

Nonprofits in the Age of Obama:

The “State of the Village”

Part Two

by Ruth McCambridge

Editors’ note: Over a three-year period, the Nonprofit Quarterly has committed to following 30 nonprofits as they negotiate this economically and politically tumultuous environment. This series of articles provides early alerts on trends among nonprofits.

In this, part two of the series, NPQ focuses on organizations in the child-care sector.¹ The first section explores three child-serving organizations’ financial concerns and ability to serve constituencies. Immediately following is an interview with Eric Karolak of the Early Care and Education Consortium, a national network of child-care centers. Third is a letter by Kathleen Enright of Grantmakers for Effective Organizations urging foundations to become involved in reforming government contracting.

DURING THIS QUARTER, WHAT STOOD OUT IN the *Nonprofit Quarterly*’s interviews with nonprofit organizations were the challenges for child-serving groups, so we have focused here on a few organizations and their relationships with government

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funding. Two characteristics link the three organizations featured in this article:

- all serve young children;
- all contract with government to a degree that overshadows other monies.

As we talked with the executives of these organizations, several issues emerged that make their financial management problematic:

- reimbursement rates that remain flat over years as operating costs rise;
- late payments on contracts; and
- a general lack of capitalization.

Additionally, where groups depend on fees from parents, enrollment has declined. Here we provide the stories of these groups as well as additional information on the extent to which the financial problems they face are common.

Badlands Head Start and Early Head Start

Belle Fourche, South Dakota

Serving approximately 1 million children each year nationwide in more than 18,000 pro-

grams, Head Start is 43 years old, an incalculably valuable legacy program of the War on Poverty. In terms of the relationship between nonprofits and government, that era was distinctive because of federally funded programs' emphasis on engaging low-income community members in the governance and delivery of programs.



For Badlands Head Start, even managing an influx of new money is a challenge.

According to the National Head Start Association, "Head Start provides comprehensive education, health, nutrition, and parent involvement services to low-income children and their families." The organization's outcomes are documented through several evaluation research studies conducted over the years in diverse geographic and demographic settings. Still, during

the George W. Bush administration, the program was up for federal reauthorization, and then-President Bush fought against its continuation. In 2007, Head Start was finally reauthorized, albeit with numerous costly and unfunded regulatory mandates. Then in 2008, after five years of flat funding (constituting a real decline of 11 percent) the program's funding was reduced by \$10.6 million. Not an enormous cut proportionately, but in a budget worn thin, it was painful nonetheless.

Finally in 2009, Head Start not only received a \$234 million increase in its appropriation but was also awarded \$2.1 billion of American Recovery and Reinvestment Act money to be used over a two-year period for various purposes, including the establishment of new programs.

Still, even managing this influx of new money is a challenge. The New America Foundation describes the mix of new money as complicated. "Untangling the amount of money that goes to different purposes can be confusing," Sara Mead wrote on the New America blog.² Some of the money is for onetime use, and some will be part of the ongoing yearly appropriation.

Nonprofit organizations—some that are either wholly dedicated to running Head Start programs or others that run a Head Start program as part of an array of community services—are adjusting to these changes. Many of the sponsoring nonprofits are relatively small and grassroots oriented.

In 1993, Badlands Head Start and Early Head Start began in the Shannon and Bennett Counties of South Dakota. Both counties contain the Pine Ridge Indian Reservation of the Oglala Sioux Nation. Both counties are rural and economically poor, but Shannon County has often earned the distinction of being the poorest or second poorest economic county in the country.

According to Doug Jacobson, Badlands' executive director, Badlands Head Start is not the only Head Start program serving Shannon County.

“Oglala Lakota College has the tribal Head Start program,” Jacobson says. “We are funded by the nontribal channel of Head Start, while they get their money through the tribal funding channel. The agreement we’ve had with the Oglala Lakota Sioux Nation is that Oglala Lakota College provides Head Start services through center-based programming, and we provide services to remote and isolated families in home-based settings.”

