



Management Control Systems in Nonprofit Organizations

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Management Control Systems in Nonprofit Organizations

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Preface

Pedagogical Goals

The purpose of this book is to expose current or future managers of nonprofit organizations to management control systems. While professionals are increasingly aware of the need for formal education in nonprofit management principles, little textual material exists in this area. *Management Control Systems in Nonprofit Organizations* is a response to this need that also provides “business” students with insights into the management of nonprofit organizations.

There are a number of college-level courses—both undergraduate and graduate—where this book can be used. They are found in such disciplines as criminal justice, social work, health care management, nursing administration, educational or public administration, institutes of public service, and business administration. This book could also be used for in-house training and continuing education programs for social agencies, for health care, and for educational and governmental units.

This textbook covers both nonprofit management principles and the technical tools of decision making. Such coverage allows instructors to emphasize either a qualitative or quantitative approach. Subject areas include the nature of nonprofit organizations, a model for managing nonprofit organizations, and management techniques for planning and control. The textual material introduces financial and fund accounting and those management accounting techniques necessary for teaching how to manage a nonprofit organization successfully. The technical generation of accounting data, while introduced, is not emphasized. This book is designed for the user of accounting information.

Successful readers of this book will understand and be able to use many of the generally accepted management techniques in their own nonprofit settings. Some of the examples, problems, and cases emphasize health care and social service agencies; others deal with churches, service clubs, state and local governments, and many aspects of education. The

wide range of examples and problems addresses most nonprofit areas. Many common threads connect the management principles; an example in a social service agency has relevancy for a health care setting since common management problems bind all nonprofit organizations.

The Management Control System Model

To provide instructional materials that are both flexible in application and integrated into a systematic whole, the authors have built this book around a model of management control—one that provides an applied rather than theoretical picture of management activities. This model recognizes and emphasizes those planning and controlling activities that successful managers use. Furthermore, it provides a global outline for grouping management principles and terminology, allowing the widest application.

The model begins with the preoperational activities of strategic planning, programming, and budgeting. The next phase of the model, operational activities, concentrates on short- and long-run decision making for service volume, pricing, cost control, and capital additions. The post-operational phase includes performance evaluation, reporting, and auditing and is concerned with determining and reporting the results of operations. Based on this applied model, the book was divided into five parts.

Part 1, *A Management Control System Model*, contains two preliminary chapters. Chapter 1 explains the role of nonprofit organizations and their importance to society. And Chapter 2 introduces the management control model for nonprofit organizations.

Part 2, *Preoperational Activities*, explores the first phase of the model. Chapter 3, "Strategic Planning," underscores the critical importance of developing a mission statement and specific goal statements and of testing their feasibility by forecasting service demand and estimating costs. (A comprehensive appendix explains the methods used by management scientists in measuring fixed and variable patterns.) Chapter 4 explains how managers group and create the mission and goal statements in order to develop the framework of the management control system—programs, program objectives, program indicators, and composite indicators. Chapter 5 illustrates how the strategic planning phase (including demand forecasting and cost estimating) and the programming phase (including developing program objectives and performance norms) can be combined into a formal budget. Special emphasis is placed on program responsibility centers.

Part 3, *Operational Activities*, expands the management control system model by examining the decision rules used. Chapter 6 introduces two basic themes of good management: (1) that managers should build a strong organizational structure around responsibility centers, with explicit statements of accountability and controllability, and (2) that sound decisions

within these responsibility centers require the understanding of relevant benefits and costs. Chapter 7 uses the short-run decision rules developed in Chapter 6 to examine decisions involving volume of service delivery. This is explored through traditional cost-volume-revenue, break-even analysis and product-service mix decisions. (A short appendix discusses circumstances in which the learning curve concepts would be useful in estimating program inputs.) Chapter 8 investigates pricing strategies, including both market-based and cost-based procedures; a variety of nonprofit organization pricing decisions; and prospective reimbursement and cost-plus contracting. Chapter 9 illustrates the use of discounted cash flows in making long-run decisions. It covers the measurement of the relevant outflows and inflows; the choice of an acceptable discount rate; and the role of capital rationing, risk, and the impact of inflation in long-run decisions. (An appendix discusses the concepts of the time value of money, future values, and present values which underlie the use of discounted cash flows.)

