

CHAPTER 1

Introduction

Background on Nonprofits

There are over 1.6 million nonprofits in the United States. They are diverse in size and mission, ranging from human service organizations to advocacy groups to religious organizations. They are growing rapidly in number. From 1995 to 2005, the nonprofits registered with the Internal Revenue Service (IRS) grew by 27 percent.¹ They are important economically, contributing 7.2 percent of the paid jobs and 6.6 percent of the total wages in the United States (see Exhibit 1.1).

Although nonprofits are extremely diverse in size in mission, each one must have a sound financial management system.

There are three types of nonprofits: *charity*, *foundation*, and *other*. In 2009, there were about 957,000 charities and 113,000 foundations registered with the IRS as 501(c)(3) organizations (“501(c)(3)s”). The “other” group includes 501(c)(4) registered mutual benefit organizations (e.g., medical plans, civic leagues, and advocacy organizations) and about 350,000 religious organizations not required to register with the IRS, although about half chose to do so.

All nonprofits are exempt from income taxes on their mission-related income, but only 501(c)(3)s can receive *tax-deductible* donations. A 501(c)(3) organization cannot support or oppose anyone running for public office but can engage in a political campaign consistent with its purpose. Most 501(c)(3)s can spend no more than 20 percent of their resources on lobbying. Exhibit 1.2 shows the types of public charities.

Board of Directors

Nonprofit governance and management rests on three legs: the Board of Directors (Board), the chief executive officer (CEO), and the staff. Board members nominate and elect fellow members. Board members have civil immunity for the official actions they take, as do volunteers, but the law

EXHIBIT 1.1 Charities' Employment

Category	Number	Percent of U.S. Economy
Paid workers	9.4 million	7.2%
Volunteer workers (FTEs)	4.7 million	3.9%
Total workforce	14.1 million	11.1%
Wages	\$321.6 billion	6.6%

Source: Lester Saloman and S. Wojciech Sokolowski, *Employment in America's Charities: A Profile* (Baltimore: Johns Hopkins Center for Civil Society Studies, 2006).

does not protect Board members from criminal, intentionally malicious, or reckless conduct. Board meetings are not subject to open meeting laws, as government meetings are; however, Board members must exercise care, loyalty and obedience. Board members should:

- Determine the nonprofit's mission and issue the mission statement
- Select, support, and review the performance of the CEO
- Contribute time and resources to the nonprofit
- Raise funds
- Conduct business ethically and professionally
- Make well-informed, engaged decisions
- Adopt the budget
- Oversee the management of funds
- Adopt a human-resource policy

EXHIBIT 1.2 Number of Reporting Public Charities by Subsector

Subsector	Number of Organizations	Percent of Total
Arts, culture, and humanities	125,170	7.7%
Education	216,021	13.3%
Environment and animals	58,209	3.6%
Health	101,458	6.3%
Human services	410,028	25.3%
International and foreign affairs	20,737	1.3%
Public and societal benefit	359,160	22.3%
Religion-related	231,858	14.3%
Other	94,806	5.9%
Total	1,617,447	100.0%

Source: Urban Institute, National Center for Charitable Statistics, *Core Files* (2007–2008).

- Follow laws
- Serve on a committee
- Promote the organization's image

The mission statement should succinctly reflect the nonprofit's core values. The Board should adopt the mission statement with input from the CEO, the staff, and stakeholders such as clients, members of the organization and community members. Board members should contribute both time and resources to the nonprofit. Some Board members have needed skill sets. For instance, a Board member who is a certified public accountant (CPA) or has a strong business background can serve on the Finance Committee or even volunteer as the chief financial officer (CFO). Likewise, a Board member who is a lawyer can provide legal advice. Board members should visibly participate in fundraising activities, contributing their own funds, and ask community members to contribute.

Boards with many members typically break down into subcommittees and each Board member should have an office or committee responsibility. As the policymaking body, the Board adopts policies, including the annual budget. This book discusses an array of financially related policies. For reference to these and other policies, the organization Boardsource offers downloadable policies in 48 topic areas, including 13 financial management policies (see <http://www.boardsource.org/?Bookstore/>).

Management

The second leg is the CEO, either volunteer or paid, who carries out the Board's policies. There is no single package of education and experience necessary to be a successful CEO. She (or he) may be an experienced professional with a graduate degree in public, nonprofit or business administration. Absent a management degree, she may have extensive nonprofit working experience as a program manager or CEO. She may even be a volunteer with limited nonprofit experience.

The CEO should facilitate the Board's interaction with herself and the staff. The CEO should seek broad Board involvement in setting policy. In serving the Board, the CEO should:

- Orient new members
- Help craft a mission statement
- Help adopt a strategic plan and envision change
- Prepare the budget for the Board's adoption
- Manage the budget during the fiscal year
- Provide financial and programmatic information
- Tout the organization's accomplishments to the community

In theory, the Board makes policy decisions that the CEO carries out. In practice, however, many Boards heavily depend on the CEO to engage more in policymaking. This is often because many Boards have an unwieldy size. For instance, 47 percent of the Boards in Indiana have 10 or more members; 19 percent have between 15 and 29 members.² Another reason for strong CEO influence is Board member turnover. Often, Board members limit themselves to three-year terms.