In 1994, Badlands Head Start eventually expanded to include programming for four northern-tier counties along the North Dakota and Wyoming borders. These counties are characterized by a Caucasian ranching culture, and the program now serves 194 children through seven offices in an area that extends from the North Dakota border to the Nebraska border. In every location, this organization has waiting lists of children indicating a need larger than the organization has the capacity to fill.

When Jacobson came aboard five years ago, the agency was undergoing a transition from a startup to a more mature and structured entity. This kind of change is never easy, but Jacobson has a history of facing challenges. “After serving in Vietnam, I joined my father and brother in farming,” he recalls.

My dad, brother, and I had 3,000-row crop acres in central Minnesota. The second year I farmed was the wettest year on record; the fourth year brought the earliest killing frost on record; the sixth was drier than during the Dustbowl years; the eighth was the tightest cost-price squeeze; and the ninth year delivered five inches of rain in two hours’ time, a total hail-out of the crop, a tornado that went through the building site, and a fire that burned down the main barn.

Well accustomed and committed to the rigors of rural life, Jacobson took leadership at Badlands Head Start and, with it, the job of improving the systems of the organization so that it could meet

existing accountability requirements (Head Start has 6,000-plus regulations). Jacobson had more to attend to than an administrative overhaul on top of running a far-flung array of early-childhood sites. Nationally, Head Start, which was up for reauthorization, was under continuous attack by the Bush administration, which attempted to block funding. Then the number of federal regulations grew, prompting some to believe that it was a strategy to smother even the hardest providers. Finally the much-fought-for 2007 reauthorization act was passed, which brought a sense of stability but also changes in governance and accountability.

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Badlands’ board of directors and policy council have hunkered down to ensure that this small organization can meet every requirement, with members sometimes driving three and a half hours one way to attend once-a-month evening meetings. All six counties served are represented on the board, which is only one of two governing bodies. Jacobson notes that the policy council, which is made up of parents, is part of what makes Head Start so unique and effective. He believes that the reauthorization act has weakened its authority, and this worries him. But so far, he says, “We’ve never had an impasse. Considering both governing bodies have blossomed into being very assertive, that’s amazing.”

The \$200,000 that this organization will get through the ARRA Cost of Living Adjustment (or COLA) and quality improvement Head Start funding appropriation is a complicated mix of temporary and permanent dollars, including some in both categories that are mandated for staff salary increases and other employee-retention incentives. A portion of these increases is tied to quality-improvement efforts. The program has also applied to receive dollars to expand programming

and address health and safety capital improvements. But at the end of all of this, the organization may have little liquidity. This is because of its singular dependence on federal dollars and the fact that Head Start does not allow organizations to build reserves from their federal grants. “We have got to have zero dollars at the end of each fiscal year,” Jacobson says. “On August 31, we have got to have committed 100 percent of the funds we receive for that year, and we have 90 days to finish spending those last funds.” This lack of liquidity can cause real difficulties when, for example, the price of gas goes up.

“Collaborate wherever you can to . . . be more effective in providing services.”

—Doug Jacobson, executive director, Badlands Head Start

Once every three years, Head Start’s federal review process sends a team of experts to review every conceivable aspect of each Head Start program, and not all reviewers are familiar with such an intensely rural setting. “When we get the federal reviewers out here, we have to take them out to outlying sites,” Jacobson says.

I might have to get them up so they can be ready to leave at 6:00 in the morning in order to be in a classroom setting by 9:30. Between here and there, they may see one town of approximately a dozen people. It’s grassland, most of it, other than some irrigated land. You’re driving through areas of gullies, and if you went down into one of those gullies, they may or may not ever find you down there. With 28 vehicles covering 300,000 miles per year in this rural area, gas price increases to \$4 per gallon terrify me. I can’t plan for that in my budget.

