# Module 8: Nonprofit Association Finances & Fundraising

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## PART I: ASSOCIATION FINANCES

### Primary Aspects of Nonprofit Financial Planning

Understanding the relationship between planning, resource allocation, and budgeting is critical to the effective management of finances and financial planning.

A. Strategic Planning

The most critical element in strategic planning is program and development. In terms of resource development, there are two basic objectives: financial stability and self-sufficiency. All too often there is a tendency among organizations to develop programs in *response* to funding; as a result, organizations often find themselves out of focus and vulnerable to financial fluctuations in other organizations. To guard against this, association Board and management must be able to clearly identify the organization's mission and program priorities. Only then should it search for resources to fund those programs.

B. Resource Allocation

Determining the allocation of funds between organizational overhead (the cost of running the organization) and other activities, such as fundraising

and program management, is difficult and often results in various formulas from association to association.

Making this determination is complicated for several reasons. First, there is no universal formula for calculating overhead. For example, many associations consider the Executive Director's salary to be overhead, while others would argue that since the Executive deals primarily with program-related issues and is essential to the success of the organization, their salary is a program expense. Second, there are no generally accepted standards for what levels are acceptable. Many effective nonprofit organizations spend anywhere from 5% to 30% of their funds on overhead, so there really is no “ideal” amount.

Here are some additional factors to consider when evaluating expenditures:

- *What is the mission of the nonprofit?* Some activities are labor-intensive and require a high level of staffing. It is not necessarily more efficient to use volunteers to provide such services, since volunteers require management and supervision. When evaluating effectiveness, it is important to understand the organization’s nature and purpose. An operating foundation, for example, may look hopelessly inefficient at first glance, until you realize that it exists to carry out programs, not to give away money.
- *In what type of environment does the organization operate?* Two organizations with identical missions might have very different cost structures if one operates downtown and the other serves a distant suburb. Does the organization's level of overhead expenses seem reasonable given its location, the number of people it is serving, and the manner in which it is providing services?
- *How does the organization raise money?* Some methods of fund-raising are simply more expensive than others. An organization that raises most of its money through direct mail or special events may have higher fund-raising costs than a nonprofit that relies primarily on large grants. Also, in evaluating fund-raising effectiveness, some activities are important for their educational value and their ability to involve greater numbers of people with the organization. These are intangible benefits that do not show up on a balance sheet.

C. <u>Budgeting</u>

Budgeting allows an organization to state its organizational plan in financial terms, while also allowing management and Board members to monitor the use of resources. Budgeting Guidelines:

- Identify the organization's short term and long term capital requirements as a basis for identifying strategies to ensure financial mobility.
- Perform cost-benefit analyses of alternative courses of action and rank program and administrative options accordingly.
- Design program or operational objectives to accomplish strategic goals relative to available resources.
- Budget allocated resources over a reasonable operating period as a basis for controlling and monitoring results.

D. Financial Controls

The basic objectives of financial controls are safeguarding the organization's assets and ensuring the reliability of financial records and reports. An effective financial control system comprises a set of procedures that minimize the likelihood of misuse of assets or errors in accounting. An organization's financial control system should exhibit the following characteristics:

a. Competent, trustworthy personnel with clear lines of authority and responsibility.
b. Adequate segregation of duties.
c. Proper procedures for authorization.
d. Proper procedures for recordkeeping.
e. Physical control over assets and records.
f. Independent checks on performance.
g. Complete and accurate documentation and a sufficient audit trail.

*Sources: www.BoardSource.org 2006, Christopher Callaghan. "Managing Finances," in The Nonprofit Board Book: Strategies for Organizational Success. Revised edition, West Memphis, AR: Independent Community Consultants, 1985. pp. 155-198.*

**Cash Management for Nonprofit Associations**

Key Events in Establishing an Annual Budget

1. Re-evaluate organization mission.
2. Develop long-range objectives.
3. Prioritize long-range objectives in terms of both programs and organizational goals, and identify options for accomplishing them.
4. Evaluate existing programs and consider new programs.
5. Determine short and long-term financial requirements.
6. Perform a cost-benefit analysis of alternative program and administrative options and rank accordingly.

7. Design programs based on available resources.
8. Develop and disseminate budget guidelines.
9. Prepare program budgets.
10. Develop capital and revenue budgets.
11. Develop operational budget.
12. Review ALL budgets and adjust as appropriate.
13. Board review and approval of budget.

