# Nonprofit Finance

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BY MARY ELLEN COLLINS

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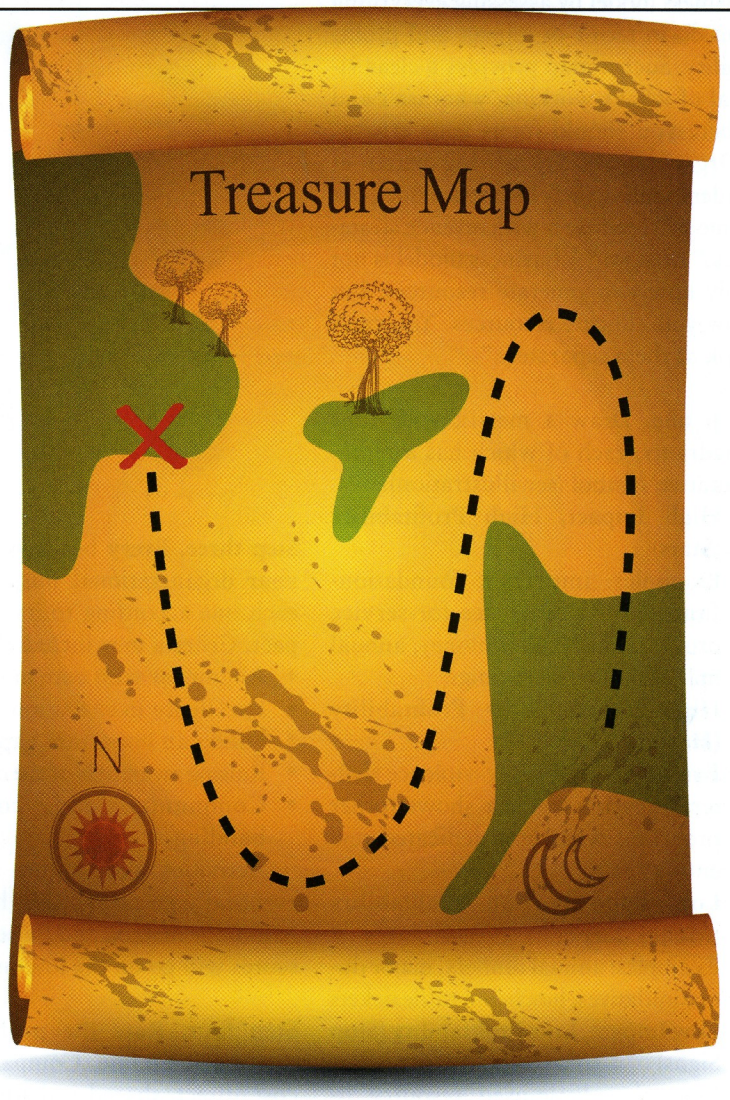



John Takai/Veer

# Map Your Way to Sustainability

All nonprofit professionals and board members want financial sustainability for their organizations, but they often make the mistake of looking at sustainability as a goal rather than a process, says Steve Zimmerman, principal at Spectrum Nonprofit Services in Milwaukee, and co-author of *Nonprofit Sustainability: Making Strategic Decisions for Financial Viability* (Jossey-Bass, 2010).

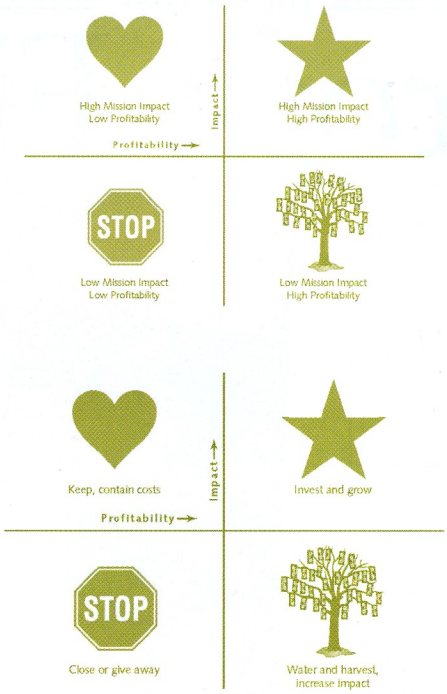
"People talk about sustainability as a destination, such as, 'Once we get there, everything will be great.' We look at sustainability as an orientation rather than a destination," Zimmerman says. "What's sustainable today may not be sustainable tomorrow, and it requires ongoing strategic decision making."