The reauthorization act actually instructs that there needs to be a focus on services to rural America, but I think that at the national level they’re still struggling to understand what that means. For example, I did submit to the

reauthorization act clarification question Web site a question regarding our ability to pitch in to provide emergency transportation during a weather emergency. We had a very rural and economically depressed area in Shannon County where the electricity was out for 10 days due to a blizzard. Technically, I would now be breaking the rules to provide transportation during a blizzard that cuts the power to people who are already extremely isolated.

One of the other commands of the Head Start act is that we be involved in community-wide disaster planning. Well, you can’t be involved in disaster planning if you’re not willing to put some resources into disaster action. Under the current rules, we can’t do it. They don’t understand: you get a blizzard in an area like that, it’s life-threatening for people. And we’ve got to be able to respond if we are to be a part of formulating community-wide disaster response plans.

But in the face of so much complexity, Jacobson is calm. “The philosophy I follow is focus on the process, not the goal; you’ll get there,” he explains. “One can cut down a forest if you focus on one tree at a time. Don’t look at the whole forest or you’ll stop. It took three years to secure this administrative building we are in now. Be creative and absolutely collaborate wherever you can collaborate to make your funding go further and be more effective in providing services.”

Imua Family Services

Maui, Hawai‘i

The 62-year-old Imua Family Services functions out of a humble location on the island of Maui, which is home to several nonprofits. Serving Maui and Lāna‘i, Imua—which, roughly translated, means “moving forward”—was originally founded to provide physical therapy to children and adults who suffer from the crippling effects of polio.



Delayed Payments to Nonprofits Worsen

Given increasingly constrained state budgets, the problem of late payments by state agencies may have worsened. A recent survey of 96 organizations by the Alliance for Children and Families found that in 19 of 30 states in which its member nonprofits did business, delayed payments were a problem.[†]

In California alone, estimates are that the state owes nonprofits nearly \$2 billion for services already rendered, and while New York has a prompt-pay law in effect, the comptroller's office estimates that state agencies are late in processing contracts for nonprofits 68 percent of the time. This delay leaves agencies not only unpaid but also working without a contract even when there is an assumption of an ongoing agreement. Since 2002, this is an increase from 15 percent of the time.

Other studies report that nonprofit executives have taken out personal loans so their nonprofits can make payroll as they wait for governments to pay. Nonprofits experiencing payment delays must divert scarce organizational capacity in juggling payments to employees, vendors, creditors, and others as they await government payments. The resulting erosion of organizational productivity inevitably impedes the delivery of service to those most in need.

[†] Varina Winder, *Some States Are Delaying Payments to Nonprofits*, Alliance for Children and Families, April 30, 2009 (www.alliance1.org/Public_Policy/nonprofit_issues/Prompt_Payment.pdf).

[‡] Debra J. Groom, "New York's Nonprofits Are Squeezing Nonprofit Agencies and Forcing Cutbacks," *the Post-Standard*, April 18, 2009 (www.syracuse.com/news/index.ssf/2009/04/new_yorks_late_payments_are_sq.html).

Imua Family Services was first organized as the Maui branch of the Hawai'i Chapter of the National Society of Crippled Children and Adults, later known as the Easter Seals Society. In 1979 the directors of the Maui Branch of Easter Seals voted to disassociate from the Easter Seals Society. The independent nonprofit agency was then named the Society for Crippled Children and Adults of

Imua has to shoulder four months of incurred costs—as much as \$800,000—until it is reimbursed in late September.

Maui County. Years later the organization changed its name to Imua Family Services to better identify the breadth of services provided to the Maui and Lāna'i communities.

True to its name and like many organizations in the field, Imua's mission has evolved with the times and with medical science to address a fuller spectrum of special needs of young children. According to Executive Director Karen Jayne, identifying and addressing special needs early on in development has a proven long-term positive effect on the children Imua Family Services is mandated to serve.

In this context, the word *mandated* is important because the preponderance of the agency's activities are federally mandated services through a contractual relationship with the state of Hawai'i. Imua Family Services' early-intervention program for children from birth to age three is a state-funded program regulated under Individuals with Disabilities Act (or IDEA) and the No Child Left Behind Act. The federal government allows states to interpret the law based on what best fits their communities. But since services are mandated by the federal government, every child with developmental delay must be supported at no cost to the family.