In addition to Board-related responsibilities, many CEOs are extensive boundary-spanners, interacting with a host of stakeholders, including funders, community leaders, service recipients, volunteers, and staff members. A typical CEO must be entrepreneurial and should be thankful to deal with less red tape and enjoy more flexibility than do government managers.³

Staff

The third leg of the stool is the staff. Many nonprofits have an all- or mostly all-volunteer staff. Volunteers are motivated to serve because of a nonprofit's good works. The CEO and the Board should consistently laud the efforts of volunteers and staff members and compensate staff equitably. The CEO should:

- Follow best practices with regard to hiring and disciplinary action
- Orient new employees
- Build a high-performance management team
- Train employees to do their job
- Treat employees fairly
- Give performance feedback throughout the year, not just at annual performance review

Finances

Most reporting nonprofits have small budgets. Indeed, 44.6 percent had annual expenses less than \$100,000 (see Exhibit 1.3). Large nonprofits, with expenses of more than \$10 million, account for only 3.7 percent of nonprofits, but a whopping 82.7 percent of total expenses.

Nonprofits have three main revenue sources. The main revenue, fees for services and goods, includes items such as Medicare and Medicaid reimbursements, ticket sales and tuition payments (see Exhibit 1.4). The second principal revenue source, private contributions, includes grants and contributions from foundations, individuals and corporations. Other revenue sources are government grants, investment, and other income.

EXHIBIT 1.3 Number and Expenses of Reporting Public Charities

Expenses	Percent of Total Charities	Percent of Total Expenses
\$10 million or more	3.7%	82.6%
\$5 million to \$9.99 million	2.6%	5.5%
\$1 million to \$4.99 million	11.4%	7.5%
\$500,000 to \$999,000	8.5%	1.8%
\$100,000 to \$499,000	29.2%	2.0%
Under \$100,000	44.6%	0.6%
Total	100.0%	100.0%

Source: Urban Institute, National Center for Charitable Statistics, NCCS-Guide Star National Nonprofit Research Database: Special Research Version (2005).

The revenue picture changes significantly when looking only at human service nonprofits, of which there are eight types: (1) crime and legal, (2) employment and job related, (3) food and nutrition, (4) housing and shelter, (5) public safety and disaster preparedness, (6) youth development, (7) community development, and (8) human service multipurpose organizations. These nonprofits depend far more heavily on government grants (see Exhibit 1.5).

Financial Management Organization

The National Association of Schools of Public Affairs and Administration (NASPAA) has issued guidelines for graduate professional education in nonprofit organizations, management and leadership.⁴ One such guideline

EXHIBIT 1.4 Sources of Revenue for Reporting Public Charities

Sources of Revenue	Percent of All Charities	Percent of Charities Excluding Hospitals and Higher Education
Fees for services and goods	70.4%	53.5%
Private contributions	12.3%	23.3%
Government grants	9.0%	17.0%
Investment income	5.4%	2.3%
Other Income	2.9%	3.9%
Total	100.0%	100.0%

Source: Urban Institute, National Center for Charitable Statistics, NCCS-GuideStar National Nonprofit Research Database: Special Research Version (2005).

EXHIBIT 1.5 Sources of Revenue Human Service Nonprofits

Funding Source	Number of Nonprofits	Largest Funding Source
Government (federal, state, or local units)	19,657	60%
Donations (individual, corporate, foundations, federated giving)	6,124	19%
Fees (public and private) for services	5,179	16%
Other	1,663	5%
Total	32,623	100%

Source: The Urban Institute, *National Survey of Nonprofit Government Contracting and Grants* (2010).

requires graduate education to cover in its curriculum budgeting and resource management, including general accounting practices and budget management, risk management, contract monitoring, supervision of grant projects, and reporting to government agencies, philanthropic foundations, and other funding agencies. To perform these functions, nonprofits organize differently, depending on their size and resources.

Organizational Options

Very small nonprofits rely on a volunteer to do the accounting. Somewhat larger ones have a full- or part-time bookkeeper with some accounting experience and usually structure themselves as shown in Exhibit 1.6. A still larger nonprofit can hire a CFO with an accounting degree and perhaps is a CPA as shown in Exhibit 1.7.

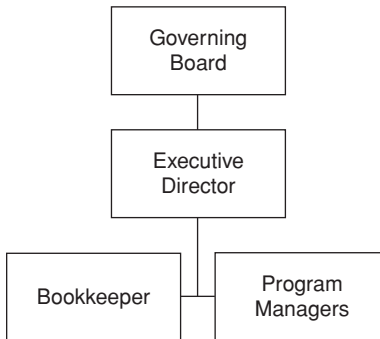


EXHIBIT 1.6 Organization with a Bookkeeper

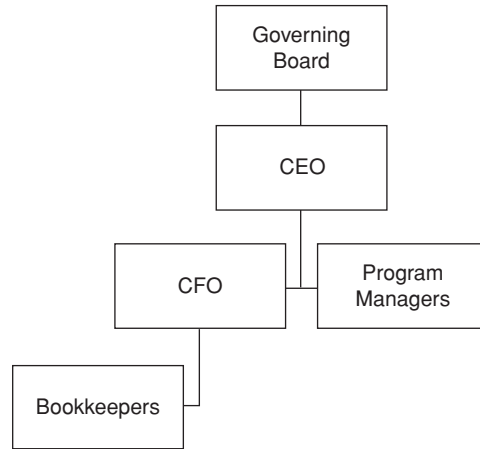


EXHIBIT 1.7 Organization with a CFO

Conclusion

Nonprofits are extremely diverse with regard to their size, mission, funding sources, and organizational structure; however, one constant remains. Each nonprofit should have a *sound* financial management system with which it can be accountable to its funders and perform capably. This book is designed to assist all nonprofits, from the smallest to the largest and most financially sophisticated, to manage their finances responsibly and professionally.

<http://www.pbookshop.com>