Part 4, *Postoperational Activities*, completes the management control system model. Chapter 10 explains how to combine effectiveness and efficiency indicators (from Chapter 4) with responsibility and program centers (from Chapter 6) to provide an assessment of actual performance. Chapter 11 explores the information content of management control system reports and differentiates between the reporting requirements for internal and external purposes, including both traditional reporting formats and specific requirements for governments, hospitals, and social service agencies. Chapter 12 examines the development of assurances that the results are as reported by discussing the types of audits, the process of auditing, and the nature of audit reports for both internal and external use.

Part 5, *Accounting Data for Management Control Systems*, is an independent section. These four chapters provide an overview of the accounting process and function and can be assigned as needed. These topics are typically introduced in the first few chapters, often giving the reader the impression that a management control system is nothing more than an accounting system. The accounting system provides significant information needed to operate a management control system; one cannot successfully exist without the other. However, the authors believe that a good management control system transcends accounting. Therefore, our approach is a separate, independent section that allows the instructor to include none, part, or all aspects of accounting.

Chapter 13 presents the basic financial statements, accounting assumptions and principles, the cash and accrual basis, and basic definitions. (An appendix explores the financial accounting function of transaction analysis using a T-account approach.) Chapter 14 discusses techniques for analyzing financial statements and managing financial resources, including vertical and horizontal analysis combined with ratio analysis. Chapter 15 deals with cost and management accounting, and Chapter 16 illustrates the

use of traditional fund accounting. (Where relevant the differences in fund accounting between governments, hospitals, and social service organizations are discussed.)

These 16 chapters provide for systematic coverage of the underlying principles of planning and controlling a nonprofit organization. An *Instructor's Manual* provides suggested solutions for all assignment material.

Flexibility of Textual Assignment

Within the limitations imposed by the use of an integrated model, an instructor's options include the following:

A. Where the readers have no background in accounting or business principles and the intent is to provide a full exposure to both principles and technical methods, the following chapter order is possible: 1, 2, 13, 14, 15, 16 (optional), 3, 4, 5, 6, 7, 8, 9, 10, 11, and 12.

B. Where the intent is to provide an overview of nonprofit principles with little or no exposure to technical methods, the following chapter order is possible: 1, 2, 3, 4, 5, 6, 10, 11, and 12 (with 13 and 14 optional either after Chapter 2 or after Chapter 6).

C. Where the readers have some background in financial accounting principles, Chapters 13 and 14 (16 optional) could be omitted. Where students have background in both financial and managerial accounting, Chapters 13, 14, 15, and 16 (optional) could be omitted. If the background is very strong, Chapters 7, 8, and 9 could be covered as a review.

D. Where the emphasis is on the principles of management control systems and the instructor wants to cover decision making briefly, Chapters 7, 8, and 9 could be underemphasized and Chapters 13, 14, 15, and 16 omitted.

Where the book is to be used for in-house training with severe time constraints, Chapters 1, 2, 3, 4, 5, 6, 10, and 11 could be used. If more time is available, then Chapters 7, 8, and 9 could be added.

The problem materials in the book are flexible enough to allow the use to take either a qualitative or a quantitative approach. Problem materials are intended to reinforce the textual materials. Cases, included for a more applied approach, are of moderate difficulty.

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We are indebted to the many people and organizations who allowed us to use their materials. The individuals who were kind enough to allow the use of their cases are listed with their case materials. Also, we are indebted to the American Institute of Certified Public Accountants, the Institute of Certified Management Accountants, the Institute of Internal Auditors, and the many publishers and organizations for their permission to quote from their publications and examinations. Problems from the Uniform CPA Examination are designated *AICPA Adapted*; problems from the Certified Management Accounts are designated *CMA Adapted*; and problems from the Institute of Internal Auditors examination are designated as *IIA Adapted*.

Finally, we recognize the indirect importance of Kavasseri (Kasi) V. Ramanathan, University of Washington, to our project. As a friend and colleague of many years, he has provided an intellectual atmosphere that has developed our awareness of the difference between knowing something and understanding its relevancy. We only hope that his ability to ask searching questions, to integrate multiple variables, and to construct explanatory models has rubbed off on us. His original thinking and contributions in the area of nonprofit control systems first awakened our interest in the subject of this book.

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