"We have to meet very stringent time lines," Jayne says. "And I don't disagree with that in the least. The very nature of the service—and what's

happening to the children in this age range—makes it urgent to provide service quickly and effectively. Every minute that the child loses can have serious long-term effects. So that means the time lines must be rigid. We can't waitlist, we can't refuse service, and the clock starts ticking from the moment the child's referred."

The problems come in the contract reimbursement. Jayne estimates that the contract covers only 80 percent of the cost of service. The organization makes up the rest by draining its surplus built up through other revenue sources and fundraising activities. This, of course, leaves the organization capital poor. On top of that, timing is an issue. "All services are provided up front, because it's a reimburse contract," Jayne says. "So we provide service, we bill the state, and the state reviews the billing and then pays. This payment process can take anywhere between 45 and 240 days." At the end of the state's fiscal year, payments of contracts are often slow; and this year, with the state in the red, things are slower than usual.

At this point, Imua Family Services' cache of reserves is so low that it has to use debt to create cash flow.

Imua has just been informed that the state of Hawai'i will not pay the agency until late September for work conducted between mid-May through August, which leaves the agency with four months of incurred costs with no payment. The dollar figure is somewhere between \$700,000 and \$800,000. Again, the agency is not allowed to stop or slow its work.

This is by no means an irresolvable problem, but it requires collective and regulatory action. Recently, interviewee Mark Weiner of CJE Senior-Life in Chicago, Illinois, noted that a stipulation on Medicaid funds included in the stimulus package has eased his management worries immensely. "The state wasn't paying us," Weiner says. "So if you had asked me two months ago, the

Government Funding Impedes Profitability

In the article "Truth or Consequences: The Implications of Financial Decisions," author Clara Miller suggests that of all funding sources, government tends to leave you least liquid and profitable. "If your organization's primary source of revenue is government, you are going to be half as profitable as organizations whose primary source of revenue comes from service fees or private contributions. And when it comes to cash availability, this disparity becomes even more discouraging."*

*Clara Miller, "Truth or Consequences: The Organizational Importance of Honesty," the *Nonprofit Quarterly*, vol. 14, no. 2, Summer 2008 issue.

state was four to five months behind and owed us about \$4.2 million. That was really problematic for us because our line of credit was at \$5 million, so we were getting nervous. But because of the economic stimulus bill, in order for the State of Illinois to get money, the state had to commit to being no more than 30 days behind in paying Medicaid."

Jayne reports that even in better times she constantly works the numbers and always looks four to eight months ahead to ensure sufficient cash reserves to meet payroll. Now she faces a degree of difficulty that promises many sleepless, spreadsheet-filled nights. Imua has an annual budget of approximately \$3.4 million, with most income coming from state contracts. At this point, its cache of reserves is so low that it has to use debt to create cash flow. "The total loan limit that's set by the board is generally about 70 percent of the receivables," Jayne says. "We are fortunate to have a very good relationship with our bank. But it can get pretty stressful, because no matter how good your relationship is, they can always say no." In this case, Jayne worries that if things

at the state level get worse, the agency could need more than the board-established ceiling.

The Importance of Meeting Payroll

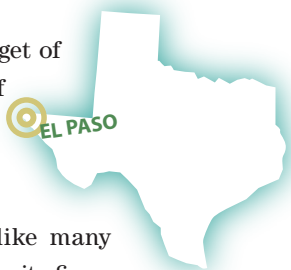
Imua's services—many of which are home based—require a full complement of professional, well-trained, culturally competent staff, which is hard to manage when turnover rates are high. Jayne estimates that Imua's salary base for therapeutic staff is roughly 30 percent below the nationwide average for such highly trained professionals—even in areas where the cost of living is relatively high. This creates recruitment challenges that the agency has worked hard to overcome. Over the past few years, by coupling salary with a generous benefit package and recognizing and rewarding staff work and commitment, Imua has reduced its staff turnover rate from 50 percent a year to 35 percent. Missing payroll would, of course, undo these efforts—not to mention the fact that children and families would suffer from a lack of timely services. So, for Jayne, making payroll is a nonnegotiable and a constantly moving target.