Zimmerman recommends creating a "matrix map" of your organization's business model by assessing everything you do in terms of impact and profitability. Such a map provides a clear visual of what's working, what isn't and where you should focus your efforts. "Organizations are getting better at understanding their business model, but some still confuse it with revenue strategies," he says. "A business model is not only how you generate resources, but how you allocate resources. You can't look at them separately."

**Step one.** Draw a matrix with four quadrants, each of which has a representative symbol (see illustration):

- **High Impact, High Profitability (Stars)**
  Examples: important foundation-funded program, fee-for-service program that makes money, annual mail donations campaign
- **High Impact, Low Profitability (Hearts)**
  Examples: a domestic-violence shelter, experimental art shows, other programs without a dedicated revenue stream
- **Low Impact, High Profitability (Money Trees)**
  Examples: annual dinners, major donor initiatives, luncheon, raffle tickets
- **Low Impact, Low Profitability (Stop Signs)**
  Examples: little-used resource library, program that no longer has funding, stale fundraising event

**Step two.** Make a list of your "business lines." This is a for-profit term that means any activity on which you spend time, including programs and fundraising efforts. "If we want program people to think about the profitability of their programs, then fundraisers need to think about the impact of their programs," Zimmerman says. "All business lines have both components. By including program and fundraising staff in this exercise, you can get away from the 'we raise money and they do programs' mind-set that doesn't lend itself to a holistic view of the organization."




**Step three.** Every business line affects your organizational mission, so rate each one according to its mission impact. Criteria may include:

- Alignment with core mission
- Excellence in execution
- Filling an important gap
- Raising awareness of the organization
- Community and constituency building

Activities with higher scores will eventually go on the top, high-impact half of the matrix, and those with lower scores will go on the low-impact half.

**Step four.** Rate the profitability of each business line. Compare the total cost (direct, shared and administrative costs) with the revenue each one brings in. Those that actually bring in money have high profitability, and those that are subsidized or lose money have low profitability.

**Step five.** Using your mission impact and financial profitability scores, place each business line in the appropriate quadrant. "That's a visual depiction of the organization's business model," Zimmerman says. "You can see how every business line lends itself to the organization's impact and financial viability."

**Step six.** Once you see where all of your business lines fall in the matrix, you can begin to determine strategic imperatives, or action steps. For the activities in each quadrant, Zimmerman provides a strategic imperative that contrasts a new, sustainable orientation with a commonly used but less effective approach.

## High Impact, High Profitability (Stars)

- **Strategic imperative:** Invest in and grow each activity that appears here.
- **Rather than:** Taking them for granted or focusing more on problem areas. "Most people think, 'That program is doing fine. It doesn't need our attention.' But you should actually focus on it," Zimmerman says. "It's a strength, so you should focus on how you can do it even better."

## High Impact, Low Profitability (Hearts)

- **Strategic imperative:** Keep these activities, but contain costs.
- **Rather than:** Closing the program because it isn't breaking even or, conversely, making it a sacred cow that cannot be criticized. "This tends to be where programs lie," Zimmerman says. "There's a lot of talk about growing a program that has a high impact, but you can't because it costs so much. People will say, 'Let's expand it and we'll just raise the money,' but it has to be about integrating it with the overall business model."

