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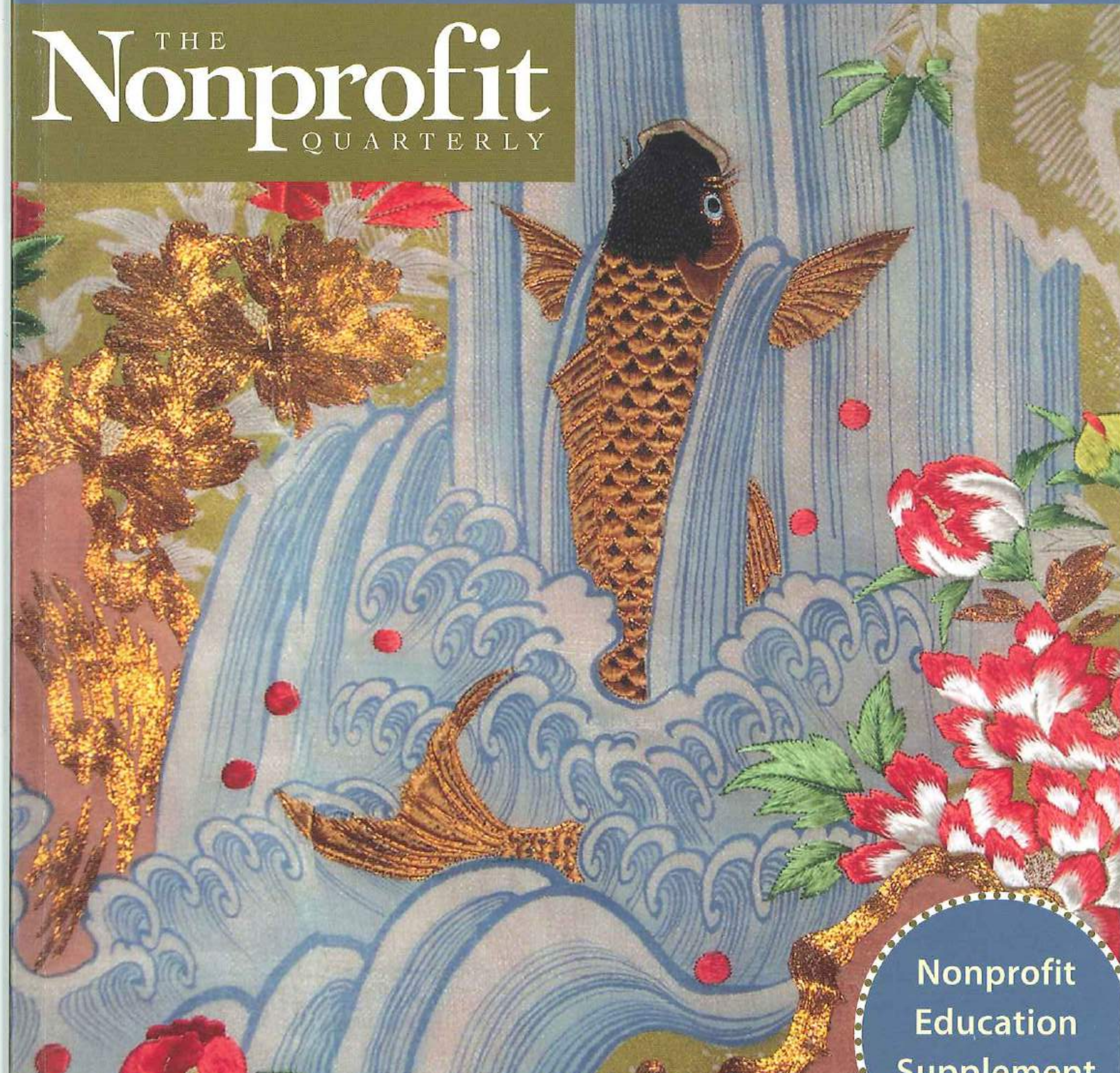
# THE Nonprofit QUARTERLY



Nonprofit Education Supplement

## Revenue as Destiny

**Bowman** the Goldilocks Budget

**Foster, Dixon, Hochstetler** the U-Shaped funding curve

**Gaskins Jones** surviving executive transitions

**Bell & Zimmerman** what to do if you don't audit

Volume 14, Issue 1

THE Nonprofit QUARTERLY

Spring 2007

## Features



Page 4

Page 9

Page 16



## Special Supplement



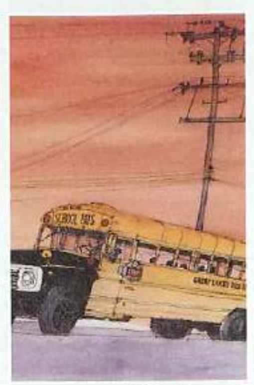
COVER: KIMONO, SILK WITH SILK AND METALLIC THREAD EMBROIDERY, JAPAN, LATE 19TH CENTURY
GIFT OF DR. AND MRS. PAUL HAVENS
COURTESY OF THE DESIGN CENTER AT PHILADELPHIA UNIVERSITY

## Departments




Page 26


Page 30


Supplement



Mission:
The *Nonprofit Quarterly* strives to provide nonprofit leaders at every level, paid or voluntary, a forum to exchange innovative ideas and informational resources—so that they can more fully realize their organizations' missions.

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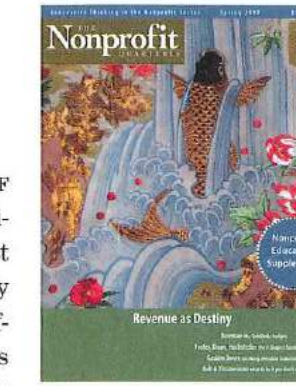
# Welcome



Welcome to the Spring 2007 issue of the *Nonprofit Quarterly*, on the realities of nonprofit finance. When we last addressed this topic we had firmly established that there indeed are significant differences between the finances of nonprofits and businesses. In this issue we look at more of the patterns and variables which are powerful determinants in nonprofit finance, but are often unrecognized by managers.

The first article in this cluster is on a topic we have been thinking about for some time: the function of "slack" in an organization's budget. It is not unusual to examine the budget of a nonprofit with an annual expenditure in the tens of millions and find it completely "house poor;" its overhead kept minimal by the contracts that support it, its facilities deteriorating, and information systems outmoded. Author Woods Bowman offers you a test to look at your organization's level of financial health and agility.

In our interview with Richard Brewster, executive director of National Center on Nonprofit Enterprise (NCNE), he discusses, among other things, the variable of the "transaction costs" that accompany each funding source, walking us through the impacts of these costs on organizations.

The third piece was one we kept hearing people talk about: that the mix of funding sources was related to an organization's size and age. They referred to the concept as "the U-shaped curve." After a little investigation we found research that had been developed by the Bridgespan Group that looked at the budgets of two types of organizations and found that they tended to start with a few funding sources, move to many, and then return to a few types as they grew in size. The authors do not claim that their research is conclusive but propose the model as an evolutionary pattern that nonprofits may be following.

Of course, there is much more in this issue as well. We have two wonderful pieces on conflict of interest. A few months ago we asked our readers to send us their conflict of interest policy statements and an indication of how they were approaching the topic with their boards and within their organizations. Did they just have the policy and have board members sign-off or was the discussion more active than that? Mel Gill, a researcher from Canada had just finished a study of his own on this topic and volunteered to make sense of the reams of material we got back from you. Rick Cohen, our national correspondent also contributed to this topic with a survey of nonprofit conflicts in the news: sordid but informative. As Mel comments, there is a large grey area in this one, but when you slip over to the dark side and are exposed, you must certainly wish you'd stayed out of the shadows.

# The Nonprofit Ethicist

by Woods Bowman

Dear Nonprofit Ethicist,

One day I was sitting at my desk when I overheard a coworker who had pumped up at a gas station which only charged him 31 cents a gallon for supreme gasoline. Mind you, I never get supreme gasoline. However, 31 cents a gallon was too good for me to pass up. I was on empty and about to do my errands for the day, so I figured why not go check it out and if it's still marked wrong, yep—I was going to take advantage of the situation.

Sure enough, I got 11.5 gallons of gas for just $3.71. We were lectured for stealing by the president of the company. Those of us who did not confess our "theft" from a small business owner were terminated, and those of us who did confess were charged the full amount of fuel, suspended for three days, were not allowed to submit for promotion or raises for a year, and were required to write an essay as to why we wanted to continue our employment at the company and why what we did was wrong.

Honestly, I didn't think of this as stealing. I associated my behavior for getting cheap gas as a shopper would at Sears who found a shirt that was incorrectly priced at $5 instead of $50. I would have bought plenty and told my friends, unfortunately the same as I did for the gasoline.

Now I submit to you my question: Was my behavior unethical or technically ok? It wasn't against the law. They incorrectly priced the pump and are required to uphold the price by law, correct? Please advise.

—Opportunist

*Dear Opportunist,*

*This is a gag, right? Of course it's wrong. Let's try this shoe on the other foot. Suppose your employer made a mistake in your paycheck and moved the decimal point one position to the left. You looked at it, but because the first few numbers were right, you didn't notice. You deposited it to your account through an ATM—keying in the amount you expected in your paycheck. You became aware of the mistake when your bank sent you an adjustment letter indicating that you had deposited 10 percent of the amount you thought you had. You go to your employer to rectify the problem and he says, "Too bad, you cashed the check." (By the way, under federal law your employer has to make good, but assume he doesn't know that.) How would you feel? You should be proud to be working for an organization that lives its ethics so emphatically.*

> Let's try this shoe on the other foot. Suppose your employer made a mistake in your paycheck and moved the decimal point one position to the left.

Dear Nonprofit Ethicist,

In my agency's first-ever experience with an online charity auction, one of the items was a romantic weekend at a chichi bed and breakfast on an exclusive local lake. The package included a candlelight dinner at a local restaurant. The son of our executive bid and won the package and immediately started negotiating the details with his mother. He wanted a different (and more expensive) weekend and he wanted dinner at a different (and more expensive) restaurant—all without paying any additional. Long story short—she caved to his whining. She originally told the staff that she would pay for the difference herself since it was her son, but after the event I learned that she decided that the organization should pay. She based this decision on her research on what the package as it finally was structured would have cost against the amount her son had bid. Sure, we still made some money, but I feel like our director missed the point entirely. When I tried to reason with her







## Doing "the Right Thing:" Serving Immigrants

Dear Nonprofit Ethicist,

What are the ethical and moral obligations of nonprofits to serve people who have entered the U.S. as undocumented immigrants? Many nonprofits will not be reimbursed by funding sources—public or foundation—for undocumented immigrants. So when a child is a citizen but its parents are undocumented immigrants, is an organization obligated to serve the whole family or is it all right to serve just the child?

—Wanting to do the Right Thing

*Dear Wanting,*

*The Ethicist has been waiting for this one. If he could award a prize for raising the most important ethical question to confront the nonprofit sector since the civil rights movement of the 1960s, he would give it to you. Not every nonprofit works with immigrants, but those that do are on the ethical frontier of today. It is a short step from your issue to churches providing sanctuary to immigrants trying to avoid deportation, and to foundations struggling to cope with anti-terrorism laws. Permit me to raise the broader question of what is the proper response to an unjust law? The answer is both simple and complicated.*

*First, the simple part: the reason we have nonprofit organizations is to serve the public interest, and they have an ethical obligation to follow their mission wherever it leads. If it leads to conflict with civil law, then an organization needs to take time out for a values check. Precisely what is its mission? How does the law compromise its mission? Is it a just law? If, like Jim Crow laws, a law is unjust, an organization has an ethical obligation to do something about it. A litmus test for determining whether a law is unjust is whether it compromises a political principle that is enshrined in one of our founding documents (e.g., "all men are created equal").*

*Now, life gets complicated. There are many possible courses of action beginning with advocacy and extending to civil disobedience. Nonprofit organizations do not do enough advocacy or public education these days, but let us focus on two points on this continuum: your question of providing services in the absence of reimbursement and, the toughest ethical issue of all, civil disobedience.*

*Only you can answer the questions posed above, but it sounds as if you think the law is unjustly interfering with your ability to carry out your mission. If the issue is just one of money, then by all means, your organization has an obligation to provide service and to redouble efforts to raise the necessary funds. But these efforts might be unsuccessful, so it is first necessary to ask whether the organization is acting in the best interests of all the people it serves? Educate your constituency about the possibility of short-term adverse consequences and mobilize them in support of your policy of long-term reform.*

*The question of whether to obey an unjust law has been the subject of much writing since Thoreau's famous 1849 essay. Dr. Martin Luther King, Jr. wrote "I [am] convinced that noncooperation with evil is as much a moral obligation as is cooperation with good." This column has space for only a brief elaboration.*

*Civil disobedience is a last resort. Even if a law is unjust, proceed with caution, because respect for the law is (or should be) enshrined in all codes of ethics. One should consider: Are there alternatives? Have they been tried? Why not try them first?*

*Obviously, repealing immigration laws would leave a policy vacuum, so it is incumbent on those who disagree with current immigration laws to fashion a just alternative that a majority can embrace. Dr. Martin Luther King, Jr. understood this and articulated his vision in numerous speeches and letters.*

*As in the case of all ethical choices, one must openly acknowledge one's actions, vocally defend them, and then accept the consequences—knowing that they are likely to be unpleasant. People willingly went to jail for civil rights. With hindsight, a rap sheet from that era is a badge of honor.*

When I tried to reason with her about the ethics of her actions, she would hear none of it.

This is really bugging me. I believe she owes the agency $175, which is the difference between the originally offered and the final package. What do you think?

—Upset

*Dear Upset,*

*Back up. It is customary for organizations to exclude staff members and their families from games of chance and auctions. Such a policy reassures participants that the outcome will be on the up-and-up. In ethical matters, appearances matter. Moving on: if the CEO said she would pay for it out of her own pocket, she should pay for it. That was the basis on which decisions were made. After-the-fact "research" and rationalizing doesn't cut it.*

Dear Nonprofit Ethicist,

An elderly donor, who had a long-term relationship with the organization, was targeted as a potential planned gift prospect. The goal was to interest him in donating his very expensive home (valued at $3.5 million) as part of a bequest to benefit the regional office. The donor was indeed interested and a cultivation process began where I had the lead responsibility. He was particularly interested in seeing the funds benefit the state wherein he resided.

On most of the initial visits the president of the organization accompanied me, and then in the latter ones I became quite close to the donor and conducted regular visits independently. All seemed fine until the final closing of the donation. With the president from the national office present, the donor explicitly asked me to assure him that the gift would be to benefit his home state. I assured him this was my understanding and promised his intent would be honored.

Upon leaving, the president was furious with me, saying that he intended the gift to go to the general endowment of the organization and not to make grants within that particular state as we had been communicating to the donor throughout the cultivation process. I was stunned and said that was not my understanding. The end result was that the gift did indeed go to the endowment with very vague wording that the specific state would be served. I know enough about these kinds of transactions to know that the language should have indicated that the funds were limited to use in that state. The donor, based upon my assurance that day, signed the documents my organization prepared.

The donor is in very poor health, and I have had a close relationship with him for the past seven years. Every time we have discussed his gift subsequent to that meeting he seems to be quite pleased that he has left a legacy for his state. I struggled with the option of revealing this to him but eventually decided not to as it seemed to be a way of destroying the joy he had in making this gift. I was unsuccessful in having the language revised to honor his intent. What could I or should I have done in this situation? I've subsequently resigned from this position, as I did not feel confident that I could assure donors their intentions would be honored. Nevertheless, this experience has continued to bother me and I'd appreciate your observation on the appropriate action fundraising professionals should take should they be confronted with this situation. Thank you.

—Regretful

*Dear Regretful,*
*The Ethicist's Rule #14A: Never promise anything that is not in your power to deliver. When the donor explicitly asked you to assure him that the gift would be to benefit his home state, you should have referred the question to the president from the national office who was present at the closing. The president was wrong not to have jumped in, taken control of the discussion, and negotiated a mutually satisfactory agreement. The donor erred by not getting the organization to commit in writing. (It never ceases to amaze me that people who work hard to amass wealth and manage it scrupulously are willing to turn it over to someone else on a handshake.) The Ethicist is a proponent of full disclosure, but since you have resigned and the donor did not follow up with the organization to ask what projects it actually funded with the money, I suppose you are off the hook at this point.*

The Ethicist's Rule #14A:

Never promise anything that is

not in your power to deliver.

Dear Nonprofit Ethicist,
If a nonprofit operates a grant-funded care management program and it contracts with for-profit providers to deliver services to clients, should it ask its providers to support other activities of the agency through their direct donations or indirectly by buying vendor space at conferences, or paying for a speaker at an event? Should staff of the for-profit contractor be asked to serve on the board or committees of the agency? Should the for-profit contractor be treated any differently than the nonprofit contractor?

—Vendor Bender

*Dear Vendor Bender,*
*Treat this for-profit contractor like any other vendor. You need not be shy about asking it for money, but keep its representatives off your board and committees. They necessarily have a conflict of interest.*

**Woods Bowman** is Associate Professor of Public Service Management, DePaul University.



**Correction**
The Maryland Association of Nonprofit Organizations (MANO) noted some inaccuracies in Rick Cohen's Winter 2006 article entitled "Gloria Wise Boys and Girls Club: Implications of the Scandal" concerning a reference to MANO's review of the ethical standards of an organization called CHIMES. MANO points out that CHIMES had not been certified as compliant under MANO's Standards for Excellence program. MANO had begun a review of a related organization, the CHIMES Foundation, which was a member of MANO, pursuant to MANO's by-laws after seeing news reports about CHIMES in the *Baltimore Sun*. The CHIMES Foundation resigned its membership rather than respond to MANO's request for information.