"I don't know that you can measure the amount of time spent dealing with cash, whereas if you just had consistent payment, a lot of that distraction would go away," she says. Ultimately, if cash flowed as it should, the organization could focus where it should: on children and their families and on providing service to the Maui and Lānaʻi communities.

YWCA El Paso del Norte Region

El Paso, Texas

With an annual budget of \$30 million, a staff of 550, and its own foundation, this YWCA might seem fairly robust. But like many smaller organizations, its finances are plagued with problems brought on partly by a board vote five years ago to delay



a capital campaign. Additionally, in 2007, the agency added some \$325,000 in salaries to comply with the first of three mandatory increases in the federal minimum wage. By 2008 the cumulative second-year impact of the wage increase rose to \$775,000, and this figure will reach a cumulative total of more than \$2 million in additional annual salaries at the end of the three-year, three-step process. All but \$11 million of its annual budget is state-funded child-care contracts. In short it has grown and stored up money in a largely inaccessible endowment while running several programs with below-cost reimbursements (through

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contracts and fees). This has created predictable problems, including repeated deficits, cash-flow difficulties, and deferred-maintenance problems.

Sandra Braham, the current CEO, takes some responsibility for the organization's lack of liquidity. For several years prior to taking executive leadership three years ago, Braham was a board member. In that role, she helped pass budgets that appeared balanced but that did not address prior years' deficits (which the organization incurred largely because of noncash depreciation, which was annually budgeted). Because of the size of the agency and its history, the downward trend in covering the organization's depreciation was not immediately alarming.

Braham was the second successor to an executive who had been at the agency for nearly 40 years. During that time, the culture of the organization was financially frugal but programatically prolific. Programs flowered, but staff salaries were depressed and the organization built nominal reserves. Over time the organization began to run deficits that were covered by what was budgeted for depreciation. When a tract of valuable donated land was sold for \$5.5 million,

the profits were put into the foundation, making it largely inaccessible for immediate needs. As a result of the downturn, foundation funds have shrunk considerably: from \$10 million to between \$7 million and \$8 million.

Between the long-term executive and Braham, the former CFO stepped in to lead the organization, and as Braham describes it, the CFO's response to the agency's lack of financial robustness was to further cut expenses. This lack of investment contributed to the organization's deficit and declining infrastructure in two major divisions: health and wellness and child development. Budget cuts in the child development division increased staff turnover and decreased

As a result of the downturn, foundation funds have shrunk considerably.

revenue from fees. Aging fitness equipment in the health and wellness division led to frequent breakdowns and created a need for capital investment. Given these units' space utilization and size of payroll, space and administration allocations for these two divisions were the highest in the agency. And the aging technology infrastructure was insufficient to manage such large operations.

Likening it to a "whack a mole" situation, Braham explains the approach to reducing certain programs' year-upon-year deficits to improve the agency's balance sheet and cash position. First, the organization had to spend. With the help of foundation funding, the organization increased its investment in its fitness facilities and made long-overdue capital improvements. These investments allowed it in turn to increase fees, which drove up membership. In half a year's time, the organization reduced the child-care division's deficit by increasing the number of center directors, establishing an enrollment-based incentive plan, and raising entry-level salaries. It also increased fees to cover a portion of the additional cost. But driven by the failing economy, Braham

Declining Child-Care Enrollment

Susan Wilkins, the executive director of the Association for Supportive Child Care in Arizona, notes a declining enrollment dynamic similar to that at YWCA El Paso del Norte Region. "Not only are child-care providers hurting because their [subsidized care] rates were recently cut by 5 percent, but we're seeing a huge reduction in the number of families that are using formal child-care arrangements because of the economy," Wilkins says.