## Low Impact, High Profitability (Money Trees)

- **Strategic imperative:** Nurture and increase the scope of these activities.
- **Rather than:** Giving them second-class status or keeping them separate from other programs. A lot of fundraising programs fall into this quadrant, and Zimmerman emphasizes the importance of "thinking in terms of impact and how we are using fundraising vehicles to increase awareness of the organization."

## Low Impact, Low Profitability (Stop Signs)

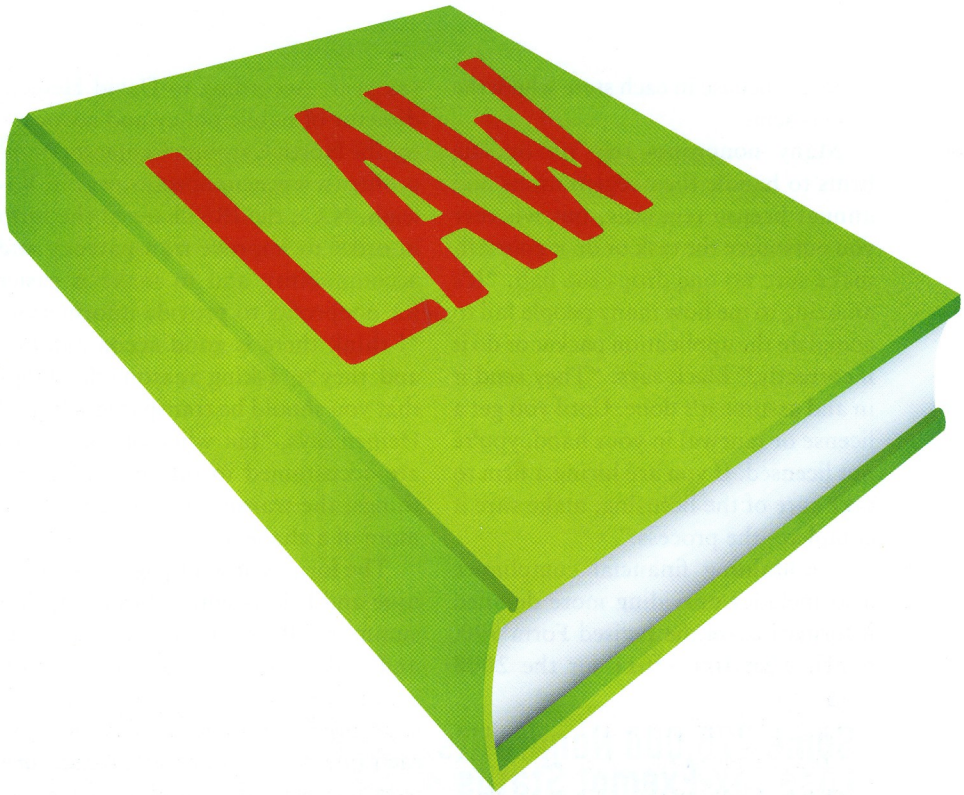
- **Strategic imperative:** Close or divest these activities.

- **Rather than:** Trying once again to improve them or ignore them. When activities score low on profitability and impact, it is time for difficult conversations, and seeing the visual may help you take a broader view of your efforts. "I think it's hard for people to close a program, but you need a good reason not to do it," Zimmerman says. "This gives you the template to have a different discussion. It's not that you don't want to do the program, but you may be losing $20,000 on it that you could be investing in the business lines in the 'stars' quadrant."

What are the most common mistakes people make when working toward financial sustainability? "They don't base their plan on their own organization's strengths," Zimmerman says. "Board members often say, 'This organization made a lot of money on Facebook, so we should use Facebook.' Just because it works for someone else doesn't mean it will work for you. Also, people look at things in silos: 'Let's discuss this event or program without seeing how it fits into the bigger picture.' You can't look at how something is doing in a silo without looking at how it interacts with all other business lines."