EAGLE NEBULA: (X-RAY: NASA/CXC/U. COLORADO/LINSKY ET AL.; OPTICAL: NASA/ESA/STSCI/ASU/J.HESTER & P.SCOWEN)



# Dark & Light Matters in the Nonprofit Universe

by Jon Pratt

***Editors' Note:*** *While the media, researchers, and nonprofits use some impressive numbers to describe the nonprofit sector,* NPQ *remains uncomfortable about how the scope and size of the nonprofit sector are defined. Jon Pratt takes on this subject, examining the implications of these oft-cited numbers.*

## Getting the Numbers Right

IT IS WIDELY ACCEPTED THAT 83 PERCENT OF the mass of the universe consists of dark matter—galaxies that create gravitational fields but are invisible to astronomers and astronauts.In the nonprofit world, the invisible dark matter consists of the smaller organizations underneath the radar of researchers and the IRS—informal, unincorporated, so small they are not required to file IRS forms—as well as the 350,000[1] religious congregations exempt from filing requirements. How many are there? The number is currently unknown but will soon become more knowable.

Unlike virtually any other industry in the United States, nonprofit organizations lack reliable or timely access to economic performance information. While the Departments of Commerce, Agriculture, and Labor collect statistics on specific industries, the economic activity of nonprofit organizations is tracked once a year through IRS Form 990, filed four and a half months after the end of the fiscal year and tabulated on a national level a year or two later.

Unlike virtually any other industry in the United States, nonprofit organizations lack reliable or timely access to economic performance information.

**Jon Pratt** is the Executive Director of the Minnesota Council of Nonprofits and Contributing Editor to the *Nonprofit Quarterly*.

These 546,200 nonfilers represent the unknown matter.

The new *Nonprofit Almanac 2007*,[2] prepared by the National Center for Charitable Statistics at the Urban Institute and based largely on IRS Form 990 filings, provides a comprehensive update on the scale and scope of the nonprofit sector, including these facts:

• In 2004 the United States had 1,413,708 official tax-exempt nonprofits,[3] one organization for every 214 Americans, a ratio both higher and lower than some expected.

• These organizations had revenues of $1.4 trillion and assets of $3.0 trillion.[4]

• Among the total, 845,233 were IRS Code 501(c)(3) public charities, and 103,880 were 501(c)(3) private foundations.

• 546,200 (64%) of the 845,233 recognized public charities do not report to the IRS, leaving 299,033 "active filers."

These 546,200 nonfilers represent the unknown matter. No one knows how many are still active or whether they did much after receiving their 501(c)(3) letters from the IRS. (The July 1, 2006, fee increase for filing the Form 1023 application—which costs most organizations between $500 and $750—may decrease the number of hopeful-but-never-quite-airborne organizations—more about this below).

These numbers, however, create a lopsided impression. The concept of the nonprofit sector, in which a disparate group of organizations (from food pantries to Harvard University) are described as occupying the same section of the economy, sharing a common set of tax exemptions and Tocquevillian social capital–building relationships can be deceptive. Hospitals, for example, account for 60 percent of the total financial activity of the nonprofit sector.[5] And, while combining the small with the large is a proven strategy in government relations, especially when demonstrating the negative effects and costs of government regulation, it can be a poor gauge to measure the standing of one's own nonprofit relative to others.

Sometimes a single sentence will combine descriptions of local food pantries and neighborhood organizations with the aggregate numbers: 1.4 million charities, 8.3 percent of all wages and salaries paid in the United States, and $1.8 trillion in assets.[6] These figures could lead some members of the public to conclude that local pantries and neighborhood organizations must not be so needy after all.

It is interesting but not particularly useful to know that your organization is one of 1.4 million organizations with nearly $3 trillion in assets. Instead, for many boards and managers, the most useful comparisons are those involving "similarly situated organizations": nonprofits conducting the same kinds of activities, residing in the same geographic location, and having the same size and revenue type. (A tool created to conduct such an analysis was provided in "Financial Strategy Tools: Cohort Analysis," *Nonprofit Quarterly*, Spring 2006.)

Categorizing the 1.4 million organizations along these lines indicates the number of counterparts that the majority of *NPQ* readers actually have: that is the 299,033 social service, community, arts and culture, legal, civic, and environmental organizations with more than $25,000 in annual financial activity. This could be called the "nonprofit wing" of the nonprofit sector: those organizations most reliant on charitable contributions and individual participation and the least likely to hold their assets in securities.

*The Nonprofit Almanac 2007* shows that the nonprofit sector is continuing to grow and has posted its "biggest nonprofit ever" in 2004, based on financial activity with public charities reporting $1,050 billion in revenue (up from $763 billion in 1999 and $538 billion in 1994). As always, though, averages tend to obscure the picture and fail to account for the dominance of the largest organizations (i.e., the light matter).

## Shrinking Nonprofit Universe: 2010

The biggest revelation of the true size of the dark matter is on the horizon: a new federal "Are the lights still on?" requirement. Organizations are in the process of being informed of this requirement via notices mailed to their last known address. Every public charity with annual financial activity of $25,000 or less must now file an annual notice electronically with the IRS that discloses the following:

• the organization's legal name;

• the organization's mailing address;

• the organization's Web site address;

• the organization's taxpayer identification number;

It is interesting but not particularly useful to know that your organization is one of 1.4 million organizations with nearly $3 trillion in assets.

• the name and address of a principal officer;

• evidence for continuation of the organization's exemption from filing Form 990; and,

• upon termination of an organization's operation, notice of that termination.

This requirement is effective for tax years that begin after August 17, 2006. While there are no monetary penalties for failure to file, if organizations do not file for three consecutive years, it will result in revocation of tax-exempt status.

| | Number of Organizations (2004) | Expenditures (in millions) |
|---|---|---|
| Reporting 501(c)(3) public charities | 299,033 | $981,000 |
| Hospitals and health care–related nonprofits (12.9 percent of reporting public charities) | 38,633 | $588,299 (60 percent of reporting public charities) |
| Education-related nonprofits (17.7 percent of reporting public charities) | 53,074 | $150,034 (15 percent of reporting public charities) |
| Other reporting public charities (e.g., social service, community, arts and culture, legal, civic organizations); (69.3 percent of reporting public charities) | 207,326 | $242,938 (25 percent of reporting public charities) |
| Non-reporting organizations (with less than $25,000 per year financial activity) | 546,200 | Unknown |
| All nonprofit organizations | 1,413,708 | $1,255,000 |

There is no question that smaller organizations represent an important, albeit unknown, share of nonprofit activity—operating small-scale food pantries, summer camps, cultural activities, and neighborhood participation and issue advocacy groups. They tend to be more fleeting than established organizations. Look back 20 years, and many of the organizations devoted to grassroots community efforts at that time have disappeared or become something else.

By May 15, 2010, the deadline of three years of required reporting for the 546,200 organizations with less than $25,000 in revenue will have arrived. If they have not electronically filed their information by then, the IRS can revoke their tax-exempt status, ending their ability to receive tax-deductible contributions. But many organizations may not know their tax-exempt status is jeopardized if the notice to file is sent to an outdated address. These organizations may not learn until years later that their status has been revoked and that it costs $750 to reapply (assuming the fee doesn't increase by 2010).

Last year a possible foretelling of what might happen nationally occurred at the state level. In Minnesota, which has an annual filing requirement with the secretary of state, 4,712 organizations were statutorily dissolved on January 1, 2006. Unfortunately, at least 100 of these organizations were very much alive, with employees, offices, active boards, and ongoing operations. The loss of corporate status is serious in itself, putting corporate immunity in doubt and also making the organization's name available for another organization to appropriate.

How many of the half million nonfilers will survive this cut? If the Minnesota example is any indication, expect a mass revocation and disruption in the dark matter of the nonprofit universe.

# Changes in the State of our Finances

*Individual donations.* The Center on Philanthropy at the University of Indiana finds that individual giving generally tracks the ups and downs of the S&P 500. "Fundraisers are reporting a fairly stable giving environment," says Patrick M. Rooney, director of research for the Center on Philanthropy, in a press release about the center's semiannual "Philanthropic Giving Index."[7] "Nearly 50 percent of fundraisers surveyed reported that the economy was having a positive impact on giving," he said. "This is probably tied to improved stock market conditions. However, about 30 percent of fundraisers said the economy was negatively impacting giving. The result likely will be a year-end giving season that is similar to last year."

Nonetheless, in 2006, total year-end individual donations will be lower than in 2005 due to the thankful absence of a tsunami- or Katrina-scale disaster (some have noted that bad news is always good news in fundraising). Warren Buffet's highly public commitment of 85 percent of his Berkshire stock to the Gates Foundation went down as the largest philanthropic gift in history and generated hopes that other superwealthy might follow suit. Unlike other large-scale donations, which have gone to foundations or universities, the Buffet gift targeted low-income individuals mostly outside the United States.

The field for individual contributions is crowded and not restricted to charitable organizations. The 2008 presidential and congressional campaigns are already taking shape, and for the first time the presidential race will reach the $1-billion level. Political campaigns are aggressive fundraising efforts, with candidates fishing in the same stream as public policy, advocacy, and social change organizations. In some instances, as reported by the Campaign Finance Institute, organizations have developed contribution umbrellas with 501(c)(3), 501(c)(4), PAC, and 527 arms, of which the latter two are explicitly political instruments that can raise and distribute funds for charitable or political purposes as the need arises.

One long-sought incentive contained in the Pension Protection Act of 2006 permits individuals to roll over up to $100,000 from an individual retirement account directly to a qualifying charity without recognizing the assets transferred to the qualifying charity as income, but this provision will expire at the end of 2007. Should it be renewed? Universities and community foundations were the rollover's most enthusiastic supporters. It's too early to know exactly how the benefits have been distributed among types of organizations and taxpayers, but the campaign for renewal has already begun. While it was intended to benefit charitable giving overall, the beneficiaries almost assuredly will turn out to be the largest organizations and high-net-worth taxpayers.

*Federated Drives:* With shifts in the sources and declines in the real dollar revenue totals of United Way—a bellweather in terms of federated drives—there is a perception that the United Way system is becoming a less reliable and more variable funder of urban social services. Counting an additional $26 million raised for Katrina-related relief, the aggregate fundraising of United Way campaigns reached $3.96 billion in 2005–2006, up from $3.15 billion in 1995–1996, but a net reduction over the

There is a perception that the United Way system is becoming a less reliable and more variable funder of urban social services.

decade corrected for inflation.[8] Even without the Katrina funds included, United Way total revenues raised from all sources for current year support rose by nearly 3 percent between the 2003–2004 and 2005–2006 campaigns. Excluding major gifts, planned giving, corporate sponsorships, initiative giving, and government grants, the increase was much more modest, a bit under 1 percent.[9] But focusing more closely on the workplace giving component—the United Way's traditional source—this accounted for well under half of total revenues amounting to $1.7 billion during its 2004–2005 season, significantly below $1.96 billion in the 2001–2002 campaign season.[10] Participation rates of employees of companies with United Way campaigns have declined from 35 percent in 2000 to 20 percent in 2005.[11] The United Way is increasingly seeing its biggest fundraising growth in high-net worth individuals and corporate and institutional donors, reflected in its reported 410 percent increase in major gifts and 39.5 percent increase in corporate sponsorship revenues between 2004–2005 and 2005–2006.[12]

> Legislatures are hearing more demands that they address education, transit, health care, and rising higher-education costs and are more receptive to tax increases as part of the response.

*Foundation grants.* The 10 percent loss in foundation assets between 2000 and 2002 caused the first decline in foundation grants paid out in 20 years. The Foundation Center estimates that foundation grants rose 5.5 percent to an estimated $33.6 billion in 2005 (though inflation-adjusted giving in 2005 remained below the 2001 peak) and that projected growth in 2006 giving was likely to be small. Nevertheless, after-inflation foundation grant dollars have more than doubled since 1995.

Many foundations' recent asset reduction experience increased their cautiousness about their allocation of funds. While they are obliged by federal law to make expenditures equal to 5 percent of the value of their assets and are occasionally under both internal and external pressure to exceed this, they now have a strengthened will to resist.

## Looking Forward: Government Support

*A shift in public opinion.* A Pew Research Center for the People & the Press survey found that 66 percent of the American public thinks that the United States is more politically polarized than in the past, and 75 percent express a strong desire for political compromise. Three-quarters say that they like political leaders who are willing to compromise, compared with 21 percent who see this as a negative trait. One of the clearest indications of this new public mood is the fact that all but one of the initiatives that sought to limit the power of government were voted down, including limits on the judiciary, term limits, tax and spending limitations (such as the Taxpayer Bill of Rights), and major tax and revenue cuts.[13]

*Shift in control.* After six years of retrenchment and tax battles in state legislatures and in Congress, the 2006 election changed party control of Congress and tipped the balance in state legislatures. Democrats now control legislatures in more states than at any time since 1994, including majorities in both chambers of the legislature in 23 states; Republicans control both in 15 states; and 11 states have split control.

The tax cuts of 1995–2000 and "no new taxes" pledges that triggered budget and service cuts of 2000–2005 seem to have run their course. Legislatures are hearing more demands that they address education, transit, health care, and rising higher-education costs and are more receptive to tax increases as part of the response. Not mentioned here is the third and largest revenue source for nonprofits, program service fees: the fees accrued for nonprofit services, such as tuition, counseling fees, tickets for arts performances, and so forth. The distribution of program service fees skews heavily to the largest entities, especially health care and higher education, and also to the largest organizations in each activity area.

While the larger entities absorb the lion's share of the funding, the nonprofit wing of the nonprofit sector, including the smallest organizations exempt from filing, are not directly inhibited in their ability to attract modest amounts of resources. For the larger sponsors and supporters of the work undertaken by nonprofits, it is worth examining whether the current patterns of distribution are dictated more by habit, social network, and economic prowess than by community impact or human need.

### Endnotes

1. National Center for Charitable Statistics (NCCS) Web site. "The Nonprofit Sector In Brief: Facts and Figures from the Nonprofit Almanac 2007" at http://www.urban.org/UploadedPDF/311373_nonprofit_sector.pdf.





2. At the time of writing, the Nonprofit Almanac has not yet been published. The references cited are taken from the NCCS Web site. "The Nonprofit Sector In Brief: Facts and Figures from the Nonprofit Almanac 2007" at http://www.urban.org/UploadedPDF/311373_nonprofit_sector.pdf
3. "The Nonprofit Sector In Brief: Facts and Figures from the Nonprofit Almanac 2007" This number is comprised of 845,233 public charities, 103,880 private foundations, and 464,595 other nonprofits.
4. "The Nonprofit Sector In Brief: Facts and Figures from the Nonprofit Almanac 2007"
5. "The Nonprofit Sector In Brief: Facts and Figures from the Nonprofit Almanac 2007." Of the 981,271 million in expenses among public charities, approximately $588,299 million were attributable to hospitals and health care.
6. "The Nonprofit Sector In Brief: Facts and Figures from the Nonprofit Almanac 2007." Further, consider that in 2004, 464,595 civic leagues, fraternal beneficiary societies, veterans' organizations, business leagues, and so on were included in the 1.4 million tally. This number decreased from 490,235 in 1996. (The rarest exempt status? Section 501(c)(23) is limited to veterans' associations formed prior to 1880—of which there are only two, the Veterans of Foreign Wars and the American Legion, with $2.3 billion in assets between them.)
7. Press release, 4 December 2006, http://www.philanthropy.iupui.edu/News/2006/pr-PGI-December2006.aspx
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9. United Way reports, 5 October 2005, 11 September 2006.
10. "Giving Back: Trying to Mend the United Way" by Sally Beatty The *Wall Street Journal* April 28, 2006.
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# Organizational Slack (*or* Goldilocks and the Three Budgets)

by Woods Bowman

Think of slack as the financial aspect of organizational *capacity*.

ORGANIZATIONAL SLACK IS AN IMPORTANT concept in the management literature, but you won't find it mentioned in articles on nonprofits. It has several definitions, but all boil down to *extra* resources or resources held in *reserve*. The difference between a hand-to-mouth organization and a vibrant one is slack. Think of slack as the financial aspect of organizational *capacity*.

Nonprofit commentators write about capacity as if an organization can't get enough of it, but slack (financial capacity) has a dark side. Too much slack can distort priorities, erode managerial discipline, and encourage wastefulness, especially high salaries. I will emphasize the positive aspects because I believe that most nonprofits do not have enough slack, but I caution that it *is* possible to have too much of a good thing.

## A Primer on Slack

Nobel laureate Herbert Simon (1947) disparaged the economic assumption that decision makers seek to maximize utility, profit, or anything at all, arguing that maximization requires more information than ordinary mortals are likely to possess or could even process if they had it. Instead, he proposed that decision makers stop short of that elusive goal when they reach a sat-

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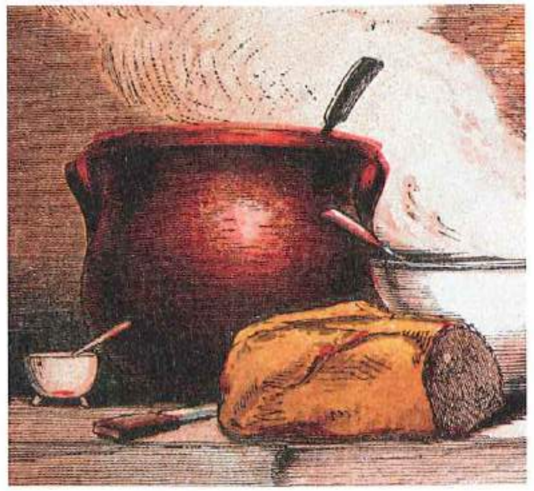
A cold organization is frail, unable to adapt to changing needs of its constituents, unable to invest in training and new technology, and unable to take advantage of opportunities.



isfactory state of affairs—a situation he famously called "satisficing."

