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NEW YORK NONPROFITS IN THE AFTERMATH OF FEGS: A CALL TO ACTION

Nonprofit human services organizations play a critical and longstanding role in building and supporting the wellbeing of New Yorkers, enabling millions of people to contribute to their communities as students, parents, neighbors, and workers. These providers deliver services to an estimated 2.5 million New Yorkers annually.[1] They train and help keep workers in good jobs, provide early childhood education and after-school programs, run food pantries, respond to emergencies and natural disasters, provide mental health counseling, shelter people experiencing homelessness, and care for the elderly, among many other community services. By administering human services programs, nonprofits are building the wellbeing of New Yorkers, maximizing their potential and ensuring that New York maintains its global competitiveness. The collective services provided by human services nonprofits make the difference between success and failure for countless individuals and families. Yet the sector itself is facing a crisis.

As with any industry, nonprofits in the human services sector close and merge, but recently, there have been many questions about why so many have disappeared. Organizations, including Alianza Dominicana, GroundWork, Day Top Villages, and Palladia, have merged or closed their doors, putting pressure on the rest of the provider community to pick up programs. In March of 2015, the Federation Employment and Guidance Service (FEGS), a $250 million behemoth nonprofit human services provider, announced it would be closing; a clear signal that systemic issues threatened the survival of the sector as a whole.

Until it filed for bankruptcy, FEGS, one of the largest human services providers in New York, delivered an array of mental health, disabilities, housing, homecare, and employment services on an annual budget of about $250 million. The closing of FEGS after 80 years in operation left about 1,900 employees without jobs and unpaid creditors holding more than $47 million in debt. Additionally, the 120,000 households and individuals that relied on FEGS for services had to be transferred. The City and State agencies that contracted with FEGS were blindsided by its poor financial condition and were forced to find replacement providers to administer about 350 of its ongoing program locations.

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FEGS, like hundreds of other human services providers, was funded largely through public contracts with governmental agencies. Over the past 40 years, government has transferred most legally mandated support functions to the more efficient and nimble nonprofit sector at a fraction of what it would cost government to administer directly because of lower expenses at nonprofits and investments made by private funders. (“Private funders” refers to philanthropic giving from institutions, corporate donors, and individuals. It does not include loans or other private non-giving sources of funding.). The combined value of government human services contracts in New York is estimated at more than $5.8 billion for the current fiscal year.

The closing of FEGS raised urgent questions: How could such a large and well-established organization implode? Was FEGS unique or symptomatic of the financial challenges facing the nonprofit human services sector? How many other organizations are in trouble, and how many people would be affected if they close? How can more closures and the associated consequences be averted? What will it cost if this industry collapses? What is required to ensure that this does not happen? In March 2015, the Human Services Council (HSC) set out to answer those questions.

Since 1991, HSC has worked to unite and empower New York’s nonprofit human services sector and has advocated for public policies that enable it to better serve New Yorkers. HSC recruited 32 seasoned human services executives, civic and philanthropic leaders, former government officials, and other individuals with critical experience and knowledge concerning nonprofit management and oversight (see Commission Participants, page 41). They were asked to conduct a rigorous assessment of the state of the nonprofit human services sector and to recommend measures to ensure that vitally needed organizations survive and thrive until they are no longer needed. Gordon J. Campbell, a former senior government official and former President and Chief Executive Officer of United Way of New York City, was appointed the Chair of the Commission, charged with examining the state of the nonprofit human services sector in the aftermath of FEGS.

Commission members met frequently over nine months in committees with specific agendas (see committee members and charters, attached as Appendices A.1 through A.5, respectively). The findings of their exhaustive review follow.

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Major findings

Human services nonprofits have a higher rate of insolvency than other types of nonprofits. Organizations with budgets from $10 million to $49 million are more likely to be in financial distress than those with budgets of less than $1 million, and a significant portion—60 percent—are financially distressed, having no more than three months of cash reserves.

Underfunded government payment rates are the primary driver of financial distress. Government contracts dominate provider budgets but pay only about 80 cents or less of each dollar of true program delivery costs, leaving budget holes that private funders cannot, or should not, fill.