You may think you can easily rattle off your organization's strengths and weaknesses, but you may be surprised when you can actually see how all of the business lines work together. Since sustainability requires ongoing, strategic decision making, matrix mapping should not be a one-time activity.

"As funding streams change, profitability changes, and as budgets, constituent needs and other things change, the mission impact changes," Zimmerman adds. "We say [in our book] that the matrix map is a snapshot, but in reality it's more like a moving picture. Therefore, to get the most accurate snapshot, you want one that isn't too old. This doesn't have to be difficult. What it comes down to is creating an aid for engaged conversations and decision making."




John Takai/Veer

# Doing Business by the Book

Increased scrutiny from donors, stakeholders and the government—and a new emphasis on accountability and transparency—have made it more important than ever for nonprofit professionals to follow the letter of the law. In June, the IRS revoked the tax-exempt status of 275,000 nonprofits that did not file a Form 990 for three consecutive years (see sidebar).

The vast majority of organizations are staffed by honest people who want to play by the rules, but achieving financial compliance can be a challenge if you are not up to date on the requirements. "It's not that nonprofits don't want to be in compliance. They might have limited time and resources, and the executive director may wear many hats. They just may not have the time to find every single piece of information they need to be in compliance," says Heather Black, director of charitable solicitation licensing, North Carolina Department of the Secretary of State (**www.secretary.state.nc.us/csl**) in Raleigh, N.C. "Every time we go out to speak, there's always one panicked person in the audience who says, 'I don't know if we even have a license!'"

Most nonprofits must register for a license in order to solicit contributions, although there are exemptions for educational and faith-based organizations. Regulations vary from state to state, and licensing usually falls within the attorney general's office, the secretary of state's office or the agriculture department. If you need information or assistance, the National Association of State Charity Officials (NASCO) website (**www.nasconet.org**) lists the state offices that are responsible for charitable licensing.

If you raise money in different states, you should be licensed in each of them. If your organization does Internet solicitations, you should be familiar with the Charleston Principles, which evolved from a NASCO conference. The principles are guidelines that states agreed to use to help them interpret fundraising laws. For example, if an organization has a "Donate Here" button on its website, it needs to be registered only in its home state. However, if it does direct-mail or e-mail solicitations that ask people to go to the website and donate, it is required

to have a license in each state where the mail is sent.

Many nonprofits rely on outside firms to handle their registrations and annual license renewals, but whether you outsource the task or do it yourself, make sure no one drops the ball. "It's amazing to me how many people fail to complete the application packet or do it incorrectly," Black says. "They send it in and assume it's done. Until you get a license or renewal in your hand, you're not licensed. If you are hiring a firm to take care of the licensing, make sure it completes the process."

Maintaining financial compliance also includes providing more detailed information on the revised Form 990, which went into effect for the 2008 tax year. According to David Heinen, director of public policy and advocacy for the North Carolina Center for Nonprofits (**www.ncnonprofits.org**) in Raleigh, N.C., the IRS changed the form in order to improve transparency and accountability and to make it easier for nonprofits to provide information. "I think there is good accountability, and they're asking reasonable things that you should be transparent about," Heinen says, "but when organizations are accustomed to one way of doing things, the transition to a new way is more of a challenge."

The form is now 11 pages instead of nine and begins with a brief snapshot summary of an organization's assets and activities. There are also 16 additional schedules that organizations may have to fill out, depending on the type of work they do. The addition of numerous, specific questions about governance and management provides an enlightening behind-the-scenes view of organizational operations. Also, having all nonprofits provide that information in the same format makes it easier for the IRS and stakeholders to make apples-to-apples comparisons when assessing how organizations function.

"The IRS is asking many yes or no questions about things that may not be legally required but that are best practices, like 'Do you have a conflict of interest policy?' and 'Do you have a whistleblower policy?'" Heinen ex-

## Some 275,000 Nonprofits Lose Tax-Exempt Status

In June the Internal Revenue Service announced that approximately 275,000 organizations lost their tax-exempt status because they didn't file annual reports for three consecutive years. The IRS believes the vast majority of these organizations are defunct, but it also announced special steps to help any existing organizations apply for reinstatement of their tax-exempt status.