Estimating Costs

The best predictor of costs is what has been experienced in preceding years. The most appropriate basis for estimating costs is through program planning, which identifies the resources required to accomplish program goals. Rather than assuming the organization can simply add a certain percentage increase over the previous year's budget, a more precise budget can be developed when each aspect of a program's budget is reevaluated for the upcoming fiscal year. In addition, varying economic conditions, uncertainty, and seasonality should be given thought when estimating costs.

Estimating Revenues

Often great uncertainty surrounds the estimation of revenues. Special consideration must be given to the type of funds the organization expects to receive. Some funds will be earmarked for general operations, while others will be restricted for specific purposes. Additionally, certain programs will generate funds on their own through fees for service. In all cases, the Board and management must have a clear understanding of the different types of funds available (i.e., unrestricted, restricted, endowment, etc) in order to plan their use in line with expectations, contracts and grant agreements.

Contingency Planning

Every association's financial plan should reflect its plans for responding to unforeseen occurrences. Every budget should have a contingency reserve specifically listed, the size of which depends on a variety of factors. This reserve fund should be thought of as protection against decreasing revenue, unexpected expenses, or an unexpected rise in cost. Its size depends on the predictability of income, relative stability of the organization, extent to which expenditures are fixed in advance, and age and experience of the organization.

*Source: Christopher Callaghan. "Managing Finances," in The Nonprofit Board Book: Strategies for Organizational Success. Revised edition, West Memphis, AR: Independent Community Consultants, 1985. pp. 155-198.*

## The Importance of Profits for Nonprofit Organizations

For many reasons, operating a nonprofit at a deficit is a bad policy. The most successful and responsible organizations find ways to generate an annual surplus and build a reserve fund to insulate the organization from the inevitable ups and downs that any nonprofit faces, such as donors failing to pay on their pledges, unexpected contract or grant terminations, failure to reach fundraising targets, and other unforeseen events. To survive these events, most nonprofits need a reserve fund, and the easiest way to build such a fund is to operate at an annual surplus, generating net revenue which can then be added to reserves. A healthy reserve fund also gives a nonprofit the flexibility to research and develop new programs and to respond to sudden opportunities.

### Financial Reserves

The level of reserves required to adequately protect an association depends on the mission and type of organization. Nonprofit organizations created to run a specific event or those that do not intend to operate in the long-term may not be as concerned with developing reserve funds.

Those who argue for a very low level of reserves point out that an organization with a particularly imperative mission — the eradication of a disease, for example — has an ethical and moral obligation to use all its resources to carry out that mission as swiftly as possible. Others have questioned the ethics of an organization soliciting the public for donations while maintaining reserves that would allow it to operate for many months, or even years, without any additional public support.

The distinction between reserves and endowment (restricted funds) is significant. An endowment is a pool of money that is invested so that the income can be used to support the nonprofit. Often, donors have restricted these funds so that the principal cannot legally or ethically be used to cover day-to-day expenses. Reserve funds are more flexible. Reserves come from the accumulated surpluses of the organization over time, and can usually be designated or allocated by the board. Reserves can be spent to expand programs and run the organization, while endowment usually cannot.

*Source: www.BoardSource.org 2006*

## Financial Responsibilities of the Board of Directors

One of the primary responsibilities of the Board of Directors of any organization is to ensure the organization's financial health. The Board fulfills a key role in the area of budget and expenditure oversight for the association, and should be kept

up-to-date on all significant financial issues. However, the Board must understand that the Executive Director and other association staff maintain day-to-day authority over the association's budget. In addition, financial management should not be considered an end in itself. Rather, it is a tool for accomplishing the program priorities set forth by the Board of Directors.

Ten Key Financial Questions for Board Members

1. Have we run a gain or loss? (i.e., are we better or worse off financially than we were a year ago?)
2. Are our key sources of income rising or falling? If they are falling, what are we doing?
3. Are our key expenses, especially salary and benefits, under control?
4. Do we have sufficient reserves? Has the board adopted a formal policy for the establishment of reserves?
5. Is our cash flow projected to be adequate?
6. Are we regularly comparing our financial activity with what we have budgeted?
7. Is our financial plan consistent with our strategic plan?
8. Is our staff satisfied and productive?
9. Are we filing on a timely basis all the reporting documents we are supposed to be filing and fulfilling our legal obligations?
10. Are appropriate cost classifications clearly identified for all association activities, operations, and fundraising?