The difference between satisficing and maximizing is slack. This seems to be an ideal starting point for nonprofit analysis, since profit maximizing is not the norm for nonprofits (Steinberg 1986; Brooks 2005). Nonprofits even shun the word "profit," preferring to use "surplus" as the name for an excess of revenue over expenses.

I like a definition from the traditional (i.e., for-profit) management literature. Slack is "A cushion of potential resources which allow an organization to adapt to internal pressures for adjustment or to external pressures for change in policy, as well as to initiate changes in strategy with respect to the external environment" (Bourgeois 1981). This seems to me to perfectly capture the idea of nonprofit financial capacity, so from here on that is what I will call it.

Bourgeois and Singh (1983) identify three forms of slack, i.e., financial capacity. Several methods are available to measure each one (Bowman, Keating and Hager 2005). Here I have selected the simplest methods.

First, there is *available*, or *unabsorbed*, financial capacity. Think of this as ready cash, although a more accurate description would be liquid assets. One purpose of available financial capacity is to cope with occasional or periodic negative cash flows without having to borrow from outside the organization. Another purpose of available financial capacity is to cope with occasional budget shortfalls on an annual basis without having to borrow from outside the organization.

A standard metric of short-term available financial capacity is *working capital*, which is current assets minus current liabilities. Current assets are unrestricted cash and cash equivalents, inventory, and monies an organization expects to receive within one year. Current liabilities are obligations to creditors that an organization must discharge within one year. An alternative metric useful for comparing available slack in organizations of different sizes is the current ratio, which is current assets divided by current liabilities.

The second form of financial capacity is *recoverable*, or *absorbed*, financial capacity. Think of this as overhead spending. When times are tough, overhead can be cut and resources recovered for operations (Chang and Tuckman 1991). The metric for this form of financial capacity is administrative expenses divided by the sum of administrative expenses and program expenses.

Overhead should not include spending on fundraising because spending a few dollars more or less on overhead will not influence the organization's revenue. Money spent on fundraising should pay for itself and then some. If fundraising spending is optimized, it would be foolish to cut it in a crisis because more revenue would be lost than the amount of money saved.

Third, there is *potential* financial capacity. Think of this as the capacity to borrow. There are multiple ways of measuring this concept. The simplest metric is the ratio of total liabilities to total assets—the value of everything owed divided by the value of everything owned—a quantity commonly called leverage. Simply put, the less an organization owes, the more it can borrow.

Long-term borrowing should be reserved for expanding the organization's ability to increase its revenues. If this sounds crass, consider this: without more revenue, an indebted organization will have difficulty repaying principal with interest. Unless an organization is careful, additional long-term debt might leave it in worse shape for years to come and, in the worse case, may cause its extinction. Potential financial capacity indicates that an organization has not borrowed to the hilt.

## Cold Organizations Need It

A cold organization is frail, unable to adapt to changing needs of its constituents, unable to invest in training and new technology, and unable to take advantage of opportunities. It is stale though not yet failing. It has ideas but does not have sufficient capacity to implement them.

At the most basic level financial capacity reduces risk. It cushions an organization from economic shocks. It permits a nonprofit to maintain service levels in the face of temporary reductions in income.

Many nonprofits are tyrannized by inflexible business models. Cold nonprofits easily become locked into program models not fully appropriate to their communities—but favored by their funders. In other words, financial capacity gives nonprofits the flexibility to navigate around restricted funds and to avoid mission distortions that can result from overdependence on grants.

It also allows the organization to equalize budgets among various parts of the whole. An example of this might be the community mental health organization that used cash earned from a thrift store to support a domestic violence program which it had adopted in an underfunded state.

Above all, financial capacity supports innovation. Vibrant organizations do research about the needs and interests of their communities and about promising program models, and experiment with new ways of doing things. Financial capacity facilitates strategic behavior, allowing a nonprofit "to experiment with new strategies such as introducing new products and entering new markets" (Tan and Peng 2003, paraphrasing Thompson).

## How They Can Get It

Where does financial capacity come from? There can be only one place: annual surpluses. Some nonprofits worry that it is bad to have annual surpluses. Others would like to have surpluses but believe they are unaffordable. Both views are wrong.

A budgeted surplus is an insurance policy against a deficit and allows the organization to remain nimble and responsive to constituents. Unexpected adverse circumstances will create a smaller surplus than anticipated, but this unhappy situation is better than having an actual deficit. Besides, nonprofits cannot sell stock. If a nonprofit wants to grow, it will need to invest in physical capital. An annual surplus allows a nonprofit to accumulate the resources needed to pay cash or to service a debt.

Instead of explicitly budgeting a surplus, too many organizations take the easy, but sloppy, road by deliberately underestimating revenue and overestimating expenses. It is best to avoid this expedient. It will require some tough choices to adjust a tight budget to provide for a surplus, but once it is in a budget, it is easy to retain because it makes no demands on new dollars. Phase it in—first one percent of revenue, then two, then three, and maybe more depending on the long-term reliability of the organization's funding. Higher risk requires higher surpluses.

A budgeted surplus is just the first step. Managers need to be able to spend extra resources to deal with unforeseen contingencies and opportunities. Top managers—CEOs, finance directors, chief program officers—need contingency accounts in their departmental budgets to be able to respond to business opportunities, to pay the bills if the electric company raises rates in the middle of the year, or to hire lawyers if the organization is hit with a lawsuit.

All contingency spending is not created equal. It is important to distinguish among three types of new spending:

- non-recurring (one-time);
- new spending that will recur in future budgets, but will generate more than enough new offsetting revenue; and,
- new spending that will recur in future budgets without new offsetting revenue.

Ideally, all "just right" contingency spending would be of the first type, establishing no new ongoing commitments. Contingency spending of the second type can be thought of as an investment but, as with all investments, there will be the problem of judging how long it will take to break even. If it will take more than a year, future financing must be secured before spending occurs. A financing plan is required for contingency spending of the third type.

Too much financial capacity can support waste, high executive salaries, lack of discipline, hoarding behavior . . .

## Hot Organizations Have Too Much

A hot organization is one that is extremely successful—at least financially. It has a big portfolio and yet money keeps rolling in. These fortunate nonprofits are an exclusive club, but as I have said, there is a dark side to their success.

Too much financial capacity can support waste, high executive salaries, lack of discipline, hoarding behavior, and lack of innovation—with no one taking notice. Paradoxically, some organizations that have the greatest capacity to do research, experiment, and innovate are restrained by their wealth. "Don't mess with success," could be their motto.

The idea that a point exists where financial capacity passes from being merely large to being excessive is based on the observation that people (and organizations) tend to lose their edge when they are sated.

Frumkin and Keating (2001) analyzed CEO compensation in over 15,000 nonprofits in relation to organization size, managerial performance, and free cash flow. They define the latter concept in terms of liquidity, which is what I call available financial capacity. They use statistical techniques to hold two of these three variables as well as industry constant while measuring the effect of the third on CEO compensation.

They find that CEO compensation is positively related to organization size (measured by value of physical assets and total program services), but not related to managerial effectiveness (measured by overhead ratio and dollar growth in donations). CEO compensation is positively related to free cash flow (measured by liquid assets-to-expenses ratio) and the size of an organization's investment portfolio in relation to its total assets. However, after controlling for organization size and managerial ability, the effect is not large. Human service organizations were the only ones where organization size and managerial performance significantly outweighed the effects of free cash flow and portfolio size on CEO compensation.

It is easier to say how much financial capacity is too little than to identify the threshold where it becomes too much. The idea that a point exists where financial capacity passes from being merely large to being excessive is based on the observation that people (and organizations) tend to lose their edge when they are sated. It need not happen to everybody; Warren Buffet is as sharp today as when he was a mere millionaire. For a nonprofit, the secret of continued success lies in its board. If its board is self-renewing and keeps the best interests of its clientele in mind, a huge financial capacity need not create problems.

## Goldilocks and the Three Budgets

Every nonprofit has a culture of budgeting. This is illustrated in an exchange between two board members of an organization in its early stages of development. One board member was arguing for austerity based on the organization's relative youth and her own natural fiscal conservatism. Another challenged her saying "that's scarcity thinking. We need to have abundance thinking here!" In some cases these two orientations do not get resolved—one simply wins out over the other. This can result in an organization's starving itself or, alternately, resolving to build its asset base almost as a mission goal in and of itself.

Without knowing it, the board members were arguing about the appropriate level of financial capacity. As we have seen, both too little and too much are bad—for different reasons. An optimal amount of financial capacity must lie somewhere between (Nohria and Gulati 1997). Organizations fortunate enough to operate in this financial environment are the "Just Right" nonprofits.

A careful analysis of an organization's financial capacity should include a study of its financial statements (see A Primer on Slack on page 16), executive compensation, and administrative staffing. The sidebar to the right (What's Your Financial Capacity Quotient?) provides a nonscientific, rough and ready scorecard of financial capacity quotient for readers to assess whether a detailed analysis would be worth the time and effort. Persons with a good working familiarity of an organization should be able to complete the scorecard without leaving their armchair to hunt for old financial statements.

The highest possible financial capacity quotient is 8; the lowest possible quotient is -8. A "Just Right" organization has a low positive score. The best way to understand how the scoring system works is to examine three alternative hypothetical scenarios. Obviously an organization with a +8 quotient on the first scorecard is hot and one with a quotient of -8 is not. The following examples are in the middle of the pack.

*Scenario A.* The revenue of a large human services organization consists of 30% restricted government contracts, 25% individual donations, 25% program service income, 15% restricted grants, and 5% investment income (-1). It ended three straight years with a surplus (+3), including one of 11% (+1). It has a line of credit but never needs to use it (+1). It recently filled a new administrative assistant position (+1). The





## What's Your Financial Capacity Quotient?

To find out whether your organization has too little or too much, fill in the scorecard. The number in parentheses after each statement is the score for a true statement. Write it on the line that introduces the statement. The score for a false statement is zero. A statement that bodes well for financial capacity earns a positive score; a statement that implies impaired financial capacity receives a negative score. The highest possible financial capacity quotient is 8; the lowest possible quotient is -8. "Just Right" organizations have low positive scores. Be careful answering questions about surpluses and deficits; they should be based only on unrestricted amounts, including resources released from restrictions.

Item 13 costs more than most people think, but an organization with financial capacity should be able to finance it easily. An organization with a performance budget based on measurable outcomes is probably staying sharp, even if it has a very large financial capacity, but it will need an R&D program to keep its performance measures updated.

The figure 10% in the last two items represents the approximate rate of inflation over the past three years. It is not possible to say exactly how much R&D and training an organization should do without knowing something about its mission and its business model, but one can say that all organizations should be doing some of each and their spending on these activities should keep up with inflation.

The Adjusted Financial Capacity Quotient should be approximately zero. A negative sub-total on the first scorecard and a score of -2 or more negative on the second one indicate that good work is probably unsustainable at its current level.

1. ___ The CEO or CFO has a budgeted contingency account. (+1)
2. ___ Unrestricted income from investments is greater than 10% of annual budget. (+1)
3. ___ Restricted revenue is greater than 1/3 of budget. (-1)

*Within the last three years the organization:*

4. ___ had a unrestricted surplus every year. (+3)
5. ___ had a unrestricted deficit every year. (-3)
6. ___ had at least one unrestricted surplus greater than 10% of revenue. (+1)
7. ___ had at least one unrestricted deficit greater than 10% of revenue. (-1)
8. ___ was refused a line of credit, or was refused a higher borrowing limit. (-1)
9. ___ did not use its line of credit. (+1)
10. ___ borrowed to the maximum on a line of credit. (-1)
11. ___ cut general administrative positions. (-1)
12. ___ added general administrative positions. (+1)

___ Financial Capacity Quotient: items 1–12 (range +8 to -8)

*The critical issue is how an organization uses its financial capacity. If your organization has a quotient above zero, then fill in the short scorecard below. These are things that organizations should be doing because they reduce risk and improve service quality, but cold organizations can't. Hot ones have no excuse for not doing all of them. "Just Right" organizations should be doing at least some of them, so their score should be near zero. The item scores are negative because they use financial capacity, but that is the point of this scorecard.*

13. ___ The organization has a performance budget with measurable outcomes. (-1)
14. ___ The program service budget increased every year. (-1)
15. ___ The program service budget increased in years when total income decreased. (-1)

*Within the last three years the organization:*

16. ___ made a major investment in new technology. (-1)
17. ___ increased its research and development budget by more than 10%. (-1)
18. ___ increased its training budget by more than 10%. (-1)

___ Adjustment: items 13–18 (range 0 to -6)

___ Adjusted Financial Capacity Quotient: items 1–18 (range +8 to -14) financial capacity quotient for this organization is +5. It is borderline hot.

*Scenario B.* The revenue of a small human services organization consists of 70% restricted government contracts, 10% individual donations, 10% program service income, and 10% restricted grants (-1). It had deficits two of the last three years (-1), and one was larger than 10% of its budget (-1). It maxed out its line of credit (-1) and had to cut one administrative position (-1). Its financial capacity quotient is -5. It is cold.

*Scenario C.* The revenue of a small arts organization consists of 80% ticket sales, 10% individual donations, and 10% grants (+1). It has no endowment, but it ended each of the last three years with a small surplus (+1). It uses its line of credit occasionally (-1). It added one administrative staff in group sales (+1). The financial capacity quotient for this organization is +2. It is neither cold nor hot. It is "just right."

The second scorecard determines whether financial capacity is working or wasted. When this score is added to the first, the Adjusted Financial Capacity Quotient should be near zero. Look at the three budgets again.

*Scenario A:* The hot organization's revenue increased three years in a row, and it increased its program service budget each year (-1). It invested in new technology (-1). Its Adjusted Financial Capacity Quotient is +3. It has capacity to do more.

*Scenario B:* The cold organization is not in a position to keep program spending constant when income goes south. It cannot do much R&D, training, or investing in new technology.

*Scenario C:* The small arts organization probably could afford to do one or two of the items 13 through 18, but not all. It chose to increase its production budget (+1) and to invest in technology (+1). It is neither hot nor cold. With an overall quotient near zero, it is a "Just Right" organization and would probably use additional capacity wisely.

The Financial Capacity Quotient is designed to challenge organizational denial and complacency and to give all organizations a "to do" list. If you are a cold organization in denial, the Financial Capacity Quotient will point out what you can improve. If you are a complacent hot organization, the Financial Capacity Quotient will show you how to put your financial capacity to work. Now, go to it!

The Financial Capacity Quotient is designed to challenge organizational denial and complacency and to give all organizations a "to do" list.

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# Transactional Analysis, Nonprofit Style

## An Interview with Richard Brewster

Groups that sought to diversify seem to cross another threshold and begin to concentrate on one type of funding which may provide up to 85% of their income. Some believe that this re-concentration is driven, at least in part, by transaction costs.

*NONPROFIT QUARTERLY* RECENTLY interviewed Richard Brewster, Executive Director of the National Center for Nonprofit Enterprise (NCNE), to garner his thoughts about some of the economic models that nonprofit managers and their advisors work with in developing their organizations.

**NPQ:** Many funders are pushing nonprofits to "go to scale," but what does that mean and does it make sense as an organizational approach to the development of responses to social problems?

**Brewster:** I don't think that many small to mid-sized programs think too much about "getting to scale" if that means increasing impact by growing the single organization and increasing delivery of services. This willingness to stay smaller is probably based on realism and a concern about outcomes. Of course, organizations can and do grow within their geographic area to increase the numbers of people helped, but they can rarely get close to helping everyone in that area who may need the service they provide. Many times there is a ceiling on the availability of funding. Thus, it very rarely happens that an organization can permeate a population in need with its model of service even if that model is very effective—so the growth of a single organization may not be the avenue to a strong, consistent response to a social problem.

One archetypal response to this ceiling can be to grow through geographically dispersed affiliates. But another response is for organizations to try to bring work to scale through collaborating with organizations to try to act as more than the sum of their parts.

### Costs and Benefits of Fund Diversity

**NPQ:** Do you think there is a "U-shaped pattern" in the way organizations are funded over time? Can you describe it?

**Brewster:** As William Foster's article on page 26 in this issue indicates, most nonprofits start out with one to three sources of funding. From there many tend to diversify. The reason for this, of course, is to increase the money the organization has to work with and to decrease its risk.

Eventually the same groups that sought to diversify seem to cross another threshold and begin to concentrate on one type of funding which may provide up to 85% of their income. Some believe that this re-concentration is driven, at least in part, by transaction costs.

**NPQ:** What do you mean by transaction costs?

**Brewster:** Transaction costs include those costs that are over and above the directly attributable costs of fundraising: the costs of administering a particular type of funding (meeting reporting requirements, for example); the costs of developing systems to support fundraising and administration; the time spent by the executive director and key staff in building relationships with potential funders; and the time and attention of program managers, who may be forced to act differently as a result of a particular funding stream.

It is important to take these transaction costs into account even if some of them seem qualitative.

Bob Herman and Dick Heimovics of the University of Missouri-Kansas City have produced some good evidence that one of the transaction costs critical to the effectiveness of a nonprofit is the time the executive director spends securing support, such as networking with politicians or maintaining relationships with foundation or United Way staff and large donors. But what about the opportunity costs of this activity? What other work is not performed because of the effort devoted to this activity? There are only so many hours in the executive director's day: in effect, he or she can become a bottleneck that *checks* growth in revenues. One response to this may be to concentrate on one or two sources of funds.