Congress passed the Pension Protection Act in 2006, requiring most tax-exempt organizations to file an annual information return or notice with the IRS. For small organizations, the law imposed a filing requirement for the first time in 2007. In addition, the law automatically revokes the tax-exempt status of any organization that does not file required returns or notices for three consecutive years.

For several years, the IRS has made an extensive effort to inform organizations of the changes in the law through multiple outreach and educational approaches, including mailing more than 1 million notices to organizations that had not filed. In addition, last year the IRS published a list of at-risk groups and gave smaller organizations an additional five months to file required notices. About 50,000 organizations filed during this extension period. Overall, the IRS believes the vast majority of small, tax-exempt organizations are now in compliance with the 2006 law.

The IRS issued guidelines on how organizations can apply for reinstatement of their tax-exempt status, including retroactive reinstatement. In addition, the IRS announced transition relief for certain small, tax-exempt organizations—those with annual gross receipts of $50,000 or less for 2010—that were made subject to the new "postcard" filing under the PPA. The relief allows eligible small organizations to regain their tax-exempt status retroactive to the date of revocation and pay a reduced application fee of $100 rather than the typical $400 or $850 fee.

If a group appears on the list of organizations whose tax-exempt status has been automatically revoked, it is because IRS records indicate the organization did not file the required returns or notices for 2007, 2008 and 2009.

The list of organizations whose tax-exempt status has been revoked is available on the IRS website (**www.irs.gov**) and includes each organization's name, employer identification number and last known address, and is searchable by state. It also includes the effective date of the automatic revocation and the date it was posted to the list. The IRS will update the list monthly to include additional organizations that lose their tax-exempt status.

This listing should have little, if any, impact on donors who previously made deductible contributions to these organizations because donations made prior to the publication of an organization's name on the list remain tax-deductible. Going forward, however, organizations not reinstated are no longer eligible to receive tax-deductible contributions, and any income they receive may be taxable.

Publication on the list of organizations whose tax-exempt status has been revoked serves as notice to donors and others that they may no longer rely on a prior listing in IRS Publication 78, Cumulative List of Organizations, as an indication of an organization's tax-exempt status or its eligibility to receive tax-deductible contributions. An updated version of Publication 78 with current listings is available. Nor can donors rely on an IRS determination letter issued to the organization prior to the date of automatic revocation.

Existing organizations that seek to have their tax-exempt status reinstated must complete an application and pay a user fee, regardless of whether they were originally required to file such an application.

For more information, visit **www.irs.gov/newsroom/article/0,,id=240239,00.html**.

plains. "Although organizations are not penalized if they answer 'no,' the information may invite closer examination by increasingly savvy donors who want to be sure the organizations they support demonstrate the highest level of integrity and professionalism."

Other significant changes involve executive compensation. Nonprofits now need to explain their process for determining compensation for the CEO or executive director. That information was not sought in the past. They also must list their top five highest-paid employees who make more than $100,000 rather than following the $50,000 cutoff used in the past. Some observers believe that increasing the salary threshold decreases transparency, and there is a lack of clarity about exactly who should be included in the highest-paid category because of differences in how organizations define "officer." The IRS is continuing to refine the form, and in May 2011 it distributed an announcement soliciting feedback on a number of issues, including compensation reporting. (At press time, comments were due in August.)

In the past, nonprofits with a budget of less than $25,000 did not have to worry about filing a 990, but that also has changed. Now every nonprofit with a budget of less than $50,000 must file an e-postcard called a 990-N. "This way, everyone goes on the record," Heinen says, "but this is a huge change because it's something these organizations never had to do before."

