Defining Broad Goals and Mission, Developing Tentative Objectives, Gathering and Analyzing Data, Setting Objectives; Programming; Budgeting; Budgetary Documents: Line-Item Budgets, Program Budgets, Functional Budgets.
4. **Budgeting 63**

Functions of the Budget: Clarification, Coordination, Communication, Control; Budget Processes; Budget Documents; Preparing the Budget: Developing a Budget Calendar, Forecasting Service Volume, Developing Expense Budgets, The Expense Budget, Program Expenses vs. Administrative Expenses, The Salary Expense Budget, Estimating Public Support and Revenue, Revenue, Public Support, Estimating Cash Flow, Preparing Budgeted Financial Statements, Modifying and Adopting a Balanced Budget.

Reading 4–1: Preparing, Presenting and Defending the Budget 88

5. **Marketing and Fundraising** 97

The Role of Marketing in Fundraising; Components of marketing; The Marketing Process Applied to Nonprofit Organizations: Initial Planning Stage, The market audit, Setting Marketing Goals and Objectives, Targeting, Setting Strategies, Budgeting, Implementing Strategies, Evaluation, Feedback, Modification,; Implications of Fundraising for Nonprofits: Unrelated Business Income Tax, Accounting for Contributions; Ethical Issues for Organizations that Engage in Fundraising Activities.

Reading 5–1: CBBB Standards for Charitable Solicitations 120

Reading 5–2: A Donor’s Bill of Rights 122

6. **Grantwriting and Grants Management** 125

The Grantwriting Process: Assign grantwriting responsibility, plan program/project, search for appropriate funding source(s), evaluate and select appropriate funding source(s), initiate contact with funding source(s), write and submit grant; Writing The Grant Proposal; Grants Management.

Reading 6–1: Writing the Grant Proposal 139

Reading 6–2: Excerpts from OMB Circular A-110:
Grants and agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit

Organizations. 142

7. **Purchase of Service Contracting, Fees for Service and Third-Party Payments** 147
 Purchase of Service Contracting; The Contracting Process; Types of Contracts; Advantages and Disadvantages of Contracting; Fees for Services; Third-party Payments; Break-Even Analysis.

III. *RESOURCE DISTRIBUTION AND CONTROL*

8. **Internal Control** 165
 The Organizational Control System: Control Environment, Risk Assessment; Control Activities: Controlling Costs, Controlling Cash and Other Assets; Information and Communication; Monitoring: Variance budgets, Budget Summaries, Internal Audits; Designing The Internal Control System.
 Reading 8–1: Excerpts from NASW Code of Ethics 181

9. **Investments** 185
 Investment Planning for Human Service Organizations: analysis of long-term organizational goals and needs, gathering, analysis of financial condition, analysis of costs/risks/benefits, development of investment strategy, periodic review and evaluation; Fixed-Income Investments: Bonds, Certificates of deposit, Preferred Stocks; Variable-Income Investments: Common Stocks; Mutual Funds; Socially Responsible Investing; Selecting an Investment Advisor; Implications of Investing for Nonprofits.

IV. *RESOURCE RECORDING AND REPORTING*

10. **The Basics of Accounting** 211
 Basic Accounting Principles and Concepts: Postulates, Principles: Input-Oriented Principles, Output-Oriented Principles; Types of Accounting Systems; Unique Accounting Characteristics of Nonprofit Human Service Organizations;

	The Accounting Equation: Effects of transactions on the accounting equation; Financial Statements.	
11.	Nonprofit Accounting	233
	Fund Accounting; The Accounting Equation; The Accounting Cycle.	
12.	Financial Reporting	247
	Purposes of Financial Statements: To describe inputs, To describe throughputs, To describe outputs; Users of Financial Reports; Qualitative Aspects of Financial Statements; Required Financial Statements: Statement of Financial Position (Balance Sheet), Statement of Activities, Statement of Cash Flows, Statement of Functional Expenses, Notes to Financial Statements, Schedule of Expenditure of Federal Awards; Internal Revenue Requirements: Form 990	
	Reading 12–1: Form 990-EZ	269
13.	Financial Statement Audits and Analysis	273
	Audits of Financial Statements: Types of Audit Opinions; Analysis of Financial Statements: Fiscal Compliance, Stewardship, Financial Strength, Operating Efficiency.	
	Reading 13–1: Excerpts from <i>OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organization</i>	287
	Reading 13–2: Auditor’s Unqualified Opinion	287
14.	Financial Information Systems	291
	Systems Development Decisions: setting up systems committee, organizational self-study, feasibility study, choosing consultant, systems study, designing the system, selecting vendor, conversion of system; Components of Success.	
	Fund Accounting Vendors	309
	Appendix	311
	Glossary	319
	Index	329