In organizations largely funded by grants and contracts, managing the interplay of restrictions that come with certain sources of funding is also time consuming and can back the organization into a corner.

**NPQ:** So are you suggesting that for diversification to be positive, you have to consider the source?

**Brewster:** Absolutely. The best source of funds for a nonprofit has three key characteristics. First, it yields a lot of dollars (of course!). Second, it is unrestricted. This is important partly because a nonprofit can shift this money to cover the loss of other funding. This is rarely possible. A good example is government money: a mental health organization that I know has recently diversified successfully by winning new government contracts to add to its principal contract with the county. If any of these contracts has cuts imposed, however, none of the income from the others can be used to cover the loss. The only thing that can be said is that at least the organization is still helping *somebody*. The other reason unrestricted funds are important is that they can give a nonprofit the financial capacity to respond nimbly (as described in "Goldilocks and the Three Budgets" on page 16). The final, crucial characteristic is that the source is "internally diversified." That is, it comprises in itself a number of individual sources that are not correlated—so if one disappears or goes down in value, the others aren't affected.

The final, crucial characteristic is that the source is "internally diversified." That is, it comprises in itself a number of individual sources that are not correlated.

This kind of diversification is sometimes mentioned in the literature but is, in general, seriously undervalued. If you can find the dollars you need, the ability to do with the money what you want, and the spread of risk, you don't need to diversify into a different category of funds, and you can avoid the transaction costs that are involved in establishing and managing new people, systems, and relationships.

**NPQ:** What are these quality sources?

**Brewster:** The sources that offer these advantages are essentially private contributions and profits on earned-income activities.

There are a number of types of nonprofit that actually benefit from these advantages. Organizations that supply guide dogs for blind people in the US and around the world all have high reserves—a lot of organizational "slack." On average, 60% to 70% of their revenues come from one specific source—bequests. Most of the people who leave bequests are friends and relatives of the people who benefit directly from a guide dog, the amounts are usually relatively large and unrestricted, and a decision by one particular person to leave money doesn't affect the decision by another.

Another, more ordinary example might be a small organization that provided support and residential services to women with mental health concerns and their children in one neighborhood in Boston. They were innovative and their story rang true at an emotional and intellectual level and they were able to build quite a large base of individual donors to supplement government contracts and foundation grants. This allowed them to remain the adaptive and independent program they were despite pressures to conform. Thus, if at the very least a nonprofit can find enough unrestricted, relatively low-risk support to provide the financial capacity to adapt to changes in the environment and innovate, it is in a much stronger position to exploit the restricted but often very substantial resources that government funds, for example, provide.

# In Search of Sustainable Funding: *Is Diversity of Sources Really the Answer?*

by William Foster, Ben Dixon, and Matt Hochstetler

***Editors' Note:*** *This article is based on a research paper, "Funding: Patterns and Guideposts in the Nonprofit Sector," which explores funding patterns among large, financially sustainable nonprofits across several domains and among organizations of various sizes engaged in youth services and environmental advocacy. The full study is available at www.bridgespan.org.*

We identified a . . . "U-shaped curve," characterized by fewer funding sources at the smallest and largest ends of the spectrum and a greater mix in the middle for mid-sized organizations.

FUNDING IS A CONSTANT AND PRESSING concern for nonprofit organizations across the United States. It is surprising, therefore, how little information exists about patterns in funding at a level below that of broad domains (such as youth services) or the sector overall. Such information could be of enormous use to both practitioners and funders, because it could provide guidance about what tends to happen in the financing of specific types of nonprofits and the consequences of those tendencies.

Lacking such pattern-level information, funders and nonprofit leaders have little choice but to make assumptions—like "diversification of funding sources (e.g., individual, government) makes for a healthier organization." As with much common knowledge, this assumption may be true to some extent but incomplete. Better identification of patterns among similar organizations could both test such assumptions and provide important guideposts for nonprofits that want to build robust economic models.

To that end, in 2003, the Bridgespan Group studied the patterns of funding sources in two specific sub-sectors. We looked at a small number of organizations in youth services and environmental advocacy. Using Form 990 returns complemented by organization-specific reports and personal interviews, we found clear differences in the typical funding mix of organizations depending upon their size. We also identified a distinct pattern that can be described as a "U-shaped curve," characterized by fewer funding sources at the smallest and largest ends of the spectrum and a greater mix in the middle for mid-sized organizations (see figures 1 and 2).

A broader study might reveal a different picture. Nonetheless, our efforts point to some potentially generalizable patterns that need to be further tested and explored.

***Pattern Hypothesis #1:*** *The U-shaped curve exists and is generalizable across sub-sectors of nonprofits.*

***Pattern Hypothesis #2:*** *Organizations hit distinct "funding walls" at the key transition points along the U-shaped curve.*

The funding mixes for organizations in these two domains appear to change at distinct size points, which correlate with marked drop-

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**Figure 1**

Dominant (>50%) Funding Sources for a Sample of Environmental Advocacy Organizations in Different Size Ranges

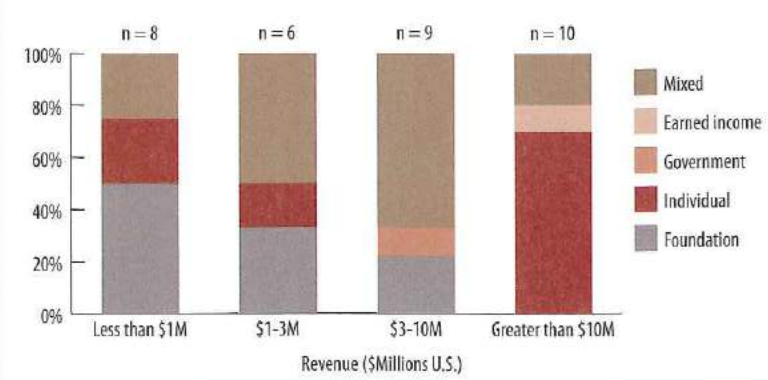
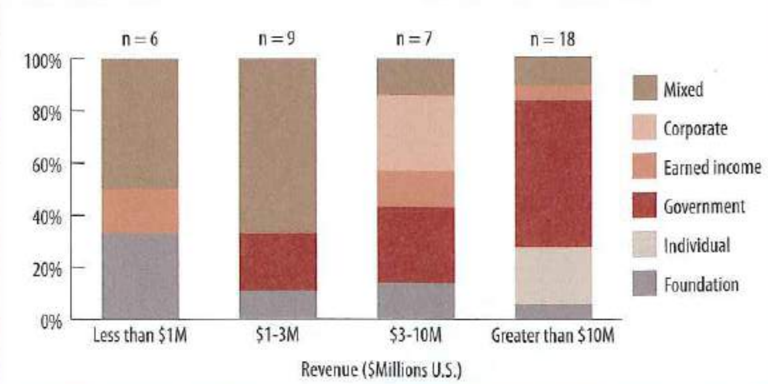



**Figure 2**

Dominant (>50%) Funding Sources for a Sample of Youth Services Organizations in Different Size Ranges




**Note:** Figures 1–2 display the number of organizations with more than half of their funding coming from one of the named sources. "Mixed" indicates that the organization does not have a single source providing more than 50% of revenues.

offs in the absolute number of organizations. If it is true that different economic models support different-sized organizations, then nonprofit leaders must be able either to recognize the need for change and adapt, or to understand that beyond certain points growth is unlikely.

For youth services organizations, diversification in funding sources appears to increase until about the $3 million mark, at which point we observe a transition to more concentrated funding sources. For environmental groups, $3 million in revenue is the point where organizations transition away from foundation funding and to their most diverse funding sources. Our data then suggest that environmental organizations transition back to concentrated funding (individual) at $10 million. If these walls do occur at predictable points in each sub-domain, they could signal when a transformation is necessary (see figures 3 and 4).

***Pattern Hypothesis #3:** The U-shaped curve reflects organizational learning at work.*

If this hypothesis is true, nonprofits do not necessarily start with an economic model that remains constant throughout their lives; but rather a "set-point" model evolves over time. This "evolutionary" view creates an important role for experimentation (hopefully complemented by data on other organizations) and suggests that a diversity of funding sources is an important interim stage for organizations that aspire to grow large.

Taking this view, diversified funding might become a poor strategy for larger organizations over the long haul for a host of reasons. These include: transactional costs, or the administrative and fundraising expenses incurred by maintaining a variety of resource identification and reporting systems; the inability to become truly expert or "world class" at more than one source; and/or the simple lack of large-scale funding interest from multiple sources for organizations with particular kinds of missions.

Interpreted this way, the data suggest a natural learning curve that leads, in the case of larger organizations, to the identification and predominance of the few best funding sources relative to domain and particular need.

***Pattern Hypothesis #4:** Some funding sources take you farther than others.*

Alternatively, these findings could suggest that successful growth may require concentrating on certain types of funding sources from early on—the growth "winners" had different economic models than their peers. If this second interpretation is correct, organizations either need to lay the groundwork early on to attract those kinds of funds or recognize that large-scale expansion will probably not be the way their nonprofit achieves impact.

***An additional research question:** How are scalability and individual donor base related?*

Funding types are not equal, of course, either in transaction costs or in payoff. Our data suggest that the particular mix of funding in an organization varies by domain (e.g., larger environmental advocacy groups are supported primarily by individuals, and larger youth service organizations are supported primarily by government). However, the very largest organizations in both sub-sectors were supported by individuals.





This raises important questions about which individuals are driving such large-scale expansion. Is it thousands of small donors or dozens of very large donors? What is the role of the brand, and how do volunteers factor in? How do the very largest nonprofits in some sub-sectors succeed with individual donations while, overall, the sub-sector does not?

## Implications for Foundations

We hope that better knowledge about funding patterns in the nonprofit sector will benefit foundations and other funders looking to maximize the impact of their charitable donations.

For example, the findings in this study highlight that foundation contributions decline as a percentage of total funding in larger organizations and are not the dominant source of funds for large organizations. As a result, one could argue that foundations play a more pivotal role in the lives of small and mid-sized organizations. At the same time, the absolute amount of foundation funding for large organizations is still considerable. Nothing in our findings suggests that this is a bad thing, but it does beg an important question: Should foundation leaders think differently about grants to nonprofits of different sizes, particularly when they are considering investments in capacity-building versus program-specific resources?

For large nonprofits, limiting funding to direct program services would seem to foster only a small amount of growth on top of what other sources are already covering. Would it be sensible, therefore, for a foundation to value more highly the opportunity to provide scarce capacity-building or unrestricted funding to their large grantees?

For small organizations, foundation dollars may pay for a great deal of the actual program work. If the foundation is committed over a long time frame, this can be quite a stable situation. But what about the growth of such small organizations? If growth is an objective, can foundations play a critical role in helping these nonprofits grow by providing capacity dollars to identify and build their funding models around other sources (e.g., government, individual, etc.)?

## Help Us Think About This Issue

As mentioned earlier, expanding the sample sizes and sub-sectors covered in this research could be a useful approach in providing more

**Figure 3**

Number of Environmental Advocacy Groups at All Sizes Above $1M

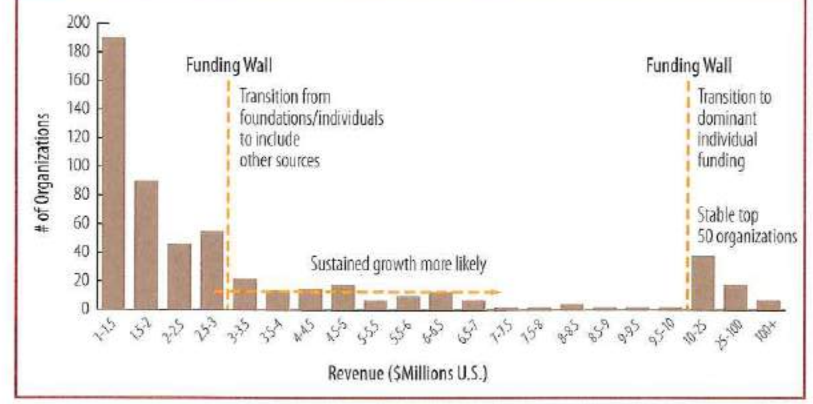
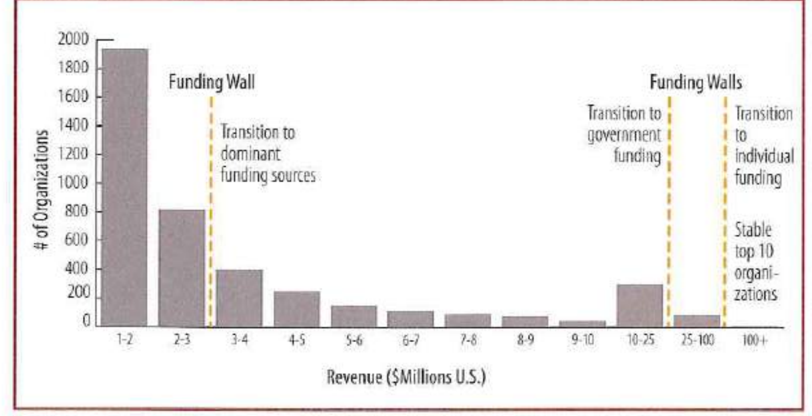



**Figure 4**

Number of Youth Service Organizations at All Sizes Above $1M




**Note:** Funding walls indicate transitions between different types of funding sources.

reliable guideposts for nonprofit organizations and funders. At this point, our efforts indicate that youth services and environmental advocacy organizations follow a "U-shaped curve," with the smallest and largest organizations relying on fewer funding sources, and mid-sized organizations using a greater mix. Our research also suggests the presence of distinct funding "walls" and indicates that predominant sources for support are identifiable for each sub-sector.

We are curious to hear from other organizations whether this curve fits their experience; we would also like to collect stories from those that have been able to achieve significant growth to gain more generalizable insights into building effective economic models and fund development strategies.

CASE STUDY

# *In* Economic Redevelopment *Nonprofits Should* Not *Get Stuck in the Bleachers*

by Judith R. Saidel, Ph.D.

"Let's think like the powerful economic sector that we are!"

***Editors' Note:** Over the past ten years it has become a relatively common occurrence for a local or regional sub-sector of nonprofits to measure its proportionate share of the economy. Those numbers are then publicized in media stories and reiterated in speeches and in annual reports. The numbers can be impressive. However, although this exercise is a necessary step on the road to being taken seriously as economic actors, it stops well short of ensuring that nonprofits or the communities they represent exert any direct influence on the crafting or adjusting of local economic policies. Of course community development corporations and other groups with economic development specifically in their mission purview have from time to time inserted themselves powerfully into a local conversation about the economic future of a region, but we do not often see nonprofits as a collective force that can intervene in a trend. What follows is a case where a roundtable group did do the measuring exercise and then took matters a half-step further down a road all nonprofits should explore.*

The Nonprofit Executive Roundtable in New York's Capital Region, now Tech Valley, decided to seize the moment early in the region's current period of high-tech-driven economic expansion and tackle the issue of the sector's absence from key planning processes head on.

In 2002, a group of then 12 nonprofit CEOs from the human services, arts, health care, philanthropy, and recreation sub-sectors met for the first time at the invitation of the University at Albany's Rockefeller College of Public Affairs and Policy. To the surprise of the conveners, the voluntary sector leaders chose not to prioritize problem-solving around individual organizational dilemmas. Instead they asserted "Let's think like the powerful economic sector that we are!"

From this fundamental commitment, the Roundtable's two key goals emerged:

- to document awareness of the voluntary sector as a key contributor, along with business and government, to the economy and quality of life of the Capital Region;
- to catalyze cross-sector conversations about the challenges and opportunities for Tech Valley of technology-based economic growth.