Although dotting the i's and crossing the t's of financial compliance may sometimes seem like labor-intensive overkill, it is important to remember that the reasoning behind it is for your benefit. "Recently, as a result of unemployment, we're seeing more and more people say, 'I'll just start a nonprofit,' to line their own pockets," Black says. "We're on the side of the good nonprofits—we appreciate the role they play and we want them to prosper. Our goal is to help them stay in compliance and to get rid of the bad guys. Resources are limited, but we want to ensure that donors are giving to the good guys." (P)



Orly/Veer

# Increase Your Accounting IQ

If your discomfort with financial statements prompts you to refer all finance-related questions to your colleagues in the accounting department, you are missing a valuable opportunity.

"The finances of an organization are an important part of the organization's story," says Cari Keller, president and CEO of Discovery Partnerships Inc. (**www.discoverypartnerships.com**) in Arlington, Va. "Donors want to know about the health of the organization, how confident the human capital is in critically thinking, communicating and making decisions about finances. If you can't speak to the financial health of the organization, you can't have those conversations."

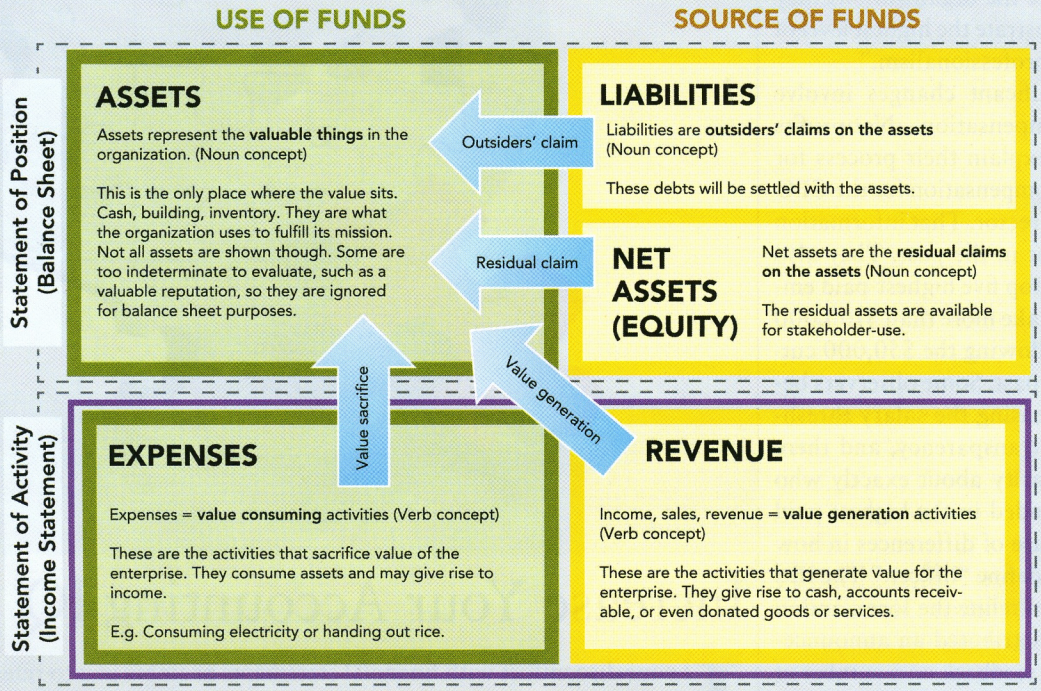
According to Keller, the way in which accounting is taught often muddies the waters. "The traditional way of teaching accounting hasn't been very effective," she says." Many people leave classes more confused than before because of the emphasis on jargon and theory. Accounting is about five concepts—assets, liabilities, net assets (equity), expenses and revenue—and their framework. To learn to speak the language of accounting, you need to understand those five concepts and how they relate to each other. It's incredibly liberating and empowering when you understand the framework that underlies financial statements."