**FINANCIAL MANAGEMENT
FOR NONPROFIT HUMAN
SERVICE ORGANIZATIONS**

I. OVERVIEW

Chapter One

THE SOCIAL CONTEXT OF HUMAN SERVICES FINANCING

After reading this chapter you should be able to:

1. Understand the social context within which nonprofits operate;
2. Describe the human service organization in systems terms;
3. Have an understanding of the place of financial management within the nonprofit organization.

INTRODUCTION

This book is about the management of resources in nonprofit human service organizations. Using a systems approach, we will examine various aspects of financial management in the nonprofit organization, including budgeting, fundraising, financial statements, and agency accountability. However, before we begin a discussion of these topics, it is necessary to place the financing of human services in a larger context.

This chapter begins with a brief historical overview of nonprofits. Then a presentation of systems concepts as applied to the nonprofit will be presented, including the suprasystem, the sociopolitical environment in which such organizations operate, the nonprofit organization as a system, and its various subsystems.

HUMAN SERVICES: AN OLD ENDEAVOR

Care of the poor and others in unfortunate circumstances is a fundamental human impulse that goes back to the dawn of history as reflected in the Bible and other early writings. This concern flows through time and is embodied in the Elizabethan Poor Law of 1601, the Social Security Act of 1935, and the social welfare legislation of most world countries. Before the Middle Ages, organized religion had been the main source of support for the needy in the Western world. Religious

groups, both Christian and Jewish, followed such teachings of the Bible as:

For the poor shall never cease out of the land: therefore I command thee, saying, Thou shalt open thine hand wide unto thy brother, to thy poor, and to thy needy, in thy land (*The Holy Bible*, 1985, Deuteronomy 15:11).

With the passage in 1601 of the Elizabethan Poor Law in Great Britain, responsibility for the poor came under the aegis of small units of government, the local authorities representing the interests and resources of both Church and State. Many of the principles of social welfare regarding treatment of the needy in the 21st century can be traced back to the early 17th century. Some of these principles include the responsibility of local government for the needy in their jurisdictions; the idea that any monetary subsidies given to the poor should be lower than the lowest local wages; and the distinction between the “worthy” and the “unworthy” poor (Axinn & Levin, 1997).

When the first settlers came to the New World, they brought their values and some of their laws with them. These included laws regulating the provision of services to the needy. As more immigrants came, voluntary societies were formed to meet the needs of their members. Many of these voluntary societies, some of which are still with us today, were formed based on some special characteristic of the members, such as ethnic group, religion, or nationality (Sanchez Mayers, 1980). For example, the Scots Charitable Society was set up in Boston in 1657; a Friends Almshouse for poor Quakers was established in Philadelphia in 1713 (Axinn & Levin, 1997). Unlike many European countries that had some type of social welfare legislation in place in the nineteenth century, the United States had no national social welfare system until rather recently. Not until the middle third of the twentieth century did the federal government become involved in the provision or funding of social services, except for such groups as seamen, military personnel, and veterans. Up until the passage of the Social Security Act of 1935, social services were provided by private local nonprofit agencies, religious organizations, municipal authorities, or those states that had passed “mother’s aid” legislation. The 1935 Act was passed in response to the tremendous needs brought on by the Great Depression and the inability of local agencies to fill these needs.

The passage of this Act and its subsequent amendments, as well as other major legislation in the 1970’s, 1980’s, and 1990’s, has had a significant impact on the funding of social services in the United States.

Over the years since 1935, human service organizations have depended more and more on federal funding for the operation of their programs. This is true to the extent that many programs could not continue functioning without such funding, and some did not continue when funds dried up due to the vagaries of the economy and shifting political currents.