At a time when people are having a hard time, they might turn to their grandmother or their aunt or their sister or somebody to help them care for their children rather than going to a formal child-care arrangement.

So we're seeing a huge increase in the number of unregulated providers, and regulated child-care providers calling us through child-care resource and referral, telling us they're desperate for children. So there's a world of hurt out in the child-care field, and programs—some are starting to close; some are starting to lay staff off—it just depends on the economy of their situation, their environment.

noticed in late 2008 that child-care enrollment decreased in after-school programs and in child development. "We have 52 after-school sites and 14 child development centers," Braham says.

El Paso has worked to improve its position from that of a low-wage town. But with the downturn in the economy, what we have been hearing from families is that people are less able to afford full and sometimes even partial out-of-pocket expenses for child care. The alternative may be an empty house or older sibling or family member. At the same time, we have waiting lists of up to 1,500 families for the subsidized spots.

And in Texas, because rates are adjusted to the local economy, those fully subsidized spots are reimbursed at below the cost of service. As a result, a program in El Paso gets far less than a program in, say, Austin. Braham estimates that the YWCA subsidizes the state subsidies to the tune of approximately \$300,000 a year on child care alone.

It will be interesting to watch how the YWCA will handle its complicated financial picture. Its current-year budget—which showed the organization running a \$76,000 surplus—was dependent on the sale of a property. Since the organization had an existing agreement on the property that would have brought the agency almost \$600,000, it was perhaps not completely outlandish to budget this way. But after the buyer's federal funding fell through, the sale fell apart as well. This and the decline of principal in the endowment leave the organization with quite a hole to fill.

Because of state budget constrictions and a reduction in parents' ability to pay, the child-care crisis (outside the Head Start network) could worsen in 2010. Add to this situation contracting problems that cause cash-flow issues and staff turnover, and you have a tangle of management challenges that threaten to distract providers from their real work: the care and preparation of young children.

Where Is the Nonprofit Economy Headed?

As always, to some extent the answer to the question of where the sector is headed depends on a nonprofit's field of work, its geography, and its level of influence, among other factors. But there is a more general answer. Unfortunately, every indication is that nonprofits will fare even worse economically in 2010 than they did in 2009.

Foundation budgets are more than likely to be reduced, as are many United Way campaign results. The stimulus money will have largely passed through the system, and the national deficit will loom as a political issue, State budgets are

likely to be more hard hit, extended joblessness may well depress individual giving and people's ability to pay fees to nonprofits that charge them, and, finally, constituent need may be greater and more acute. The Alliance for Nonprofit Excellence report "Downstream and in Demand: Mid-South Nonprofits and the Economic Crisis" states that client profiles have changed, expanding not only to include those not previously in need of service but also in terms of acuity of need.³ The Spring 2009 issue of *NPQ* noted this trend, but as the Alliance report states, "Respondents noted two specific recent trends. First, more 'severe,' 'dramatic,' and 'urgent' needs for services are observed, e.g., health conditions, co-occurring disorders, dangerous living conditions, and extreme hunger. A second and related pattern is that a wider array of services is being demanded."

This last observation conforms with what we have heard in our interviews. Fewer resources coinciding with increased need and a delay in accessing help means that people will approach caregivers in more immediate and acute need just when the wherewithal to meet those needs may be limited.

ENDNOTES

1. For part one of this series, see "High Anxiety," the *Nonprofit Quarterly*, vol. 16, no. 1 Spring 2009 issue (http://www.nonprofitquarterly.org/index.php?option=com_magazine&Itemid=26).
2. Sara Mead, "Getting the Ball Rolling on Head Start Stimulus \$\$," the New America Foundation blog, April 3, 2009 (<http://www.newamerica.net/blog/topics/stimulus>).
3. *Downstream and in Demand: Mid-South Nonprofits and the Economic Crisis*, the Alliance for Nonprofit Excellence, July 1, 2009 (www.npexcellence.org/documents/DownstreamReportFINAL.pdf).

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