Coincidentally, at the same time, another small group of nonprofit executives was knocking on the door of the Albany-Colonie Regional Chamber of Commerce and pushing hard for the establishment of a new Nonprofit Business Council within the Chamber. Several key players

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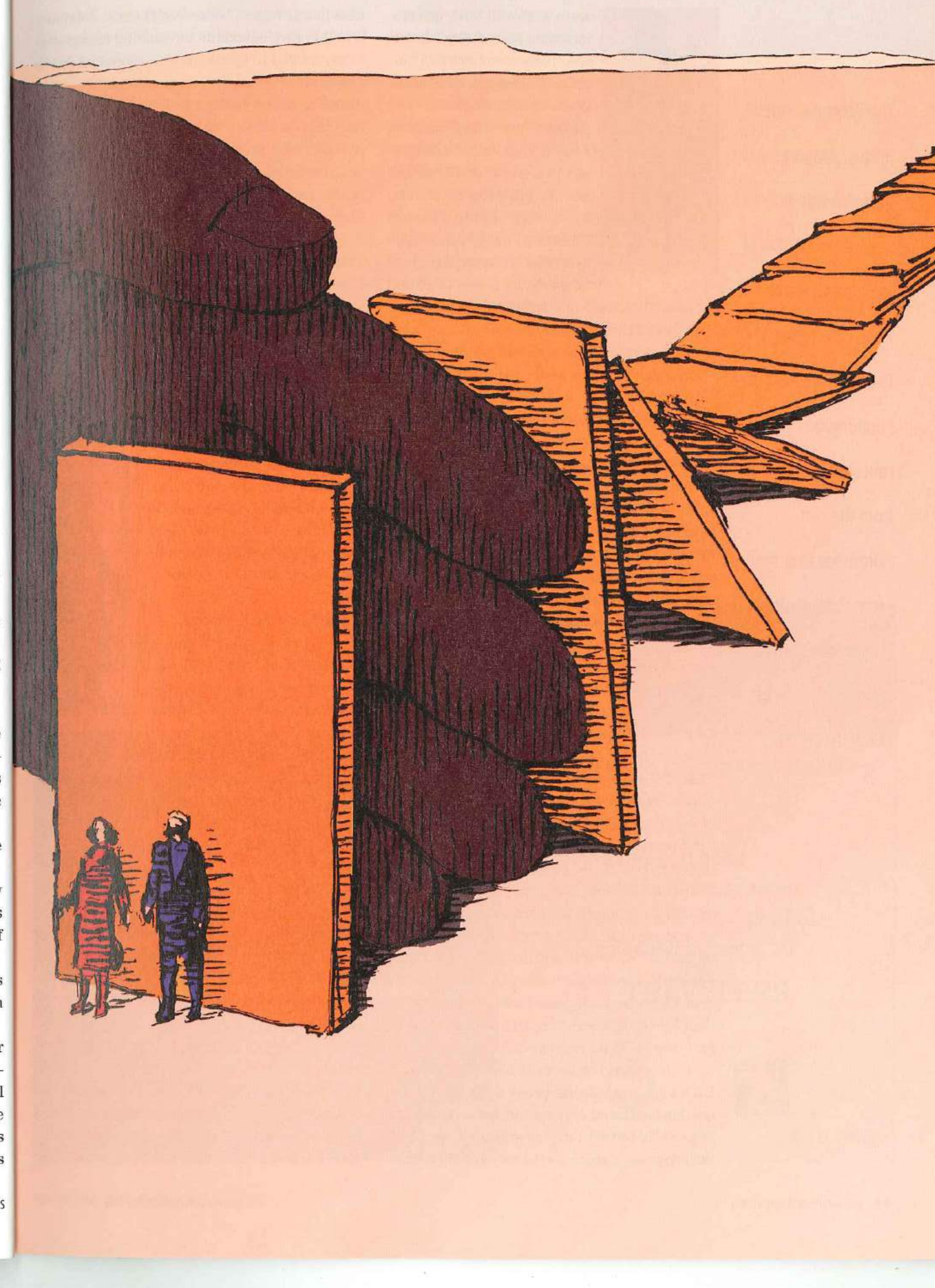


IMAGE © IMAGES.COM/CORBIS

The synergies and mutual support between the Roundtable and the now thriving Nonprofit Business Council have been stunning, a refreshing change from the turf skirmishes that too often characterize inter-organizational relationships in the nonprofit sector.

were active in both groups, including Roundtable Leadership Team members Teri Bordenave, president and CEO of Girls Incorporated of the Greater Capital Region, Alan Krafchin, president and CEO of the Center for Disability Services, and Ray Schimmer, executive director, Parsons Child and Family Center. The synergies and mutual support between the Roundtable and the now thriving Nonprofit Business Council have been stunning, a refreshing change from the turf skirmishes that too often characterize inter-organizational relationships in the nonprofit sector.

So, how do nonprofit leaders, often engaged in ferocious competition for finite human and financial resources, move together to play in the economic and social development and planning game where, at best, they are usually in the bleachers? The answers may surprise you. The first project that the Roundtable launched was an empirical economic and quality of life impact study titled "A $4-Billion Growth Industry That Cares, The Impact of the Nonprofit Sector on the Capital Region of New York State" (*www.cwig.albany.edu* and click on research).

Conducted by researchers at Rockefeller College's Center for Women in Government & Civil Society, the founder and facilitator of the Roundtable, the 2003 study reported that about 1,500 501(c)(3) nonprofit organizations in the Capital Region had combined revenues in 1999 of more than $4 billion and, in 2002, employed 1 in 5 private sector employees and 1 in 7.7 combined private and public sector workers. Between 1998 and 2002, despite an economic recession, nonprofit employment grew by 3.25% on average annually. As well, the 12 nonprofit organizations on the Roundtable provided opportunities for service and participation in civic life through the contributed efforts of more than 5,800 volunteers annually, or one volunteer for every two paid employees.

The report was released at a joint UAlbany/Roundtable press conference and quickly generated widespread media attention. "There can be very little question of how critical the nonprofit sector is to the very vitality of business in this region," observed Hugh A. Johnson, a well-known economic forecasting expert regularly invited to speak in the national business and general press. Very soon information from the report found its way into board meetings and retreats and various civic gatherings, including remarks by both the Chamber of Commerce's board president and chief executive officer at the public reception that launched the Nonprofit Business Council.

Roundtable leaders were also invited to an editorial board meeting of the Capital Region's *Times Union*, a daily newspaper widely read in statewide policy circles. Subsequently, the Roundtable's co-founders, Judith Saidel, director, Center for Women in Government & Civil Society, and Patrick Bulgaro, immediate past president and CEO, Center for Disability Services, wrote an Op-Ed piece, headlined "Nonprofits are the Core of the Capital Region," for the Sunday Perspective section of the *Times Union*. After underscoring the appropriateness of the new Tech Valley moniker for the Capital Region, the authors argued:

> But it is not only the changing economic profile of the business sector that should attract our attention. Our area, like other regions around the country, now features an economy made up of three sectors—business, government, and not-for-profit organizations that fulfill increasingly important and unique functions.

The point? Relying on a community-university strategic partnership, the Nonprofit Executive Roundtable took the initiative and successfully introduced the "three-sector economy model" way of thinking into the region's public discourse.

### The Next Steps

"Now that we've hit a home run with our first product," commented one of the Roundtable leaders, "what can we do that is as good or better?" Fortunately, a promising idea surfaced that continued the Roundtable on its self-chosen path. Participants decided to take up a challenge that had been posed some months earlier by Chamber CEO Lyn Taylor after 33 Capital Region leaders traveled to Austin, Texas, on a fact-finding trip sponsored by the Tech Valley Chamber Coalition. "How can the Capital Region learn not only from Austin's triumphs," Taylor asked, "but also from the missed opportunities, especially with respect to consequences for the broad community of Austin's economic boom and post-boom years?"

In May, 2005, Saidel and Bordenave interviewed 15 movers and shakers from the nonprofit, business, and higher education arenas who were key actors in Austin's technology-driven economic development and post-boom dramas. Subsequently they developed a case study, "High-Tech Growth and Community Well-Being: Lessons Learned from Austin, Texas," in which the Austin players tell the story in their own voices (*www.cwig.albany.edu* and click on research). Here are two of the many findings in the case study:

- The boom period was not positive for all Austin residents, especially low-income African Americans and Hispanics and other low wage workers. Racial disparities in economic well-being continued to widen.
- Austin's nonprofit leaders were largely uninvolved in economic development planning prior to and during the tech boom periods. Their unique knowledge of unmet community needs and vulnerable populations did not inform planning processes.

And here are two "lessons learned" as articulated by Austinites who generously shared their insights with the case writers.

- Create opportunities for broad community learning, planning, and visioning.
- Involve stakeholders from all sectors—business, government, nonprofit, universities—in creating the vision for Tech Valley.

The report was released last May to a standing-room-only audience of over 80 people at a meeting of the Chamber's Nonprofit Business Council. The event was covered by all regional print media and a major local television station. Saidel, Bordenave, and Jim Johans, then chair of the Nonprofit Business Council, were invited guests for the full program of TV Channel 6's *Business Forward* talk show. Presentations on

Austin's nonprofit leaders were largely uninvolved in economic development planning prior to and during the tech boom periods.

> "It is a radical proposition that there is a place for nonprofits in economic planning . . . As nonprofits, we're entering into new territory."

the case study were invited in about seven other venues, reaching over 250 people, including all regional mayors and county executives who comprise the Local Government Council of the Center for Economic Growth.

In a Call to Action at the end of the report, the Roundtable invites a vigorous, community-wide conversation about how Tech Valley can maximize the positive consequences and mitigate potentially negative outcomes for the entire community of the high-tech-driven period of economic growth unfolding in the Capital Region. The Roundtable has been awarded a seed grant from the Bender Family Foundation to host a Tech Valley Civic Forum later this year that will promote cross-sector conversations and identify key "human side" issues related to high-tech-driven economic expansion that require joint monitoring and potential action.

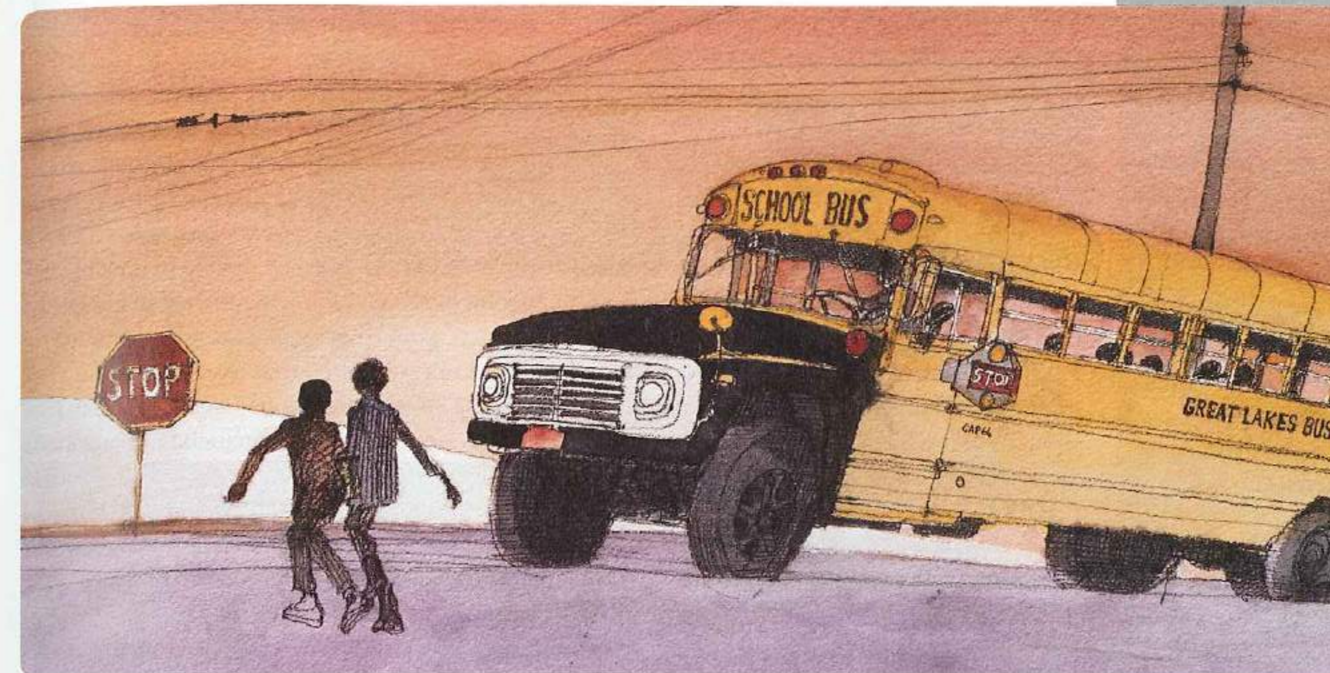
According to Roundtable Leadership Team member Ray Schimmer, "It is a radical proposition that there is a place for nonprofits in economic planning . . . As nonprofits, we're entering into new territory. We shouldn't be afraid or hesitant about this." From the beginning of the case study project, he insisted that "As we learn about Austin, we learn about ourselves." Nonprofits are learning that the stakes in high-tech economic growth for community well-being are enormous for all community members, the opportunities for creative thinking are infinite, and nonprofit leaders must step up to collaborative leadership at these critical moments in regional economic history.

**Reprints** of this article may be ordered from store.nonprofitquarterly.org, using code 140106.










# "How Do Employers Weigh a Candidate's Degree in Nonprofit Management When Hiring?"

by the editors

This is the third year that the *Nonprofit Quarterly* has run a special supplement that lists the more than 250 degree programs available in nonprofit management. In past articles we have suggested that prospective students search carefully for the right program to get the type of education they believe they need. Overall, student feedback about these programs has been very good, particularly when the programs emphasize the coupling of academic with hands-on experience.

But what happens when these students graduate and hit the work force (if they are not already in it)? In December 2006 we conducted an informal poll of our readers, many of whom are potential employers. We received a flood of responses. Among those who responded as potential employers the replies, for the most part, landed somewhere along a fairly short continuum from "I don't look at that type of credential at all" to "it is (or may be) a benefit on top of relevant experience."

The slight to marked resistance that we picked up from some readers to looking specifically for this kind of degree is probably not surprising considering the evolution of the sector and education in the sector. Until recently, education in the nonprofit sector has come not from formal degree programs, but rather from hard

IMAGE © FRANKLIN McMAHON/CORBIS

The issue isn't "to degree or not to degree" but rather how to pair professional management training with experienced workers.

experience in the field. So, formal nonprofit management education, if it is seen as divorced from practice, meets up with some natural skepticism in the sector.

*"We hire people who have the skills to run a gallery, or an art school or write grants . . . As the executive director I have worked in the nonprofit art field for 30 years and learned on the hoof."*

Many of today's nonprofits have been started within the past 40 years with tight budgets and managers who had to learn their skills on the job. The founders of these organizations didn't go into the work with a burning passion for comp-time policies or strategic planning—they came to improve abandoned children's lives or to cure AIDS or to save a lighthouse. That sense of mission is what has kept things going when funding was tight or nonexistent. The idea that someone may expect to move into management without paying "their dues" at lower levels doesn't sit well with many seasoned managers.

Jim Work at the Des Moines "I Have a Dream Foundation" puts it this way. *"You have to hire someone who cares about the mission more than their career or their ego . . . education does not give anyone that."*

Aligned with this were comments from readers that confirmed many nonprofits hire from within their own field of practice, and often from the ranks of program staff who have taken on certain management tasks gradually in the course of their work. This practice may have some limitations on its surface, if the staff's understanding of management has some gaps, but the benefit is that such staff know the field they work in. They have the relationships and some influence and know the lay of the land.

This orientation toward recognizing experience in the field over academic learning had some emotional content. *"My experience tells me that I'd rather have a smart high school dropout than someone equipped with an MBA and no street savvy,"* said one reader. *"Give me a 50-year-old who knows how to work the phones and comes with a built-in supply of solid community contacts, over a 26-year-old with a master's degree and a pile of fresh ideas."*

*"I look for people who can readily separate the theoretical from the practical,"* CEO Michael Hatzenbeler says. *"I want those who have learned to value the contributions of others, who respect the history and experience of a preexisting team, and those who are ready to jump in and take on responsibility at whatever level they are asked."*

A few readers mentioned that the availability of non-degree oriented education for people who had come up through the ranks—through workshops or even through individual courses provided by academic centers—has made it more possible for non-degreed people to pick up the useful skills and knowledge they may lack to manage today's more complex organizations.

Others suggested that they had found real gaps or misapprehensions in critical areas like board development and financial management among degreed hires.

While many of the respondents stated that a strong nonprofit management degree could be a bonus and even a deciding factor in a hire, particularly if the candidate presented strong experience, the first priority, for nearly all of the respondents, was finding and hiring people with "smarts" and on-the-ground experience who could adapt, take "no" for an answer, and still find ways to accomplish their work. *"Always on the top of my list is: 'must be smart.' Smart people figure out how to learn the skills, solve problems, and adapt as the work changes,"* says Kate Barr at the Nonprofits Assistance Fund.

Several readers, however, voiced enthusiasm for nonprofit management degrees citing a candidate's willingness to go through such a program as a demonstration of motivation and commitment. *"I would find hiring to be far more reliable if I knew that the prospective employee had a nonprofit degree,"* says Gayle Carlson of the YWCA. *"Of course, program credibility would come into play, but just knowing that the employee has the basic techniques would help reduce the training time for mid-management and higher positions."*

Dennis Morrow, who runs a small nonprofit and teaches a degree program, sums the situation up this way: *"The issue isn't 'to degree or not to degree' but rather how to pair professional management training with experienced workers—it will be a melding of the two that morphs into the nonprofit leader/manager of tomorrow (but of course as in all things, we need them today)."*

Reprints of this article may be ordered from store.nonprofitquarterly.org, using code 140107.

## Education Directory 2007

The following directory of nonprofit management education programs lists programs by state. Some institutions offer single programs, while others offer an array. The programs offered by each institution are noted by numbers accompanying the listings from 1–8.

Readers wishing to get a fuller abstract for each program, can access the database directly at http://tltc.shu.edu/npo/. Educational institutions may also update their information at this address.

Thanks to Roseanne Mirabella, Ph.D., Associate Professor, Political Science Department at Seton Hall University for working in collaboration with NPQ to produce the directory. The database resides as Seton Hall University and is maintained by the Seton Hall Department of Information Technology. Special thanks to Steve O'Brien and the Teaching, Learning, Technology Center for developing and maintaining the site.