*Sources: Adapted from Financial Responsibilities of Nonprofit Boards by Andrew S. Lang, CPA. Published by www.BoardSource.org, and Christopher Callaghan. "Managing Finances," in The Nonprofit Board Book: Strategies for Organizational Success. Revised edition, West Memphis, AR: Independent Community Consultants, 1985. pp. 155-198.*

**Guidelines for Becoming a Financially Accountable Organization**

1. Make your IRS Form 990 (and other important financial forms) easily and readily available to those who request them.
2. Publish an annual report with financial data.
3. Utilize annual independent audits.
4. Create transparent and effective financial policies and enforce them regularly.
5. Avoid and manage conflicts of interest.
6. Maintain good financial records, and keep them well organized.
7. Understand and follow local, state and federal regulations regarding the financial operation of nonprofit organization.

**Financial Audits**

Audits provide a thorough analysis of the supporting evidence underlying an association's financial data. Implicit in deciding to have an audit is a basic need

to obtain independent assurance on the completeness and credibility of the financial information. An audit must be performed in accordance with generally accepted auditing standards. The level of service (in terms of the frequency of financial audits) should meet the specific needs and available resources of the organization under review. Any organization must weigh carefully the additional benefits which accrue from varying levels of assurance needed by the organization's Board of Directors, management, and interested third parties, with the costs of hiring an outside accountant.

*Source: Christopher Callaghan. "Managing Finances," in The Nonprofit Board Book: Strategies for Organizational Success. Revised edition, West Memphis, AR: Independent Community Consultants, 1985. pp. 155-198.*

### Accountants for Nonprofit Organizations

The American Institute of Certified Public Accountants (www.aicpa.org) can provide references for nonprofit proficient CPAs. It is the professional association for accountants.

## PART II: ASSOCIATION FUNDRAISING

### Types of Nonprofit Funding

Restricted grants refer to contributions and donations that arrive with strings attached. These restrictions can determine for what purpose the money can be spent, by when it can be used, or whether matching grants are required to make the funds available. For example, multi-year grants cover a specific period of time (i.e. 5 years), and are usually restricted to be used only for the project for which the funds were granted.

An annual fund is an annual (or more frequent) appeal to a core group of constituents. Such funds are usually unrestricted (available for any use) and may represent a large percentage of your annual income.

Many nonprofit organizations earn revenue through the ongoing sale of products and services from the nonprofit itself (i.e. the Girl Scouts and their annual sale of Girl Scout cookies).

Besides seeking support from a variety of sources, your fundraising program should seek both ongoing financial support and episodic support.

*Source: Joanne Fritz, "Fundraising Fundamentals." Your Guide to Nonprofit Charitable Organizations. 2006. http://nonprofit.about.com/od/fundraising/a/fundraising101_p.htm*

## Fundraising

Fundraising is not begging! Asking for money for an important cause is NOT begging. No organization is able to function without money. Raising funds is one of the most natural activities in which Board members or active supporters can engage to show their own enthusiasm about an organization and its programs. Giving money to a cause one supports is natural, but most people do not give unless someone asks them to give.

Major Sources of Funding

- **Individuals** are the largest source of funding for nonprofit organizations. According to *Giving USA*, individual giving to nonprofits reached $187.92 billion in 2004.
- **Corporations** donate money in order to get positive publicity, community respect, and market share. Funding from corporations tends to be episodic, meaning that it revolves around particular campaigns, events, and projects. Corporate funding can be a good source of support for new initiatives, special programs, and special events.
- **Local and state governments** will sometimes fund projects that benefit people in their jurisdictions.
- **Federated funds,** such as funding from the United Way, can be steady sources of relatively large amounts of money, but tend to be available only to well-established nonprofit organizations.
- **Foundations** vary widely in their wealth and mission, but often offer substantial and prestigious grants. Private foundations usually have large assets and issue annual reports. Corporate foundations are similar to private foundations, but are often led by corporate officers. Community foundations pool the assets of many donors and are usually community service organizations. Independent or family foundations receive endowments from individuals or families.

*Source: Joanne Fritz, "Fundraising Fundamentals." Your Guide to Nonprofit Charitable Organizations. 2006. http://nonprofit.about.com/od/fundraising/a/fundraising101_p.htm*

## Solicitation Methods

Most fundraisers agree on a particular hierarchy of effectiveness when it comes to soliciting gifts. It is not a surprise that the more personal the contact is, the more positive the results are. The methods from most effective to least effective are

- personal: face to face
- personal: letter on personal stationery
- personal: telephone call

- personalized letter
- direct mail
- phone-a-thon (impersonal)
- special event
- door to door
- media advertising

*Source: www.BoardSource.org 2006*

**Fundraising Guidelines**

Based on research of nonprofit fundraising initiatives, several general guidelines can be gleaned regarding developing strategies for your own association's funding campaigns:

- In shaky financial times, those organizations with involved Boards of Directors will emerge in better shape than those with uncommitted Boards.
- Fundraising volunteers do not have to be Board members, but, like Board members, they should be kept well informed of the progress of the campaign.
- To maintain and increase your donors: send a receipt to them, thank them, communicate with them, and cultivate them.
- A poor organizational image can hinder your fundraising.
- Don't expect that for which you didn't ask.
- Ask for contributions to a specific program, and suggest a level of contribution.
- Prospective donors are interested in proof that their money is producing the results that you promised during the solicitation, so publicize your successes.
- The more sources of funding you have, the more stable your organizational funding will be.
- Put a specific amount of your fundraising revenue toward new fundraising activities to continue the momentum from year to year.

*Source: Stephen Hitchcock. "Fund Raising: The Board is the Key." The Nonprofit Board Book: Strategies for Organizational Success. West Memphis, AR: Independent Community Consultants, 1985. pp. 199-220.*

## Fundraising Laws and Regulations

Strict compliance with federal, state and local laws regarding nonprofit fundraising is extremely important. The following is a brief overview of applicable fundraising regulations, and specific questions should be directed to legal counsel or the Internal Revenue Service.

### A. Federal Tax Rules

Record-keeping and Reporting: To comply with federal tax rules and maintain tax-exempt status, organizations need to establish some basic record-keeping and reporting procedures and make informative disclosures to their members and donors. To comply with IRS reporting requirements, records should be kept on:

- the total amount of contributions, gifts and grants received
- the names and amounts given by large contributors (individuals whose total contributions during the most recent four years are greater than or equal to 2 percent of the organization's total contributions over that same period); however, because even a small contributor may become a "large" contributor it is a good idea to keep track of all individual contributors to your organization; and
- how the funds raised are spent, including separating program, administration, and fundraising expenditures.

Disclosure Statements: IRS disclosure rules require organizations to inform prospective donors about the extent to which their contributions are legally tax deductible. Disclosures should be made on membership applications, direct-mail appeals, tickets to fundraising events, etc.

### B. Postal Regulations

One benefit of attaining the IRS 501(c)(3) classification is reduced postal rates. The U.S. Postal Service - authorized to spot-check bulk mail and to impose fines if abuses are uncovered - is concerned primarily with two areas: 1) fraudulent or misleading direct-mail pieces and 2) misuse of nonprofit postal permits by allowing the permit to be used in cooperative mailings with for-profit firms.

The bulk mail coordinator at your local or regional post office is generally very helpful in answering questions bout the proper use of your nonprofit postal permit.

C. **State Regulations**

Registration: Perhaps the most difficult and time-consuming requirement - particularly with respect to a fundraising campaign that appeals to residents in a number of states - is complying with the plethora of state and local fundraising laws. Most of these regulations require organizations to register with each state in which they plan to solicit donations *before* they begin soliciting funds. Information frequently required for registration includes:

- names and addresses of officers, directors, and trustees
- a recent financial report
- a description of the organization's purpose(s)
- information on how the funds are intended to be raised, including whether any outside fundraising professionals or consultants will be used

Disclosures: Following registration, organizations often are required to file an annual report with the state. At the time of solicitation, specific disclosures, such as the fact that information about the charity is on file with the state or that professional fundraisers are being used, is often required.

Fundraisers may also be subject to a variety of other state laws, including prohibitions on fraudulent advertising. In some states, a fundraising appeal needs only to be capable of deceiving to violate these laws. More information about these statutes may usually be obtained by contacting the state attorney general's office.

D. **Local Regulations**

Many cities and counties also have registration and disclosure statutes. While it is difficult, if not impossible, for an organization to contact every city and county in which it will solicit funds, it is particularly important to do so if you are conducting a door-to-door solicitation, a raffle or a bingo fundraiser, because these types of activities are frequently subject to special local regulations. Offices regulating fundraising vary depending on the locality; however, local police, finance, tax, licensing, and commerce departments are often responsible for issuing required permits.

