Business Combinations –
Why, When and How to Integrate

Presented by:

David M. Rottkamp, CPA, Partner and Nonprofit Practice Leader

Grassi Advisors & Accountants

James Krueger, MBA, Chief Financial Officer

The ARC Greater Hudson Valley

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GRASSI
ADVISORS & ACCOUNTANTS

The Arc.
Greater Hudson Valley
New York

David M. Rottkamp, CPA

Partner and Nonprofit Practice Leader

- Over **36 years** of experience providing audit and advisory services to the nonprofit and health care industries
- **Focus:** Organizations serving individuals with special needs, religious organizations, educational institutions, membership associations, social service providers, healthcare providers, foundations, and arts and culture
- **Advises On**: Financial reporting systems, implementation of new accounting standard updates, sustainability/succession planning, internal control reviews, strategic planning, retreat facilitation, and providing quality board education and governance advice
- **Firm Involvement:** Member of the Accounting and Auditing Committee and the Strategic Partner Retreat committee, which plays a significant role in cultivating the firm's culture and strategic objectives
- **Community Involvement:** Serves on the Board of the National Multiple Sclerosis Society, the New York Council of Nonprofits (NYCON) and Governance Matters and is a member of the AICPA and NYSSCPA
- **Presentations and Publications:** AICPA and NYSSCPA Conferences, internal education sessions, webinars and the CPA Journal

David M. Rottkamp, CPA
Partner and Nonprofit Practice Leader
Grassi Advisors & Accountants
212.223.5046
drottkamp@grassicpas.com

GRASSI ADVISORS & ACCOUNTANTS
The Arc. Greater Hudson Valley New York

James Krueger, MBA

Chief Financial Officer

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Chief Financial Officer
The ARC Greater Hudson Valley
845.796.1350
jkrueger@arcghvny.org

Since 1994, Jim has overseen the fiscal operations of the Chapter and is responsible for its strategic activities. During the last five years, Jim. And the leadership team, have successfully accomplished 2 different mergers which has grown the Chapter threefold. His leadership has led the effective integration of many aspects of the fiscal and business operations.

Jim is the Vice President of the Eastern NY region of the FMA and has been an officer for several years. Jim is a graduate of UC Irvine and received his MBA from Pace University in 1993.

Business Combinations

- **Why** – What are the considerations why two nonprofits consider a business combination?

- **When** – What are the considerations when to begin, evaluate, and conclude a business combination?

- **How** – What are the considerations on how to successfully complete and integrate a business combination?

Business Combinations

- **Acquisition**
  - A transaction or other event in which a not-for-profit acquirer obtains control of one or more nonprofit activities or businesses and initially recognizes their assets and liabilities in the acquirer's financial statements.
- **Merger**
  - A transaction or other event in which the governing bodies of two or more not-for-profit entities cede control of those entities to create a new not-for-profit entity. To cede control requires that the merging entities not retain shared control of the new entity. To qualify as a new entity, the combined entity must have a newly formed governing body; a new entity often is, but need not be, a new legal entity.
- **Shared Services**
  - When two or more nonprofits agree to work together collaborating on a specific program, function, task, etc. The goal is to achieve efficiencies to provide greater value.

Business Combinations - Advantages

- Better services – Creates opportunities for additional program services
- Increased units of service – Allows for an increase in revenue generation
- Low cost - A larger combined organization should benefit from economies of scale
- Better management – It combines the best management and executive leadership
- Reimbursement – Opportunities for resetting rates or receiving the “higher of” rates
- Competition – Eliminates opportunities for individuals to go elsewhere

Business Combinations - Disadvantages

- Uncertainty with employees – Combinations may lead to uncertainty in the minds of the employees
- Added cost – The initiation and execution of a business combination generally requires outside third parties to assist with the transaction, which can be costly
- It may fail – It is not guaranteed that every business combination will result in efficiencies, surplus, retention on employees and individuals in program

Business Combinations – Why and When

Geographic expansion	Proactive vs. reactive
Addition of complementary program services	Change in board/executive leadership
Expansion of existing services	Fiscal strength or fiscal distress
Need to supplement/outsource departmental operations	Necessity to survive
Elimination of competition	Required to by outside third party
Timing	Effective management

Exploration and Consideration Principles

- What does our vision dictate we do?
- How strategic of an organization are we?
- What does our current executive leadership look like and what does our succession planning address?
- Is there depth in the governing body?
- What does our financial sustainability model look like?
- Are we providing services at the highest level, achieving the best outcomes for those we serve?