### Key to Listings

1. Noncredit Programs
2. Undergraduate Certificate Programs
3. Undergraduate Concentrations (3+ courses)
4. Graduate Nonprofit Studies classes
5. Graduate Certificates
6. Graduate Concentrations Leading to a Masters
7. Graduate Degree Majoring in Nonprofit Studies
8. Online Courses

### ALABAMA

**Auburn University at Montgomery** 2, 4, 5, 6
Dr. Thomas Vocino, Head, Department of Political Science and Public Administration, PO Box 244023, Montgomery, AL 36117; Graduate: tvocino@mail.aum.edu, American Humanics: tlucybou@mail.aum.edu

**University of Alabama at Birmingham** 4, 5
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**University of Arkansas at Little Rock - American Humanics** 2
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### ARIZONA

**Arizona State University - Graduate Program** 4, 5, 6
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**Arizona State University - Noncredit and Professional Development Courses** 1, 8
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**Arizona State University - Undergraduate Program** 2, 3
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**California State University, Long Beach** 4, 8
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**Fielding Graduate Institute** 4
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**Pepperdine University** 2, 3
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**San Jose State University** 2
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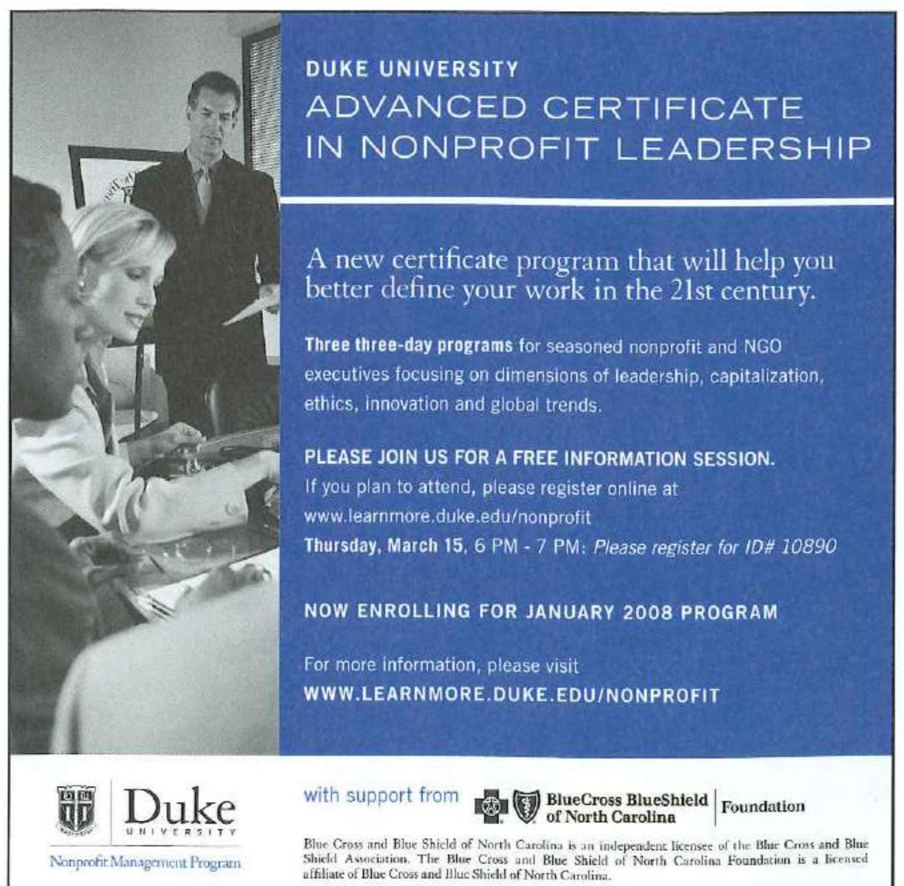







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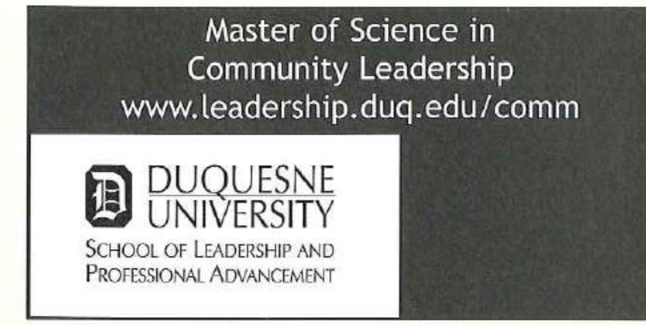


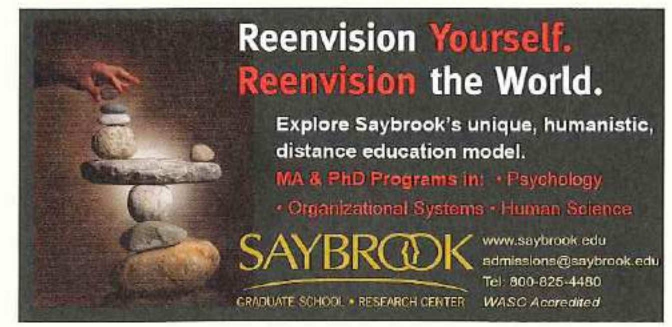



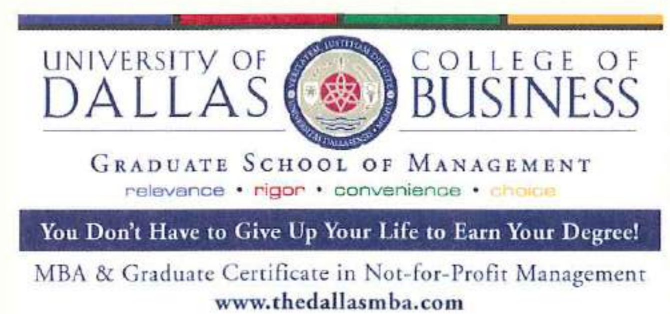



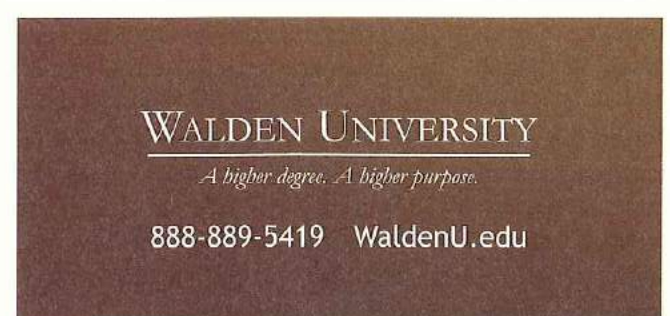


# Now You See It, Now You Don't: Conflict of Interest Demands More Than Just a Policy

by Mel Gill

THIS ARTICLE ADDRESSES CONFLICT of interest policies against the backdrop of experiences lived inside real nonprofits. In December 2006, *Nonprofit Quarterly* called on its readers to share both their policies and their encounters with such conflicts.

Dozens of readers responded with policies ranging from the most basic frameworks to the most detailed and legalistic prescriptions, laying out exactly what is expected from whom in what kind of situation. Several readers indicated they were starting to develop policies and looked forward to the results of this initiative. Surprisingly, but not re-assuringly, many stated that they had never had occasion to use their policies. This, in and of itself, is cause to worry because even in the most squeaky clean nonprofit, opportunities for conflict are everywhere. A big "danger ahead" sign should flash when we do not recognize and resolve them.

Some conflicts are "easy" to spot in that they involve the most rudimentary question of individual vs corporate interest. That does not make them easy to handle. Ironically, just as I took on the task of putting *NPQ* reader responses together with my own experiences for this article, this e-mail request for help came to me from a distressed board member:

> I am wondering if you have any articles that would specifically cover our conflict of interest situation. I'm on a board where the Chair has a proposal on the table for fundraising for the organization. This has the potential of making her a lot of money. She has not been asked to step down by the rest of the directors who seem to think I'm making a mountain out of a molehill.
>
> I need something from a neutral party that they can read over and over again until they "get it" and understand that either the proposal must be taken off the table or the Chair needs to step down until the rest of the board members decide what they want to do with the project.

This request brought to mind another situation I encountered recently. I was consulting with a board whose chair had just completed an intensive training course for corporate directors. He was also a member of the organization's foundation board. While serving in both capacities, he was actively lobbying the foundation to employ him as a fundraiser. The parent organization had a conflict of interest policy, but the chair played fast and loose with the rules, creating unnecessary turmoil in both boards. Despite his training, this chair just didn't get it. Fortunately, the most influential of the other directors understood the seriousness of the situation and the chairman lost his position—and credibility—with both boards.

These two situations demonstrate that simply having a policy or offering board training won't automatically eliminate conflicts of interest.

But conflicts of interest aren't always crystal clear; they frequently arise from circumstances where ethical shades of gray may lead reasonable people to different judgements. This makes it essential not only to have clear policies and procedures, but to embed discussion of difficult topics into organizational culture. This has to be supported by a commitment to principles of integrity, transparency, predictability, and accountability.

## Defining a Conflict of Interest

One *Nonprofit Quarterly* reader provided this definition of conflict of interest, which zeroes in on the concept with laser-like precision:

> Conflict of interest means a conflict, or the appearance of a conflict, between the private interests and the official responsibilities of a person in a position of trust.

This is basically true, but with some caveats. Every organization should watch out for the standard warning signs (see "Basic Conflict of Interest Guidelines," page 52) that alert us to avoid business dealings, family influences, and financial transactions that benefit board members directly. But it also includes more complicated issues that aren't so easy to identify or settle. In these situations, you may find these four tests helpful.





### The Peer Standards Test

The peer standards test, or the community and industry standards test, asks whether the behavior or relationship in question is commonly acceptable within a given sector. In other words, the question is, "Would the community accept and approve of this person's or organization's actions?"

One of the letters to the Nonprofit Ethicist in this issue (see page 4) asks for guidance about a situation in which an organization holds an auction, and the son of one of the organization's executives wins a vacation for two as a prize. The executive's subsequent behavior to increase the value of the prize only makes this situation more complicated, but the Ethicist rightly notes that it is standard practice for family members of staff to be excluded from such contests precisely because it raises questions of fairness. Had this agency adhered to the standard, it would have prevented the issue from causing conflict within its board.

But be careful in using this test. The excuse "Everybody else is doing it"—whether it's padding expense accounts, contracting with board members to supply services in small communities, or hiring family members as staff—doesn't give you a free pass. Applying only the peer standard poses the danger of ignoring unethical activity simply because it's accepted by that community. (Consider some of the recent ethical breaches by legislators, for example.)

### Public Disclosure: The Smell Test

With this test, the questions are, "How might key stakeholders, the public, or the media react if this activity were publicly disclosed?" and "What impact would this activity have on the credibility of the organization and its leadership?" You should engage an active imagination in this consideration, sometimes referred to as "the smell test." A perceived conflict of interest can be just as damaging to an organization's or a leader's reputation as an actual conflict.

Lots of problems are relatively invisible to those involved because they evolve into real conflicts over time. A homeless shelter that started without funding in a church basement, for example, was accustomed to checking with its board chair first when it was ready to place someone in permanent housing. It was understaffed, and the board chair, who had worked tirelessly to help establish the shelter, owned several rooming houses, which made the necessary transactions easy. For years the practice persisted until nearly all his rentals were filled with placements from the shelter. An informed organization would have understood that, if an enterprising reporter were to expose the practice, the "smell" of potential conflict of interest could further threaten the shelter's already tenuous relationship with the town in which it was located—never mind embarrassing its funding sources. In this case, a consultant alerted the board, which in turn took action and developed protocols. That reform required more work on the part of housing placement staff, but it also protected the agency from loss of credibility with its funders and community.

### The Reasonable Person Test

With this test, the question is, "What would a reasonably prudent person or board do under the circumstances?" This is very important, since it goes directly to the heart of a director's legal duty of care to "exercise the same degree of care, diligence, and skill that a reasonably prudent person would show in comparable circumstances."

Admittedly, this can lead to murky waters. The daughter of a director of a local children's services agency was planning a wedding and received a discount from a local hotel because the agency's board had used the hotel in the past for its own events. The director asked the board to decide whether providing a discount should be treated as a conflict of interest. The board decided that it wasn't for two reasons: first, the discount wasn't solicited and second, the board routinely researched hotels in the area for the best rates. In this case, the board reasonably decided that there was no conflict of interest Another board, however, might have viewed the matter differently and asked the board member not to accept the favor to maintain a less potentially tainted relationship between the the agency and the vendor.

### The Best Interests Test

The requirement to "act honestly and in good faith in what the director considers to be the best interests of the corporation" is a "duty of loyalty' that goes hand in hand with the "duty of care." Board members often feel torn between their loyalties to a particular constituency and the nonprofit organization. Indeed, all boards have a "duty of due diligence" to seek as much information as possible before making a decision on a matter. Representatives of particular constituencies have an obligation to present both facts and perceptions on behalf of their constituencies and to declare which hat they're wearing—as constituent representatives or as board members—when contributing to discussions. But when the hour of decision arrives, it's a board member's responsibility to cast his vote by determining the "best interests of the organization at hand," regardless of the impact on his constituents. If a director can't make this decision, then s/he is obliged to declare a conflict of interest and abstain from the discussion as well as the voting. This is a delicate balance that requires diplomacy and integrity.

If the interests of the organization and

### Basic Conflict of Interest Guidelines

Here are some guidelines that can help organizations define conflict of interest and frame formal conflict of interest policies:

- A conflict of interest may be real, potential, or perceived.
- Board members are considered to be in a conflict of interest under the following circumstances:
  - when they—or when members of their family, business partners, or close personal associates—could personally or professionally benefit, directly or indirectly, financially or otherwise, from their position on the board;
  - when they use their position on a board to the disadvantage or detriment of a third party;
  - when they solicit or obtain preferential treatment related to services received from or rendered to the corporation, including contracted work, employment, or honoraria;
  - when circumstances arise that compromise, or appear to compromise, the ability of board members or staff to make unbiased decisions;
  - when they appropriate financial or other resources for personal use (e.g., information, property, equipment, supplies, transportation, training);
  - when they seek, accept, or receive material personal benefit from a supplier, vendor, individual, or organization doing or seeking business with the corporation;
  - when they are involved in the contracting, employment, supervision, grievance, evaluation, promotion, remuneration, or firing of a family member, business associate, or friend of the director;
  - non-pecuniary interests may present a moral conflict of interest, if not a legal conflict.

Board members may create a moral conflict under these circumstances:

- when their personal interests conflict with the interests of members or clients or are otherwise adverse to the interests of the corporation;
- when their membership on the board or staff of another organization could create interests that conflict with the interests of the corporation or its clients and where their activities on one board might materially affect their capacity on another board.

### Managing Conflict of Interest

Even with the best policies and practices, conflict of interest issues will arise and need to be managed. Below are some principles and procedures for managing conflicts of interest drawn from my own experience and reader responses:

- Board members should disclose conflicts of interests early and often.
- Conflict of interest should be a regular item on every board agenda and periodically discussed by the whole board.
- In cases where a board member may not perceive that a conflict of interest exists, it is the responsibility of other board members who are aware of a real, potential, or perceived conflict of interest on the part of a fellow board member to raise the issue.
- If the board is contemplating a financial transaction with a board member, the process should be conducted through a fair and open process in which board members who have no personal or business interests in the matter make the final decision about awarding contracts.
- Finally, the organization should report annually (for example, on its Web site or in its annual report) any conflict of interest disclosures and their disposition in relation to any financial transactions.

those of its primary constituencies are frequently in conflict, then the organization should step back and reflect on its focus, purpose, and priorities.

Boards of directors are made up of human beings who are presumably personally invested in the work being done by the organization. While representation of personal interests has no place in a board's decision-making processes, it can be hard to know exactly what is at work in a particular situation. Lots of smaller organizations struggle with such situations. The example that follows from a reader allows us to look at the subtleties of some of the questions we face:

> I serve on the board of a small nonprofit organization [with two employees]. One board member is hired every year as a short-term educator during the summer. Because the board member isn't financially benefiting from any decision the board makes (after all, it's the executive director who hires these educators), our policy doesn't address this as a conflict of interest. But, I can't understand how a board member can effectively oversee the work of our executive director and also be her employee. Is this the conflict of interest I see it as? If so, how can it be addressed in policy and practice?

This reader's focus on the question of supervision may bring to light only one element of a potential problem as is revealed by an example posed to us by another reader:

> An instructor for a school who also serves on the school's foundation board might have a conflict of interest when applying to the foundation for funds to help pay for supplies needed in his instructional program. Of course, he could abstain when the foundation board considered the request for funds for his program, but the other board members will know who requested the funding and will more than likely be in favor of supporting this person in return for his support of other requests of interest to them!

Still, even this reader, after identifying the slippery nature of such situations, cautions us not to be so rigid in our conflict of interest definitions and practices that they work to the disadvantage of nonprofits, their board members, and staff.

### No Bright Line

"How about this one?" asks another respondent:

> I sit on a board that is reviewing an array of programming that sometime in the near future I may have an interest in being a part of as a contracted consultant or possibly staff. Program planning is at an early stage, and I am not definite about my own thinking relative to being a part of the work. Still, my gut says I should minimally disclose and, if my (or the organization's) thinking is very seriously in that direction, then I should step down from the board of directors. What do you think?

Conflicts of interest are so difficult to weigh and balance because the relationships between board members and the community also are a part of the contribution that board members make to the agency. Take another example of an organization buying a new computer. If a board member owns a computer store, the organization may well benefit from discounts and extra service by buying the computer at her store. It would be a mistake to prohibit working with board members as vendors.

This may be particularly true in communities that have a limited pool of suppliers for a particular product or service. Social, business, religious, and service club networks are often the glue that hold these smaller communities together and that sustain the nonprofit agencies in their midst. We need to take care that our approach to conflicts of interest doesn't weaken that glue yet also maintains principles of fairness and transparency.

Still, without constant vigilance, situations can devolve into self interested quicksand and remain there for far too long. Here are some examples from my own experience:.

One-third of the board of a national organization with a mandate to support education, services, and research related to a specific disease comprised researchers seeking endorsement of their research proposals from this organization. The potential conflict of interest was repeatedly discussed by the board but remained chronically unresolved.

The members of a service organization within a narrow "community of interest" elected to its board a half-sibling of the executive director from whom he had long been alienated. He claimed the ability to separate the personal history from his judgments about her performance. Let the nightmare begin!

A local community arts organization—in essence a producers' co-op—owned a property that accommodated theater and musical productions and art shows. The board chair was the executive director of one of the member arts organizations. He made arrangements for use of the facility for a theater production, assuming that his organization would have free use of the facility. When the executive director of the arts group questioned that assumption in the absence of a conflict of interest policy, sparks began to fly.