Peter Frampton, president of Accounting Comes Alive USA (**www.accountingcomesalive.com**) in Washington, D.C., takes a visual approach to demystifying accounting (see charts). Formerly an accountant for KPMG, he and a colleague devised a system that uses color and diagrams to enable people to "see" how the basic accounting concepts interact. "We invented a holistic, graphical view of the key financial reports of any organization—the balance sheet and income statement," Frampton says. "Now people see how the reports connect and that the income statement is a subset of the balance sheet. The holistic diagram makes it easier to envisage and discuss what is happening in any organization."

Sharon Farris, president and CEO of Farris Accounting & Consulting Training Services (**www.thatsfacts.org**) in Montgomery, Ala., and author of *Nonprofit Bookkeeping and Accounting for Dummies* (For Dummies, 2009), agrees with the importance of keeping accounting simple and focusing on the basics. This is how

## THE BIG FINANCIAL PICTURE OF A NOT-FOR-PROFIT ORGANIZATION

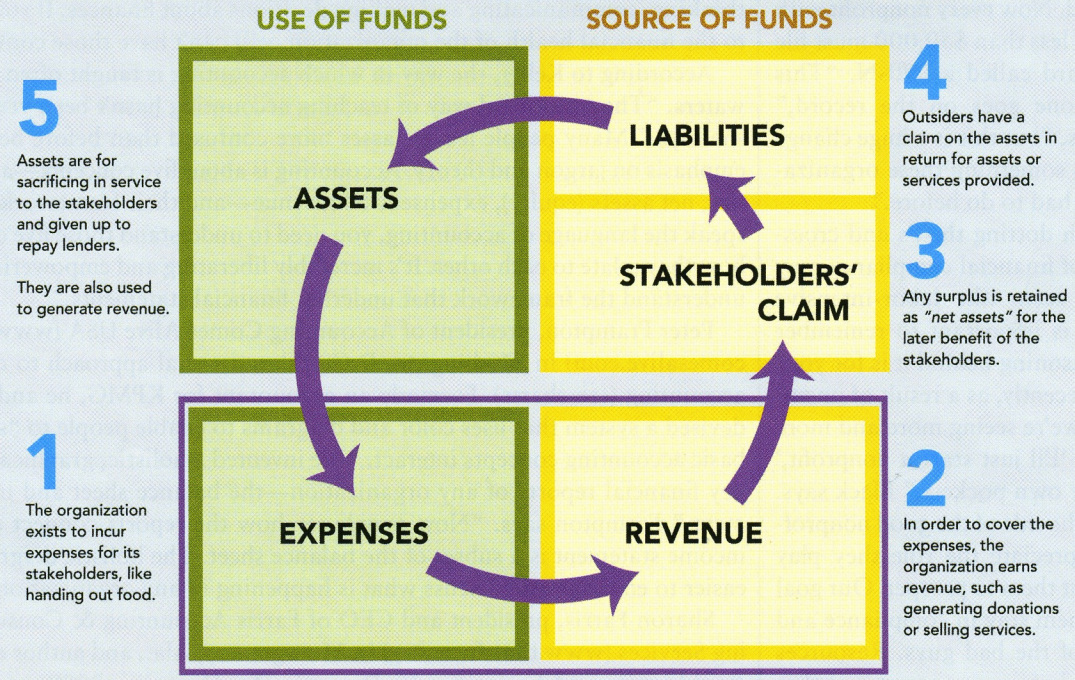
When thinking about the finances of your organization there are five elements to keep in mind, represented by the five boxes in the framework below. When anything financial happens it will always have two impacts on the framework.




*Color Accounting Framework* © AccountingComesAlive.com

## HOW NOT-FOR-PROFITS IN ESSENCE WORK

One way to think of the workings of a not-for-profit organization is shown in the Value Cycle below.