Exploration and Consideration Principles

- Must be in the best interests of the respective organizations
- Result in a stronger, healthier and robust version of either organization
- Embrace the mission and vision of each organization
- Financial health of each organization
- Program health and quality within each organization
- Allows for the combination to result in continued brand recognition or becoming a full functioning program of the acquirer

Exploration and Consideration Principles

- Ultimately lead to a strong and financially sustainable organization meeting and exceeding the needs of those we serve
- An opportunity is present to bring together two or more nonprofits that have commonalities among their leadership and their programs to achieve improved program and financial success, leading to continued sustainability
- Must have mission-focus, mutual benefits, and complimentary opportunities that allow both nonprofits to take advantage of their own uniqueness

Financial Considerations

Financial Ratio Analysis											
		----- AGENCY A -----					----- AGENCY B -----				
		Interim	Interim	Interim	Interim	Interim	Interim	Interim	Interim	Interim	Interim
Statement Description	Weighting	12/31/2018	12/31/2017	12/31/2016	12/31/2015	12/31/2014	12/31/2020	12/31/2019	12/31/2018	12/31/2017	12/31/2016
1) Current Ratio		0.9205	1.0771	1.3756	1.1178	1.1951	0.7770	0.7674	0.8388	1.1770	1.4187
2) Accounts Receivable Days		54.9805	56.3801	36.3214	44.0006	46.312	33.4596	44.3560	33.6371	46.0579	40.3530
3) Long-Term Debt over Net Assets		0.5394	0.5525	0.5559	0.5890	0.715	0.8564	0.7839	0.7460	0.6964	0.7880
4) Modified Debt Service Coverage Ratio		0.5165	0.2152	2.0176	1.0690	1.5183	0.7378	0.5971	(0.0404)	0.6174	1.2781
5) Operating Surplus/(Deficit)		(0.0238)	(0.0322)	0.0321	(0.0080)	0.0146	0.0007	(0.0104)	(0.0405)	(0.0158)	0.0143
6) Prime Reserve Days		9.0632	4.5667	21.3892	9.8939	9.4307	10.8614	0.7402	2.1771	10.6983	16.8655
1) Current Ratio	10%	1	1	2	1	1	1	1	1	1	2
2) Accounts Receivable Days	10%	3	3	5	4	4	5	4	5	4	5
3) Long-Term Debt over Net Assets	10%	3	3	3	3	3	3	3	3	3	3
4) Modified Debt Service Coverage Ratio	50%	1	1	3	1	2	1	1	1	1	2
5) Operating Surplus/(Deficit)	10%	1	1	4	2	2	2	1	1	1	2
6) Prime Reserve Days	10%	1	1	1	1	1	1	1	1	1	1
Weighted Score	**100%**	**1.40**	**1.40**	**3.00**	**1.60**	**2.10**	**1.70**	**1.50**	**1.60**	**1.50**	**2.30**

Financial Considerations

Definitions		1	2	3	4	5
1) Current Ratio measures Liquidity		0 to 1.2499	1.2500 to 1.7999	1.8000 to 2.3999	2.4000 to 3.4999	3.5000 and above
2) A/R Days measures Efficiency and Opportunity		61 or more	57 to 60.9999	49 to 56.9999	43 to 48.9999	42.9999 and below
3) LTD/NA measures Leverage and Risk		1 or more	.8900 to .9999	.4850 to .8899	.2500 to .4849	.2499 and below
4) M-DSCR measures Earnings to pay for Debt and Operations		-1000 to 1.0999	1.1 to 1.6999	1.7 to 2.2999	2.3 to 2.9999	3 and above
5) Op Surp/(Def) measures basis for adequate cash flow		-1.0 to -.0099	-.01 to .01499	.015 to .0299	.03 to .0499	.05 and above
6) Prime Reserve measures flexibility and risk mitigation		0 to 24.9999	25 to 49.9999	50 to 87.9999	88 to 99.9999	100 and above

Business Combinations - When

- What is the best time to start a business combination?
  - Due diligence
  - Term sheet
  - Implementation plan
  - Completed transaction
- Is there a regulatory of governmental driven deadline to complete?
- Does the business combination begin with a shared service or some other model before a merger or acquisition?
- What are the implications on financial reporting, CFR reporting, tax reporting, regulatory requirements, etc.