*Source: Pfau Englund Nonprofit Law, P.C. "Understanding Fundraising Law." 2003.* *www.nonprofitlaw.com/fund/fundlaw.shtml*

## Grant Proposals

Grants can comprise a significant percentage of a nonprofit association's annual budget. Although grants can be from a variety of sources (such as foundations or a government entity), most require the same basic information in the grant proposal:

1. **Summary:** The summary is placed at the beginning of the proposal and helps the grantor to quickly understand what you are seeking. At the beginning of your proposal or on a cover sheet, write a short (two or three-sentence) summary of your proposal. For example: *"The Welfare-to-Work Support Society requests $10,000 for a three-year training program to assist welfare recipients to become self-sufficient. Training modules will cover basic financial skills, job-hunting skills, and interviewing techniques."*
2. **Organizational Information:** In a few paragraphs, explain what your organization does and why the grantor can trust it to use the requested funds responsibly and effectively. Give a short history of your organization, state its mission, the population it serves, and an overview of its track record in achieving its mission. Describe or list your programs. Be thorough, even if you know the grantor well or have received funding from them before.
3. **Problem/Need/Situation Description:** This is the main section of your proposal, where you must convince the grantor that what you propose to do is important and that your organization is the right one to do it. Assume that the reader of your proposal does not know much about the issue or subject. Explain why the issue is important and what research you did to learn about possible solutions.
4. **Work Plan/Specific Activities:** Specifically indicate what your organization plans to do about the problem you described in #3. Include: target audience; activities you are designing; planning that has already taken place; status of your research activities; who will actually do the work you have described, and why they are qualified to do it; when the project will take place, and the projected start and end dates; and the location where the project will be carried out.
5. **Outcomes/Impact of Activities:** Tell the grantor how you expect the project to affect the targeted population. How will the situation change as a result?
6. **Other Funding:** Indicate any committed funds you will receive from other sources. Many funders do not wish to be the sole support for a project. Be sure to mention in-kind contributions you expect, such as meeting space or equipment.
7. **Future Funding:** Indicate whether this is a pilot project with a limited timeline, or one that has the potential to be carried out into the future. If it is the latter, indicate how you plan to fund the project in the long-term, and

8. **Evaluation:** Decide how you will evaluate the impact of your project. Include what records you will keep or data you will collect, and how you will use that data. If the data collection costs money, be sure to include that cost in your budget.
9. **Budget:** Indicate how much your project will cost by attaching a short budget showing estimated expenses and income. The expenses portion should include personnel expenses, direct project expenses, and administrative or overhead expenses. Income should include earned income and contributed income.
10. **Additional Materials:** Grantors are likely to request the following:
    - IRS letter proving that your organization is tax-exempt
    - List of your Board of Directors and their affiliations
    - Financial statement from your last fiscal year
    - Budget for your current fiscal year
    - Budget for your next fiscal year, if you are within a few months of that new year.
11. **Putting It All Together:** Compile all of this information into a single document with a cover sheet and cover letter. You may need to have your Board President sign the cover sheet or letter. The proposal should be neatly typed and free of errors.

*Source: Joanne Fritz. "How To: Grant Proposal Writing in a Nutshell." Your Guide to Nonprofit Charitable Organizations, 2006.*
*http://nonprofit.about.com/od/fundraising/ht/proposals_p.htm*

Prepared by the Southern Early Childhood Association
1123 South University, Suite 255 □ Little Rock, AR 72204
1-800-305-SECA □ www.southernearlychildhood.org

**Questions for Discussion**

1. How confident are you in the way in which your organization manages each of the four primary areas of nonprofit financial planning (strategic planning, resource allocation, budgeting, financial controls)? Do any of these areas need significant improvement? How would you institute those improvements?

2. Who is responsible for formulating your organization's annual budget? Who has oversight over the budget process? Are there any "key events" in the budget cycle that are being overlooked by your organization?

3. Does your organization place emphasis on earning profits each fiscal year? If so, what is done with those profits? If not, does your organization maintain a contingency plan to protect itself in the event of a fiscal emergency?

4. How effective is your Board of Directors in fulfilling their function of providing oversight in your association's budget process? Do you feel the Board is doing all it can to ensure the financial well-being of your organization?

5. Does your organization regularly hire outside accountants to perform financial audits? If so, how well does the organization typically fare in these audits? If not, what steps could your association be taking to ensure financial accountability within the organization?

6. What types of funding are typically solicited by your organization, and what methods are used to recruit donors? What are the major sources of funding for your organization? Is this a strong financial picture of the organization, or should changes be made to the way in which your organization raises revenue?

7. Who in your organization is responsible for ensuring compliance with federal, state and local regulations regarding fundraising and charitable solicitation? Do you feel as though the organization follows the regulations carefully, or should more attention be paid to the letter of the law?

8. Does your organization regularly apply for grants to fund its projects and operational costs? If so, what is the process by which this application is done, and who is responsible for managing the process? Do you feel your organization takes advantage of existing funding opportunities, or do you feel that more could be done in this area?

**Additional Resources**

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