Because of the tradition of local responsibility assumed from the Elizabethan Poor Law, and our American espousal of “states rights,” the administration of social welfare programs in this country has varied greatly. Even major federal programs under the Social Security Act, such as the former Aid to Families with Dependent Children (AFDC), have been administered differently in each state. That is, the amount of subsidy to eligible families has been based on an amount decided by each state. Other federal programs, such as the Social Security pension system, are administered uniformly throughout the states. Many social programs, however, are left largely to the province of the individual states. The federal government as well as state and local governments often elect to purchase services from voluntary agencies rather than providing the services themselves (Abramovitz, 1986).

The Great Society programs of the 1960’s and early 1970’s saw a tremendous increase in the funding of human services programs. Despite many criticisms and attacks from some quarters on such programs, particularly the traditional social welfare program (formerly AFDC), funding for many programs has increased over time. Such funding will probably continue to increase, especially to certain populations and certain targeted social problems. For example, with the aging of the huge cohort of baby boomers, many programs and services to the elderly are expected to expand.

As can be seen from Table 1-1, federal aid to state and local governments increased tremendously from 1970 to 1996. For example, payments to states for family support activities went from \$81 million in 1970 to \$953 million in 1996. This was an increase of 1,077%. Alcohol, drug abuse, and mental health payments to states (including grants for payments to individuals) went from \$146 million in 1970 to \$2,083 million in 1996, an increase of 1,327%. Some of this money, especially large portions of social services block grants to states, was paid to nonprofit human service organizations in the form of contracts and grants to provide services. These changes can be compared to the Consumer Price Index (CPI), an index used to chart the relative change in the cost of goods and services over time. The over-

Table 1-1
FEDERAL AID TO STATE AND LOCAL GOVERNMENTS: 1970 TO 1996*
(In millions of dollars)

Program	1970	1980	1990	1993	1995	1996	Percent Change 1970-1996***
Social Services block grants	574	2,763	2,749	2,785	2,797	2,484	333%
Payments to states for Family Support Activities (programs)	81	383	265	736	953	953	1077%
Alcohol, drug abuse, and mental health	46	679	1,241	1,994	2,444	2,083	1327%
Family support payments to states**(programs & benefits)	4,142	6,888	12,246	15,628	17,133	16,670	302%
Food stamps -administration	559	412	2,130	2,611	2,740	3,030	442%
Child nutrition and special milk programs**	380	3,388	4,871	6,589	7,387	7,757	1941%
Housing assistance**	436	3,435	9,516	14,100	18,416	16,762	3744%

*Source: U.S. Census Bureau, Statistical Abstract of the United States: 1997.

**Includes grants for payments to individuals.

***Note: During this same period the Consumer Price Index (CPI) increased 298.8% (Bureau of Labor Statistics, 1999); These program increases were well in excess of the CPI.

all CPI increased only 298.8% from 1970 to 1996 in contrast to the much larger increases in human services funding previously cited (U.S. Department of Labor, 1999). Thus we can see that increases in Federal Aid have increased dramatically over time, much faster than the average cost of living. Nevertheless, funding shifts from one program to another have left many organizations feeling pinched.

The ways in which funds have been received from the federal government has changed over time as well, from direct allocations in the form of grants to individuals and specific organizations to block allocations to states and local governments which then decide how the monies are used (Stoesz & Karger, 1993). The impetus for block grants was to give state and local governments more control over ways such monies would be spent, the assumption being that local communities are more aware of local needs than is an impersonal central government in Washington. But another factor has been the desire of political conservatives to reduce the role and scope of the federal government in social service provision (Jansson, 1997).

There are advantages and disadvantages to block grants. A major advantage to block grants is that more decisionmaking power is vested in

local governments that are presumably more aware of the needs in their communities. A major disadvantage to block grants is that they are often at the mercy of local politics and politicians, who may use the funds for political patronage. Moreover, as different locales have different values and beliefs regarding the appropriateness of some federally mandated social legislation, the goals as originally intended in some legislation become subordinated to, or distorted by, local political agendas.