**Most nonprofits would like to be known as rigorous in their approach to conflicts of interest but active vigilance is the price for this high regard.**

### Encourage a Board Conversation!

Conflicts of interest are always personal and can be highly emotional. Some boards are willing to confront their issues directly, particularly with the aid of an independent facilitator. I've found that others need to be eased into confronting their issues by first discussing a hypothetical situation or another organization's experience. That helps to generate insight into their own circumstances in a less threatening way. In these situations, a case study may be helpful to facilitate a board's conversation on the issues. Managing conflict of interest will be challenging for any board, even one with the best policies and practices. But the more that board members openly discuss these issues, the better equipped the organization will be to deal with any conflicts of interest that may arise.

### Conclusion

During my work with hundreds of organizations, I've found unresolved conflict of interest issues in about forty percent of these organizations. In many instances, volunteers encounter difficulty in challenging other volunteers. Many organizations draw board members from a network of personal and business associates who sometimes allow these relationships to cloud their judgment about what is best for the organization.

Most nonprofits would like to be known as rigorous in their approach to conflicts of interest but active vigilance is the price for this high regard. The first step is to recognize that conflicts of interest are inevitable at some time in most organizations and in most human interactions. Some organizations start every board meeting with a time for members to declare possible conflicts. Constructive management of conflict of interest is an essential element of sound risk management practices.

In all fairness, many situations with potential for conflict present in various shades of gray, where personal judgments are required in the absence of obvious solutions. While conflict of interest policies are essential, so are clarity of roles and expectations with respect to standards of conduct based on organizational values, and principles of good governance—integrity, transparency, predictability and accountability.

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**Reprints** of this article may be ordered from store.nonprofitquarterly.org, using code 140109.

# Conflict of Interest: Mischief, Thou Art Afoot

by Rick Cohen

LIKE BEAUTY, CONFLICT OF INTEREST is often in the eye of the beholder. Or, as the 17th-century French dramatist Jean Racine put it, "Crime, like virtue, has its degrees."[1] The public, the press, and the government frequently hold different definitions of conflict of interest, focus on different aspects, and act or fail to act in ways that are sometimes hard to fathom and predict.

In the past year of press coverage of nonprofits, the term *conflict of interest* pops up regularly. Sometimes conflict of interest is insinuated by outside observers and reporters, as in, "This is something that looks like it might be conflict of interest." Other times it is addressed by nonprofits themselves, asserting that what might look like *a priori* conflict of interest really isn't or that "we've dealt with it already." In still other circumstances, government monitors themselves discover conflicts of interest that leave them flummoxed about what to do.

This review of press coverage of nonprofit conflicts of interest draws on examples that illuminate some of the different circumstances and meanings of conflict of interest in the nonprofit sector. The Fourth Estate's coverage reveals a slippery concept, but one that suggests that the constituents of the nonprofit sector are none too pleased at what they see as inappropriate behaviors they categorize as conflicts of interest. The veneer of charity and philanthropy, of doing God's work on earth, doesn't provide the cover for nonprofit behavior that it used to. The public increasingly perceives what Shakespeare's insightful Hamlet found, that "one may smile, and smile, and be a villain."[2] Or, in more contemporary terms, we might adopt conflict of interest policies, but if we can't understand, test, and implement them in real-world situations, the pernicious effect of conflicts of interest will chip away at the public's trust in the nonprofit sector.

## Nothing Wrong

It took the state auditor of Ohio nearly four years to complete an audit of Oriana House, Inc., a nonprofit that runs the Summit County correctional facility, some halfway houses, and other facilities. The audit concluded that there was no misspending of government funds (or at least it found nothing that warranted recovery of monies).[3] One of Oriana's executives welcomed the report, saying, "The audit is a lot of speculation but no substance—other than that we spent the money appropriately."[4]

What the audit did find, however, was 138 related-party transactions, including 44 real estate sale or lease deals between July 1999 and December 2002, amounting to more than $3.5 million between Oriana House and its subsidiaries and business interests controlled by the president and CEO of Oriana. The audit contains pages of graphics depicting complex real estate transactions between for-profit firms associated with the Oriana CEO and various nonprofit affiliates of Oriana. As the auditor's spokesperson noted, the number and diversity of related-party transactions constituted a red flag. "It's something you don't want to see when it comes to accountability," she said.[5]

*The backstory.* There aren't many alternative sentencing programs that have real estate subsidiaries engaged in buying and selling resort properties in Aruba and Aspen. That alone probably makes Oriana House, operating on an annual budget of some $25 million, unusual. The principal of a for-profit that engages in transactions with Oriana, the CEO also happens to own property in the same two resorts and has a salary and benefits of nearly $400,000, twice the salary of the mayor of Akron, the county's largest city.[6] The CEO's spouse is also on the Oriana House payroll as his executive assistant.

The investigations of Oriana House were not spurred by its lack of programmatic success. From the courts to the media, various sources had long declared Oriana House a model; one judge described it as "the best alternative programming system in the state and possibly the nation."[7]

But an otherwise laudatory review of Oriana's programs by a University of California–Berkeley professor unleashed a hailstorm of investigations by noting in passing the organization's various potential conflicts of interest. Oriana's executive director lambasted the Berkeley study as a "personal vendetta," sued other critics for defamation, and condemned the Ohio auditor's investigation as a political "witch hunt." In response to the investigation, the Oriana executive director fought the auditor's access to Oriana's financial records, claiming the confidentiality afforded 501(c)(3) nonprofits against certain kinds of financial disclosure. Despite its near-total dependence on government funds, Oriana was not the equivalent of a public agency, the courts said, and did not have to accede to the auditor's request for unrestricted access to the records.[8] Despite having argued in court for public disclosure, the auditor then joined Oriana House in a display of contempt for the public's right to know and turned the investigation over to a private firm, meaning that the details of the investigation, per Ohio law, could be kept secret.[9]

## Oh My!

For several months, the *Myrtle Beach Sun News* reported on the mounting accountability problems of the Five Rivers Community Development Corporation (CDC) in Georgetown County, South Carolina. Some of the articles consist almost entirely of annotated lists of alleged conflicts of interest involving the leadership of the CDC. If there were a national conflict of interest competition, Five Rivers might win based solely on the numbers of instances and allegations. A sampling of the charges includes the following:[10]

- Investigators discovered that one of the daughters of the executive director was placed on the payroll without the knowledge, much less approval, of the board of directors.
- Despite her employment running the CDC, the executive director enrolled in one of Five Rivers' job training programs and paid herself $3,900 for participating. One of her children served as the CDC's chief financial officer (CFO) and was also paid for attending the job training program.
- The executive director's family got additional cash out of the CDC for life, health, and car insurance.
- The CFO's husband (and executive director's son-in-law) received more than $2,700 in compensation for tagging along on his wife's business travel; it's not clear that his travel on the CDC's nickel had any relationship to his business receiving the CDC's Entrepreneur of the Year award in 2004.
- A private developer on the Five Rivers board sold a vacant property to Five Rivers for a development that never happened, but the purchase established the "precedent price" that he needed in order to develop and sell adjacent properties under his control.[11]
- In 2005, consulting payments of $113,000 went to a consulting firm run by the former executive director of another local CDC, which happened to employ the executive director of Five Rivers and one of her daughters as consultants.[12]
- One CDC board member received a $25,000 loan from Five Rivers toward the purchase of a $75,000 home.

As of October, the members of the Five Rivers board had apparently submitted their resignations, and by November, the Five Rivers CDC was out of business.

*The backstory.* Georgetown County, South Carolina, presents a stark contrast between the conditions of African Americans and that of whites. Located along the Atlantic Ocean between Charleston and Myrtle Beach, with luxury resorts and Jack Nicklaus golf courses abounding, Georgetown County's population is nearly half African American, some descended from the Gullah communities of the coast and offshore islands. Almost 30 percent of black families live below the federal poverty level, compared with 5 percent of whites.

Started in 1995, Five Rivers CDC had the aim of developing affordable housing in otherwise luxury development focal points like Pawley Island, launching entrepreneurship programs for local residents, and running subsidized individual development accounts (IDAs) programs for local asset building. The CDC's programs won millions of dollars in federal grants and earmarks, "best practices" awards from the Department of Housing and Urban Development (HUD), case studies examining Five Rivers national replicability, and widespread recognition for the CDC's executive director.

Without the panoply of conflicts of interest, Five Rivers would be a case study of a nonprofit fighting to protect the economic and civil rights of a historic African-American community against the ravages of unbridled tourism development. If press reports are to be believed, the alleged misdeeds of the Five Rivers family of managers were not aberrations occurring at the end of an otherwise long history of stellar organizational ethics. Somehow, eager to see Five Rivers as a successful rural development model, plenty of people who should have cared and known—particularly federal and state government agencies, local banks, and philanthropic grantmakers and regrantors—seem to have turned a blind eye to the CDC's dubious practices until the accumulated evidence was simply too overwhelming to deny.

Stories like Five Rivers have human and organizational consequences. At a minimum, federally subsidized community centers and enterpreneurship training facilities probably won't be built, with most of the millions in federal monies gone without a paperwork trail. Georgetown County families counting on the CDC to fulfill commitments of matching funds for their IDAs or down-payment assistance with their home purchases must be fretting that those monies have disappeared into the organization's conflict of interest morass.

### No One Noticed

An audit of the nonprofit Palm Beach County Convention and Visitors Bureau discovered activities that "could be conflicts of interest, at least in appearance, if not in fact," including the following:[13]

- Board members' spouses were hired to work for the bureau.
- Elected officials also had their spouses on the bureau's payroll.
- The bureau contracted with elected officials for consulting services.
- A relative of the CEO got a contract to provide unspecified goods and services to the bureau.

A much larger example was the finding that the chairman of the board had won the contract to build the convention center hotel. According to the audit, "CVB Board members have the ability to affect the business of the Convention Center and to otherwise oversee their operations by voting on rate changes, contracts, policies, procedures, staffing, etc."[14] In other words, the bureau's oversight of the convention center might have been a factor in choosing the board chair's development company for the hotel project and therefore a potential conflict of interest.[15]

*The backstory.* The gentleman in question, serving simultaneously as the bureau's board chair and as a developer of the convention center hotel complex, termed much of the audit report "innocuous" and many items "nonexistent."[16]

But the audit wasn't prompted by innocuous or nonexistent accountability programs inside the organization. Try the bureau's controller stealing $1.55 million over three years, which involved the forgery of 222 checks. Apparently no one noticed counterfeit checks and other questionable, if not illegal, misappropriations. While auditors were busy uncovering conflicts and embezzlement, the CEO displayed remarkable managerial insouciance and took off for one of his 30 all-expense-paid trips on behalf of the bureau, this time to a trade show in London.[17] The globe-trotting CEO has retired, the embezzling controller has been fired (but not yet charged), and the board is pondering whether it should establish a more muscular, enforceable conflict of interest policy.

### Cracking the Nut

The Association of Community Organizations for Reform Now (ACORN) is the largest community organization in America. Although its home office is in Little Rock, Arkansas, and its national operations office is in Brooklyn, New York, ACORN has a special connection to New Orleans. Its founder, Wade Rathke, runs an organizing center there and serves as chief organizer for Local 100 of the Service Employees International Union (SEIU).

In the wake of the combined devastation of Hurricane Katrina and the abysmal response of the Federal Emergency Management Administration, ACORN was on the scene, winning visibility and plaudits, advocating on behalf of the neighborhoods most affected by the storm. ACORN quickly become involved in helping shape the city's recovery plans and positioning its development affiliate, ACORN Housing, to take on the redevelopment of much of the Lower Ninth Ward. ACORN Housing applied to get control of more than 250 residential properties, of which the organization was designated to develop about 150.

In October 2006, however, ACORN was booted from the planning team behind the Unified New Orleans Plan (UNOP). The executive director of the Greater New Orleans Foundation, Ben Johnson, attributed ACORN's removal to a potential conflict of interest.[18] From Johnson's public description, the allegations concerned an organizational, rather than an individual, conflict of interest. At least two other community organizations, Neighborhoods Empowering Neighborhoods (located itself in the Ninth Ward) and the Faubourg Marigny Improvement Association contended that it was a conflict of interest for ACORN to serve as both planner, determining what properties would be redeveloped, and developer, rebuilding the properties identified in the plan for subsidized reconstruction.

*The backstory.* In the wake of Hurricane Katrina, city leaders offered several plans for the redevelopment of New Orleans, most of which were pilloried by community organizations, including ACORN, as giving short shrift to the needs of the city's minority population and neighborhoods that had been most devastated by the disaster, especially in the Ninth Ward. The current plan for recovery, helped by a $3.5-million investment from the Rockefeller Foundation and $1 million from the Greater New Orleans Foundation, is UNOP, comprising neighborhood and citywide rebuilding plans that the city had hoped would be formally adopted in early 2007. ACORN had been designated for both planning and implementation roles in the Ninth Ward and elsewhere. ACORN's ability to position itself at the forefront of planning and development functions made it a logical target for community groups that might have also coveted the federally subsidized redevelopment deals or simply questioned the appropriateness of one organization's carrying out both functions.

Nationally, ACORN is hardly a stranger to people challenging its connections and priorities. In New York City, Forest City Ratner, led by CEO and president Bruce C. Ratner, has long promoted plans to redevelop the Atlantic Yards section of central Brooklyn, proposing major residential and commercial development plus a basketball arena for an NBA team. Despite the opposition of several community groups, ACORN's New York City chapter received funding from Ratner to help promote the development's affordable and luxury apartments (Ratner is apparently among the largest donors to ACORN in New York City.[19]) ACORN is hardly the only community organization to have struck a deal with Ratner. Brooklyn United for Innovative Local Development—unlike ACORN, which is an organization of dubious provenance—has seen its budget increase from $10,000 in 2004 to $2.5 million in 2005 and a projected $2.6 million in 2006, with just about every nickel coming from Ratner.[20]

In both Brooklyn and New Orleans, ACORN's track record of advocacy is known and admired. But while Ratner was unlikely to ditch ACORN's support, the Greater New Orleans Foundation did act on an alleged instance of ACORN's appearing to make deals that worked as much in its organizational self-interest as the broader community's. Having lost its UNOP planning role, ACORN subsequently challenged the legitimacy of the Unified New Orleans Plan and issued its own vision for the Ninth Ward.[21]

### A Potpourri of Conflicts

The examples cited above are hardly the only instances of alleged conflict of interest to find their way into recent press coverage of the nonprofit sector. A few more examples demonstrate the diversity of meanings and situations attached to the concept:

- The dogged work of the *Oregonian* newspaper examining charities across the nation that train and employ blind and severely disabled people revealed numerous abuses, including the brazen practices of a nonprofit in El Paso, Texas, whose executive director had channeled $14 million from the nonprofit to his own management firm and additional millions to for-profits also connected to him and his associates. The executive director resigned, but the

*Oregonian* also discovered that the federal committee that oversees grants to these nonprofits (the Javits-Wagner-O'Day committee) "relied on two nonprofit trade associations to regulate the program . . . which receive up to 4 percent of the contract revenues as a commission." In other words, conflict of interest at the individual organization level and conflict of interest involving the regulators themselves.[22]

• In Omaha, Nebraska, a city councilman and chair of the Omaha Housing Authority (OHA) became the first and only paid staff person of a nonprofit, Housing in Omaha, Inc., which functions as OHA's nonprofit development arm. The councilman's personal attorney advised him that there was no conflict of interest in his running Housing in Omaha and simultaneously serving on the city council (in charge of providing funding for its projects), but he did decide to step down as chair of the Housing Authority.[23]

• In San Antonio, public officials were a little surprised to discover that a major affordable housing developer, under FBI investigation for its activities in Dallas, struck a $20-million partnership deal with a local nonprofit, Our Casas Residents Council. The executive director of the small nonprofit happened to be a commissioner (and onetime chair) of the Housing Authority of Bexar County. He didn't think the agency's conflict of interest rules, including disclosure, applied to him because Our Casas was a nonprofit. The county's law firm also didn't see a reason to call the commissioner's dual roles a conflict of interest, perhaps blinded by the substantial fees the firm earned from its legal work on behalf of the partnership.[24] The for-profit's problems with the FBI in Dallas include another nonprofit developer attracting millions in city government project funds, with a board comprising people who all had personal or business dealings with the firm.[25]

• In January 2007, as the result of a federal corruption investigation, the former mayor of Ravenna, Ohio, pleaded guilty in federal court. One part of the guilty plea was failing to disclose his ownership of a lawn mowing company that earned more than a $250,000 from a local nonprofit community development corporation that managed millions in city contracts.[26]

• The indefatigable Republican Senator Charles Grassley of Iowa conducted the Senate Finance Committee's two-year investigation of the nonprofit National Association of Investors Corporation (NAIC) until it was turned over to the IRS and the Securities and Exchange Commission (SEC) for their review and action. Among the items of interest to the Senate Committee investigators were overlapping board memberships between NAIC's nonprofit and for-profit arms; benefits to board members that included company cars, entertainment expense accounts, and Detroit Athletic Club gym memberships; and NAIC's efforts to silence a whistle-blowing board member.[27]

## The Slope on Which We Slip

These and other incidents might be mistaken allegations, innocent actions by well-intentioned people, maybe nothing subject to prosecution. Many are examples of small-scale conflicts, involving inconsequential sums that hardly look worth the risk. But whether actionable or not, there are lessons to be drawn from how the public and the press are sniffing hard at the heels of nonprofits looking for conflicts of interest.