Business Combinations – How to Integrate

- Consideration factors
  - Definition of partial or full integration
  - Timing of integration plan
  - Project management of implementation plan
  - Utilization of third parties to assist
  - Drain on resources/cost to integrate
  - Drain on existing employees
  - Provision of services during implementation process

Integration Areas

Integration plans are needed for the following:	
Mission, Vision and Values	Board of Directors
Culture	Executive leadership
Management level	Human resources/benefits
Finance department	Payroll department
Compliance department	Facilities department
Technology department	Programs
Communications-internal/external	Branding/marketing

Integration Areas

Mission, Vision, Values

- Alignment of mission, vision and values
- Is one the driver over the other?
- Are they consistent, deliberate and concise?
- May need a complete redo if services are different for combining organizations

Board of Directors

- Who joins the "parent" board if one is created?
- Who becomes the new officers?
- Blending of personalities
- Strategic focus or operational focus

Culture

- Alignment of culture and values
- Employees feel respected
- Supportive leaders
- Leaders living core values
- Unethical behavior

Integration Areas

Executive Leadership

- Alignment of culture
- Who is the named leadership on the executive team?
- Succession plan
- Integration with the Board

Management Level

- Alignment of culture
- Succession plan
- Integration with executive leadership

Human Resources/Benefits

- Culture and talent assessment
- Performance management and development
- Benefits
- Polices, procedures and employee handbook
- “Onboarding” of employees
- New hires during implementation

Integration Areas

Finance Department

- GL, AP, AR, Billing Systems
- Internal controls
- Internal financial reporting
- Cash management/Treasury
- Purchasing and procurement
- External financial reporting/audit requirements

Payroll Department

- External payroll systems
- Mapping of employees to departments
- Align pay structure
- “Flip the switch”

Compliance

- Who leads compliance during integration
- Who becomes CCO?
- Timing of compliance testing during integration
- Investigative matters during transition and integration phases
- Performance of a risk assessment
- External reporting compliance

Integration Areas

Facilities Department

- Size, depth, geography reach, etc.
- Relationships with third party vendors
- Inventory
- Facility upkeep and improvement during and after integration

Technology Department

- Skill set of internal technologists
- In-house/outsource
- Architecture scalable-hardware/software
- Data integration plan
- User licenses
- Website
- IT compliance during and after implementation
- Cyber and other protocols

Programs

- Who leads each program?
- Alignment of program goals and objectives
- Alignment on delivery of services
- Assess credentialing and skill set
- Review and align HER
- Review and align billing process and supporting documentation
- Regulatory and compliance considerations

Integration Areas

Communication – internal/external	Branding/Marketing
• Internal to employees – when and how • FAQ development • External – who and when • Method of delivery	• Based on corporate structure • Website • Who is capable of new branding opportunities

Questions?

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David M. Rottkamp, CPA
Partner and Nonprofit Practice Leader
Grassi Advisors & Accountants
212.223.5046
drottkamp@grassicpas.com

David M. Rottkamp, CPA, is an Audit Partner, Nonprofit Practice Leader, at Grassi. David has over 36 years of experience providing audit and advisory services, include Uniform Guidance audits, to the not-for-profit and health care industries. David focuses on organizations serving individuals with special needs, religious organizations, educational institutions, membership associations, social service providers, healthcare providers, foundations, and arts and culture.

David has advised some of the area's most successful not-for-profits in areas such as: financial reporting systems, implementation of new accounting standard updates, sustainability/succession planning, internal control reviews, developing financial forecasts, and providing quality board education and governance advice. Through his focus on education and board awareness, he has improved the internal structure and sustainability model for many of his clients, demonstrating his industry leadership.