Underfunding leads to salaries so low that many nonprofit employees depend on safety net programs, such as food stamps and Medicaid. It also results in inadequate investment to keep facilities safe and in good repair.

Chronic delays in contract payments force providers to undertake costly borrowing to make payroll and rents, often accruing interest not covered by government contracts.

Multiple and redundant audits, along with unfunded mandates and other oversight mechanisms, add up to staggering administrative costs.

The transition to Medicaid Managed Care poses considerable risk for human services providers and there is no assurance that any of the substantial State investment to prepare for this new system will flow to human services organizations.

Government does not fully leverage the expertise of human services providers to design programs, missing a significant opportunity to innovate and develop metrics and requirements that match the government dollars available for a given contract.

Too many government regulations are redundant and unnecessary. The multiplicity of procedures that accompany government contracts detracts from the focus on mission.

Human services providers need to expand their risk assessment and management capacity to ensure that executive staff and boards focus effectively on organizational sustainability and continued delivery of services to the community.

Because of weak internal financial and programmatic reporting, providers may not be alerted to short-term and long-term fiscal dangers early enough to address them. Inadequate funding of indirect expenses has contributed to the lack of resources available for investment in effective risk identification mechanisms.

The philanthropic community is a crucial partner in the capacity building efforts of nonprofit human services providers and should better facilitate investment in these functions.

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Recommendations

To address these issues and ensure the future contributions of the human services sector, the HSC Closures Commission identifies three major problems and makes eight recommendations that are designed to work together to bring the sector back from the brink.

Problem #1: Programs intended to build human potential and social welfare are too often developed without consulting the human services providers who will be responsible for implementing them, resulting in ineffective and unworkable programs.

- Programs that work well require effective partnerships among the public sector, private funders, and human services providers. Human services providers with decades of experience would be instrumental in designing and implementing programs that more effectively serve New Yorkers and should be involved at the outset of program planning.

- Make certain that New York's transition to Medicaid Managed Care is a win for beneficiaries, taxpayers, and human services providers by ensuring that funding is available to nonprofits for investments in information technology, capacity building and training, metrics tracking, and providing a cushion against related risks.

- Oversight regulations and procedures that fail to catch bad actors are a waste of everyone's time and money and should be replaced with meaningful government oversight approaches that ensure that providers are financially and programmatically responsible.

Problem #2: Government contracts and philanthropic grants rarely cover operating costs and payment is often late and unpredictable, resulting in cash flow obstacles and chronic underfunding.

- Contracts and grants must fully cover indirect costs. Indirect (overhead) expenses like information technology, building maintenance, program evaluation, accounting, human resources, and employee training are vitally important to service delivery. Adequate funding by the public sector and philanthropies of indirect expenses is essential for providers to survive.

- Payments must be timely and reliable so that providers are not left "holding the bag." Contracts must allow for payment escalations to cover inflation and unanticipated expenses that exceed reasonable budget estimates. Contract renewals must accommodate cost increases or allow their surrender if they become unsustainable due to unforeseen circumstances, such as costly, new unfunded mandates.

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Problem #3: There is a lack of adequate risk assessment in the sector. Providers must accept responsibility for aggressively identifying, assessing, and addressing risks to their fiscal health and put in place the checks and balances needed to protect themselves and the people they serve.

- Providers must implement financial and programmatic reporting systems that enable them to identify and quantify the financial impact of changes in the operating environment. Private and government funders must underwrite the development of robust financial and performance monitoring systems necessary for long-term sustainability and program quality.

- Provider boards, in conjunction with staff, must be engaged in risk assessment and implement financial and programmatic reporting systems that enable them to better predict, quantify, understand, and respond appropriately to financial, operational, and administrative risks. Private and government funders should help build their capacity to do so by facilitating access by nonprofit staff and board members to professional development, technical assistance, and coaching.

- The human services sector must establish an RFP rating system and government agency performance survey to illuminate the risks associated with individual government proposals and highlight problematic government agency policies and practices. Providers can start to level the procurement playing field by collaborating to evaluate government performance.

For the complete report, please see http://www.humanservicescouncil.org/Commission/HSCCommissionReport.pdf

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130 East 59th St. New York, NY 10022 T: 212.836.1230 humanservicescouncil.org