*Color Accounting Framework* © AccountingComesAlive.com

she defines the two main financial statements and how the five concepts relate:

The **balance sheet** (or statement of financial position) includes:

- assets—everything you own
- liabilities—everything you owe
- equity (net assets)—the difference between the two (assets minus liabilities)

"The balance sheet indicates the solvency or liquidity of an organization—how financially stable the organization is and whether it can meet its current and long-term obligations," Farris says. "If you have more liabilities than assets, you know you have a problem."

The **income statement** (or statement of financial activities) includes:

- revenues or donations—value generated by the organization, often as donations or fees
- expenses—value consumed by the organization, such as salaries, project consumption, etc.
- net income (or loss) —the difference between the two (revenues minus expenses)

"The bottom line is, once all donations have been calculated and all expenses deducted, what is the difference?" Farris says. "At the end of the month, quarter or year, is your organization in the red or the black?"

An understanding of financial statements should be a part of every fundraiser's toolbox because you do not solicit gifts in a vacuum. "Donors want to know where you are, where you want to go and what it will take to get there," Farris says. "You need to be able to show and tell them. You don't need to become an accountant. You only need to know what you need to know—how to read those statements and understand what they mean. The numbers are going to show you how healthy the organization is. If you haven't taken the time to care about what goes on in your organization, why should the donor care?"

*Mary Ellen Collins is a freelance writer in St. Petersburg, Fla., mecollins123@yahoo.com.*

## Resources

**Sustainability:**

- *Building Strong Nonprofits: New Strategies for Growth and Sustainability* by John Olberding and Lisa Barnwell Williams (Wiley, 2010), hardcover, 186 pages
- *Financial Leadership for Nonprofit Executives: Guiding Your Organization to Long-term Success* by Jeanne Bell and Elizabeth Schaffer (Fieldstone Alliance, 2005), paperback, 152 pages
- *Nonprofit Financial Planning Made Easy* (Wiley Nonprofit Law, Finance and Management Series) by Jody Blazek (Wiley, 2008), hardcover, 256 pages
- *Nonprofit Sustainability: Making Strategic Decisions for Financial Viability* by Jeanne Bell, Jan Masaoka and Steve Zimmerman, MBA, CPA (Jossey-Bass, 2010), paperback, 208 pages
- *ROI for Nonprofits: The New Key to Sustainability* by Tom Ralser (Wiley, 2009), paperback, 176 pages

**Nonprofit registration:**

- *Nonprofit Fundraising Registration: The 50-State Guide* by Stephen Fishman, J.D. (NOLO, 2010), paperback, 368 pages
- For a list of offices that handle charity licensing visit **www.nasconet.org/documents/u-s-charity-offices**
- For information on the Charleston Principles visit **www.afpnet.org/ResourceCenter/ArticleDetail.cfm?ItemNumber=3309**

**Nonprofit accounting:**

- *Bookkeeping for Nonprofits: A Step-by-Step Guide to Nonprofit Accounting* by Murray Dropkin and James Halpin (Jossey-Bass, 2005), paperback, 272 pages
- *The Budget-Building Book for Nonprofits: A Step-by-Step Guide for Managers and Boards* (The Jossey-Bass Nonprofit Guidebook Series) by Murray Dropkin, Jim Halpin and Bill La Touche (Jossey-Bass, 2007), paperback, 240 pages
- *Nonprofit Bookkeeping and Accounting for Dummies* by Sharon Farris (For Dummies, 2009), paperback, 360 pages
- *Not-for-Profit Accounting Made Easy* by Warren Ruppel (Wiley, 2007), hardcover, 256 pages
- *The Simplified Guide to Not-for-Profit Accounting, Formation & Reporting* by Laurence Scot, MBA, CPA (Wiley, 2010), paperback, 288 pages
- *Streetsmart Financial Basics for Nonprofit Managers* by Thomas A. McLaughlin (Wiley, 2009), paperback, 304 pages
- Accounting Comes Alive USA will offer an online, color accounting course in October; visit **www.accountingcomesalive.com**