David has presented in several Nonprofit industry conferences, including the AICPA and the NYSSCPA. David leads internal education sessions, webinars and has been published in the CPA Journal several times. David is also a member of the firms' Accounting and Auditing Committee and the Strategic Partner Retreat committee, which plays a significant role in cultivating the firm's culture and strategic objectives.

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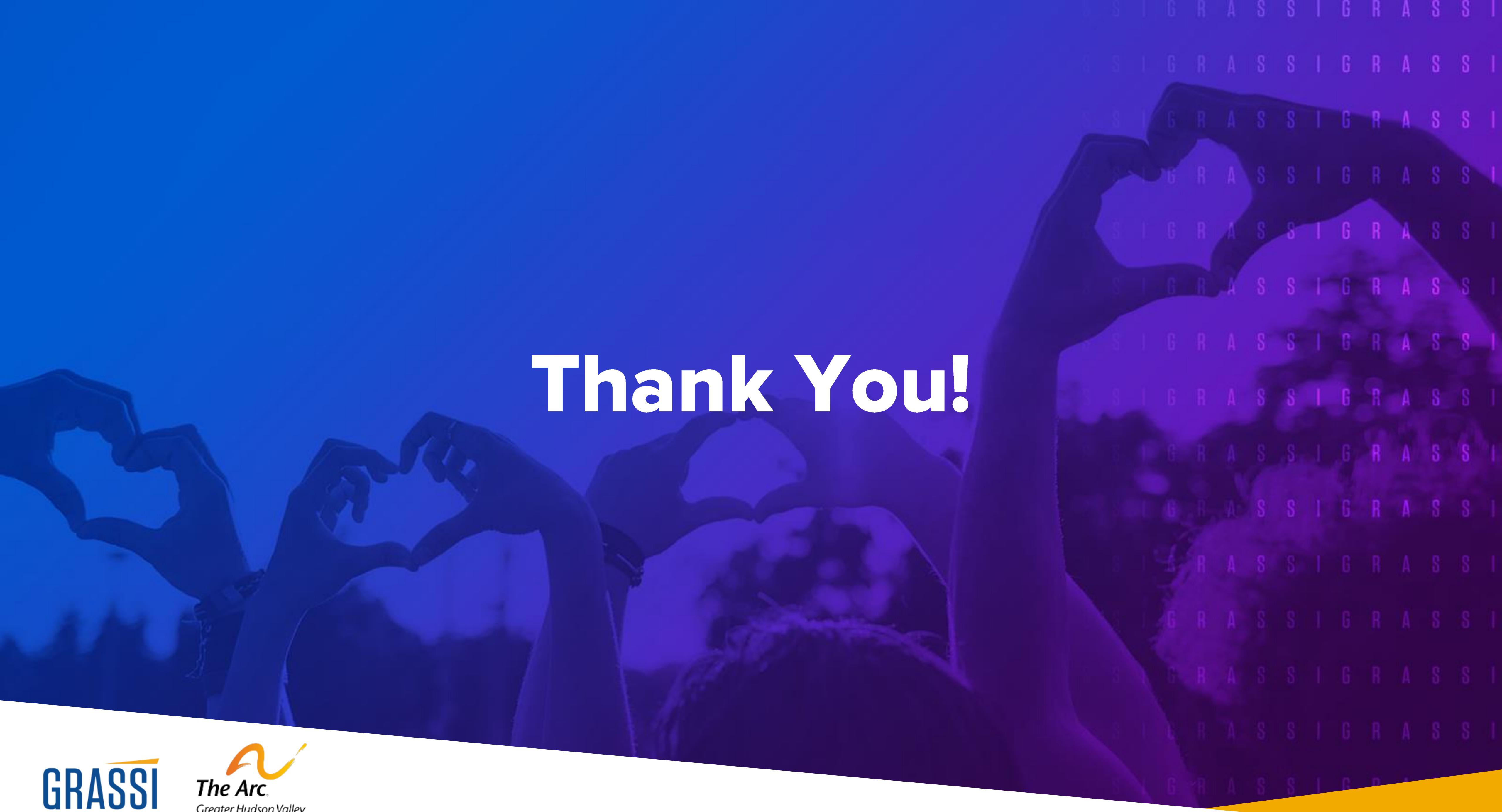

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