While government spending has become an increasingly important source of revenue for nonprofits, private dollars also continue to provide important support for social services. It is this mix of revenue and support from so many sources that makes the nonprofit experience so rich, and nonprofit fiscal management so complex. These sources of support will be more fully discussed in the next chapter and throughout this text.

As seen above, nonprofit organizations have existed for quite a long time. Most have come into existence to meet human needs whose resolution is often not seen as the province of government, or as a way to provide publicly mandated services using the less costly, and often better informed, delivery approaches characteristic of the private sector.

THE HUMAN SERVICE ORGANIZATION AS A SYSTEM

Systems theory has pervaded the physical and social sciences over the last decades and has provided a framework with which to view many different types of processes. Concepts and techniques of systems theory are important in financial management for a number of reasons. First, they are the bases for the development of computerized information systems found in all types of organizations today. An organizational systems analysis is an integral part of the planning and development of a computerized information system. Systems techniques, such as flow-charting, are used in programming. Further, modern auditing today includes in its evaluations a systems review (Bodnar, 1980; Bodnar & Hopwood, 1995). Thus, systems concepts are very important for accounting and auditing functions. Finally, systems concepts have been employed in social work (as has the related eco-systems approach) for several decades and help give us a way to look at the human service organization, its subsystems, and its processes in some kind of totality (Germain, 1978, 1981; Payne, 1997).

“A system is composed of interacting parts that operate together to

achieve an objective or purpose. Systems are not random collections of objects. Systems consist of coherent, patterned, purposeful sets of elements” (Bodnar, 1980, p. 26). The concept of open systems holds that energy and resources flow across permeable boundaries. Material resources, technologies, and values may be seen as flowing into (as inputs) and out of organizational boundaries (as outputs). The environment of the human service organization (the suprasystem) is a complex net of social values and events, economic conditions, political constraints and facilitating factors, including federal and local laws and regulations.

The Suprasystem

It should be clear from the brief historical overview provided above that approaches to caring for the needy in our society are influenced by historical precedent, politics, public attitudes, religious beliefs and so forth. Thus human service organizations do not exist or operate in a vacuum, but rather in a complex socio-political environment that is influenced by many factors (see Figure 1-1 below). This environment we term the suprasystem. Thus, “. . . the suprasystem is comprised of those external individuals, groups, and other social systems that have an identifiable direct and ongoing pattern of relationships with the subject sys-

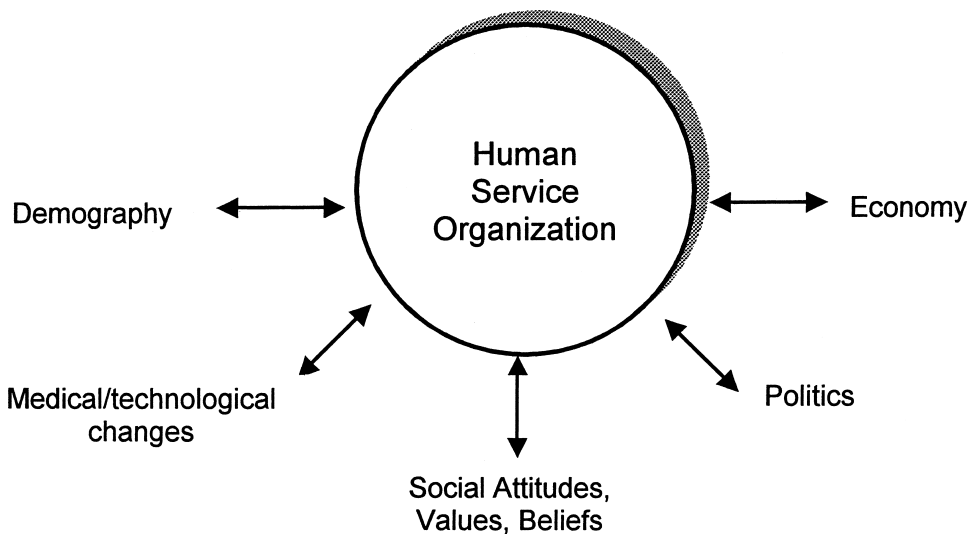


Figure 1-1: The Suprasystem of Human Service Organizations