*Big mouthfuls often choke.*[28] Sometimes the conflicts of interest yield benefits that are seem petty—a few thousand here, a few thousand there. But the people involved can't seem to pull themselves away from the table, scarfing down larger portions of illegal swag until they are exposed and caught. It is difficult to imagine that the examples cited here went unnoticed for years and years by board members until finally an investigating reporter or disgusted whistle-blower stumbled on the facts. The practice of nonprofit *omerta*—silence about the misdoings of colleagues on a board, on staff, or within the sector—is ultimately self-defeating.

*One deceit needs many others.*[29] It cannot be more obvious that conflicts of interest do not emerge as isolated instances. If the news reports cited here are to be believed, each organization's conflicts of interest were surrounded by other inappropriate, if not illegal, nonprofit muck and mire. Conflict of interest doesn't sneak up by surprise; it is part of organizational culture, usually embedded in layers of misbehavior.

*Commit a crime, and the earth is made of glass.*[30] Or perhaps Emerson might have said, "Engage in conflict of interest, and sooner or later, you'll be found out." Connecting the dots between family members and their businesses or their personal lives doesn't take much digging. In nearly every instance profiled here, the conflicts of interest were discovered by intrepid newspaper reporters and then followed up on by government agencies. The pathetic defense of some alleged miscreants that they had publicly disclosed their conflicts of interest—and then blithely pursued the self-aggrandizing booty nonetheless—fails to provide the immunity of "hide in plain sight."

*The law hath not been dead, though it hath slept.*[31] In every instance recounted here except for the anomalous ACORN story, an explicit conflict of interest regulation or statute covered these organizations and their behavior. Remarkably, despite instance upon instance of conflict of interest and often months of front-page newspaper coverage, there was little government action. For the nonprofit organizations themselves, the mere adoption of a conflict of interest policy (one of the recommendations of charitable accountability reform efforts such as the Panel on the Nonprofit Sector at Independent Sector) does not mean anything if the policies aren't remembered, tested and implemented by the board members that adopted them. In nearly every case noted here, the organizations had conflict of interest policies, the board members were vaguely aware of them and may have even signed off on them, and even controlling government statutes contained explicit conflict of interest provisions. Clearly the self-regulators and peers of these nonprofit organizations seem to have turned a blind eye to the thievery occurring in the sector's midst.

*A new science of politics is needed for a new world.*[32] Conflict of interest is seen as a problem of both individuals *and* organizations. Where organizations are seen as manipulating circumstances to their own benefit to the disadvantage of others, the public and the press will call them on conflicts of interest. The ACORN example in New Orleans may be an innocent public debate, an example of competing nonprofits in the scrum for funding opportunities in nonprofit environments, but the perception of an organization enriching itself to the detriment of its nonprofit competitors may at times be construed of and described as organizational conflict of interest.

Some of these stories sound like they were plotted by Shakespeare himself, lacking only witches and ghosts. Speaking to the entire sector, Shakespeare might have witnessed the sector's still-languid efforts to rid itself of conflicts of interest and observed, "False face must hide what the false heart doth know."[33]

The prevailing wisdom articulated by some sector leaders is that nonprofit conflict of interest occurs when malefactors slither their way into positions of power and plunder the nonprofit storehouse. As egregious as some of these alleged conflicts of interest might appear, not all of their perpetrators were people who joined nonprofits to loot and pillage.

To the contrary, the principals in most of these examples have adamant defenders, even admirers. Their organizations have track records of years of demonstrable accomplishments. Nonprofit sector apologists are shortsighted when these excesses are attributed simply to human nature and the justification that some percentage of the population is going to engage in petty larceny whether they work for charity, business, or government. No, there are dynamics in our sector that unfortunately and sometimes inexorably encourage practices that can evolve into conflicts of interest—and they require all of us to be specially attuned to make sure that things do not go horribly awry.

> In our own organizations, the baseline protection against conflicts of interest should start with the board of directors, particularly the chair.

There is an aspect of self-interest in the nonprofit sector that some people might say is natural and positive. The motivation for creating a neighborhood community development corporation, for example, might not be airy intellectual theory, but rather the result of local residents coalescing behind a community leader to build themselves some affordable housing and find job training and placement opportunities that the private market isn't willing to supply. When does that community-based self-interest cross the line into conflict of interest? How can we guard against it?

There is also a lot of personal identification of organizations with their leaders. Funders constantly talk about making decisions based on the person leading an organization rather than because of the institution itself. Nonprofits become not institutions but so-and-so's organization, linked inescapably with the persona of the executive director. Funders, board members, and others feed the personal identification of the executive director with inducements, perks, and indulgences that accrete over time, sometimes crossing the line between empowering talented leaders into permitting self-aggrandizing behaviors that constitute conflicts of interest.

We have a moral obligation to call out conflicts of interest in our sector—institutional as well as individual—and to adopt a critical posture toward activity that undermines the probity of charity and philanthropy. But, as one perceptive observer has noted, saying that we are all responsible means, in practical terms, that no one is responsible. That's how life works. More than the bland admonishment to do the right thing, the sector needs an ethic of honoring and supporting the truth tellers and whistle-blowers who are willing to call out the miscreants.

In our own organizations, the baseline protection against conflicts of interest should start with the board of directors, particularly the chair. Where the board is complicit in the conflict of interest, there isn't much to be said. But it should be a reminder to current and prospective nonprofit board members that, functionally, they constitute our sector's and our society's early-warning system against these depredations.

Beyond the specific organizations involved, peer organizations sustain the collateral damage of conflicts of interest. Consequently, it should be incumbent on nonprofits and nonprofit associations to raise questions with an organization sliding into the morass—and sound the alarm publicly if the descent into this circle of hell continues.

Ultimately, the backstop is the government agencies charged with guaranteeing nonprofit probity. Given the years over which these conflicts have spanned, the diffidence of regulators and enforcers is noticeable. Without prejudging whether the Ohio auditor's suspicions were right or wrong, it clearly cost the auditor's office time and money to go after Oriana House, starting with prolonged litigation to get access to the nonprofit's financial records. Add to that charges of a political witch hunt (the Republican auditor ran for, and lost, the position of Ohio attorney general) and the fallout for alleging that a nonprofit leader has played fast and loose with nonprofit accountability, and it's not a battle that some public oversight agencies would be eager to join.

But join they must. Public funders like HUD in the Five Rivers case, local oversight agencies such as the clerk's office in Palm Beach County, state offices of the attorney general, and others all have to examine and support the conflict of interest standards that they themselves have promulgated—and they have to do this in something getting a little closer to real time. At some point, someone has to call the behavior into question and take action.

Conflict of interest in the nonprofit sector cannot be written off as the aberrant infiltration of low-level Sopranos skimming their cut of the tax-exempt dollar. Add a few bad judgments, some uncontrolled self-interest, a dose of all-too-common egoism, and the result is a conflict of interest pit that can engulf otherwise good people and organizations.

**Rick Cohen** is *NPQ*'s national correspondent. This article's title is taken from Mark Antony's speech in William Shakespeare's *Julius Caesar*, Act III, Scene ii.

**Endnotes**

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11. The developer denies he was on the Five Rivers board at the time, saying that he joined a month after the sale, but Five Rivers documents filed with the South Carolina Secretary of State indicate that he had joined before the transaction. Cf. David Wren, "Conflicts of Interest at Five Rivers: Family Members, Loan Recipients Served on the Board," the *Sun News* (September 30, 2006).
12. "David Wren, "Board Quit, but Trouble Persists," the *Myrtle Beach Sun-News* (December 31, 2006).
13. Palm Beach County Clerk & Comptroller, *Palm Beach County Convention and Visitors Bureau Audit* (December 2006), p. 15.
14. *Ibid*, p. 18.
15. The audit recommended that the convention center rescind the contract and "use a competitive bidding process" next time around, suggesting that competitive bidding wasn't a controlling factor earlier.
16. Deana Poole and Christine Stapleton, "Audit Attacks Visitors Bureau," *Palm Beach Post* (December 15, 2006).
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31. William Shakespeare, *Measure for Measure*, Act II, Scene ii.
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# Absent the Audit: How Small Nonprofits Can Demonstrate Accountability Without One

by Jeanne Bell and Steve Zimmerman

In the ongoing debate at the state and federal levels about how best to regulate public charities, a recurring question has been, "At what annual budget size should nonprofits obtain an audit of their year-end financial statements?" In 2005, Independent Sector's *Panel on the Nonprofit Sector* recommended to Congress that federal law be changed to require exempt organizations with annual revenues exceeding $1 million to have their financial statements audited by an independent CPA, and further, that organizations with annual revenues of $250,000 to $1 million have their statements reviewed by an independent accountant. In California, where the Nonprofit Integrity Act took effect in 2006, nonprofit advocates rallied passionately against early drafts of the law that would have required audits of nonprofits with annual revenues of $500,000, arguing that the expense of annual audits was an undue burden for small nonprofits. In the end, the Act's audit threshold was a far more generous $2 million in annual non-governmental revenues. Eighteen states now require nonprofits of a certain annual revenue size to submit audits if they solicit funds from their state's residents, though the revenue threshold varies considerably from state to state. Meanwhile, watchdog groups and standards-setting entities continue to vary in their answers to the audit question. The Wise Giving Alliance has a $250,000 annual revenue threshold, while the Standards of Excellence Institute's threshold is $300,000.

With such diversity of opinion among experts and regulators alike, it is no wonder that executives and board members of community-based nonprofits are confused about when to begin having their statements audited. Moreover, with the audit proving to be a ubiquitous element of accountability legislation and recommended self-regulation, how should those community-based organizations that don't get an annual audit otherwise demonstrate their fiscal responsibility?

First, staff and board leadership must recognize pragmatically what an audit does—and does not do—for a small nonprofit. An audit is an outside CPA's professional opinion on the material accuracy of an organization's year-end financial statements. An audit has nothing to do with financial strategy or organizational sustainability—a fact that too many nonprofit staff and board members overlook. An organization's own financial statements, which minimally include a balance sheet and an income statement, are first and foremost internal management tools. Even small organizations of $50,000 to $250,000 should produce internal financial statements for staff and board on a quarterly basis; larger groups should do so monthly. With the complexity and unpredictability of nonprofit income and the small margin upon which most community-based groups survive, timely analysis of accurate financial statements is both essential and totally independent of the audit issue.

The benefits to a community-based nonprofit of purchasing an annual audit of its year-end financial statements fall into three categories:

*Generate Donor and Constituent Confidence.* From a pure return on investment perspective, perhaps the greatest benefit to a nonprofit of purchasing an annual audit is the ability to provide copies of it to prospective major donors and institutional funders. An unqualified audit is a universal indicator (though hardly a guarantee) that an organization is investing in its financial management and that the financial statements it is including with its proposal are likely to be accurate. Beyond donors, the audit is a symbol (though, again, hardly a guarantee) of an organi-

## Absent the Audit: Strategies for Accountability

| Challenge | Strategies |
|---|---|
| Generating Donor/Constituent Confidence | • Involve the volunteer treasurer in response to constituent inquiries<br>• Ensure Form 990 is done well and submitted on time<br>• Post PDFs of last three Form 990s on Web site<br>• Distribute an inexpensive annual report to the community<br>• Track restricted contributions fanatically<br>• Develop a well-formatted, high level annual budget for public consumption<br>• Consider purchasing a review by an independent CPA |
| Ensuring Compliance with Nonprofit Accounting Standards | • Recruit an experienced nonprofit CFO or executive director as treasurer<br>• Contract with an expert nonprofit bookkeeper<br>• Prioritize financial literacy and professional development at staff and board levels |
| Preventing and Catching Fraud | •Engage staff, contractors, and board to ensure segregation of financial duties<br>•Develop and follow simple accounting policies and procedures<br>•Actively maintain a culture of financial ethics and transparency |

the media and watchdog groups, that the organization is committed to fiscal accountability.

*Ensure Compliance with Accounting Standards.* Board and staff leadership benefit from an audit done by a CPA who has current knowledge of nonprofit accounting standards in that such CPAs can help move an organization towards best financial management practices. Particularly in cases where the bookkeeper is new to nonprofit accounting, the audit process can educate her or him on advanced topics such as fund accounting and grants tracking. Further, even amongst experienced nonprofit finance staff, knowing that they will have to defend accounting judgments to an auditor at year-end sustains a kind of accounting discipline, or rigor, throughout the year.

*Prevent or Catch Fraud.* This benefit is perhaps the most commonly overstated. In fact, an annual audit is only a small *potential* element of a sound system of internal controls. One need only reflect on the major corporate scandals that continue to make the news to recognize that the audit process does not always prevent or catch fraudulent activity. Certainly, the prospect of an audit may play a deterrent function, but a determined staff person or volunteer can find ways to steal from a nonprofit that an auditor, who may be onsite testing for two days each year, will not detect.

If these are the primary benefits of purchasing an annual audit, how does a nonprofit that elects not to purchase one meet these same objectives? Let's assume that the Young Artists Network (YAN) is a small community-based nonprofit founded in California six years ago to connect and support young people hoping to build a career in the arts; it has five paid staff members and annual revenues of $405,000. Without the *requirement* of an audit by the state or any of YAN's funders, the board of directors has not deemed it necessary to invest $10,000 of their barely-break-even budget in an annual audit. Still, the board and executive director definitely want to generate donor and constituent confidence, ensure compliance with nonprofit accounting standards, and prevent fraud.

*Generating Donor and Constituent Confidence without an Audit.* There are six things YAN can do to inspire financial confidence among donors and constituents. First, it can establish and maintain an active board finance committee with a strong treasurer who can speak fluently about the financial condition of the organization. When an executive director can include a board member in responses to constituent inquiry, it sends a message of financial oversight and transparency to the community.

Second, the treasurer and the executive director can work together to ensure that YAN's IRS Form 990 is done well and submitted on time each year. Without an audit, many funders and constituents will rely on the Form 990 to assess the organization's financial status. The Form 990 is due four and a half months after the close of an organization's fiscal year. Since YAN's fiscal year is January through December, staff and board should ensure that its Form 990 is submitted by May 15th or that it requests an extension from the IRS (Form 8868). To demonstrate transparency, YAN can put PDFs of its last three Form 990s on its Web site.

Third, YAN can produce an inexpen-





Third, YAN can produce an inexpen-sive annual report to the community summarizing the impacts it had over the previous year as well as the sources and uses of its funds. If thoughtfully written and presented, the annual report need not be a fancy production to effectively communicate YAN's sense of mission and financial accountability to its constituents. In demonstrating impact and accountability, an annual report is an effective marketing and donor cultivation vehicle, even though these are not its explicit intents.

Fourth, YAN staff can be fanatical about tracking restricted contributions. In the end, most major donors and funders want to be assured that their funds are used as they intended them to be. Before YAN takes a penny of restricted money, it should set up adequate systems for identifying expenses as satisfying those agreements. At a minimum, a well-structured and maintained Excel workbook that keeps a running balance on each major restricted funding source is essential.

Fifth, YAN staff can develop a summarized version of its board-approved annual budget for public consumption. Many donors and funders ask for an annual budget before they commit funds. YAN can consolidate its income and expense categories for a clean, high-level look at its financial plan for the year. With reduced line items, there will be room on the page for a short narrative about the budget's assumptions and desired programmatic outcomes. Such a document demonstrates that YAN understands the nature of outside constituents' financial questions—as opposed to staff and board's—and is responsive with an informative, digestible presentation.

Finally, YAN may elect to engage an outside CPA in a *financial statement review*, rather than a full-blown audit. Less expensive and time-intensive for YAN staff, a review does not include onsite testing and therefore does not conclude with an auditor's "opinion"—a technical term for the CPA's expert judgment as to whether the financial statements prepared by the organization were prepared in accordance with accepted accounting principles. Instead, based on limited document review and communications with staff and/or board, the review report's objective is to give limited assurance that no significant modifications to the financial statements are needed to make them conform to accepted accounting principles. For roughly half the price of an audit, YAN would have a CPA-prepared document to share with constituents, albeit one with less "bite."

*Ensuring Compliance with Accounting Standards Without an Audit.* Like many small community-based nonprofits, YAN's volume of financial activity does not warrant a full-time staff accountant or CFO. And, like most founding executive directors, YAN's leader is not fluent in accounting, much less the specifics of nonprofit accounting standards. Still, ensuring best financial practices is essential, and YAN has several strategies it can employ. First, the aforementioned strong treasurer is a great opportunity to bring a volunteer with nonprofit finance skills into the organization's inner circle. Too many nonprofits look to general business people and bank employees as ideal treasurers; instead, YAN can recruit an experienced CFO or executive director of a larger nonprofit in its community. There is great utility for a small nonprofit in having a treasurer who knows how nonprofits actually work financially.

Next, YAN can contract for monthly services with a bookkeeper who is a nonprofit accounting expert. This independent contractor can not only prepare monthly financial statements in accordance with accounting standards, but also serve as a teacher and coach to YAN administrative staff who may be growing into a finance role. YAN's executive director might consider paying to have the expert bookkeeper on site for coaching and oversight impact and ensure greater accessibility for answering staff and board questions throughout the month.

Finally, YAN's executive director and board chair can explicitly and consistently prioritize financial literacy at the staff and board levels. This might include doing annual orientations to YAN's budget and financial statements at staff and board meetings, inviting a local expert to do a training for staff and board, and/or paying for staff and volunteers to attend finance workshops or conference sessions. More fundamentally, YAN's staff and board leadership can insist upon dual bottom line thinking—managing for mission impact *and* financial sustainability at all times—rather than allowing outdated program-versus-finance cultures to persist. The more that staff and volunteers have a holistic view of the programmatic and financial aspects of their organizations, the more likely they are to shepherd the organization to a place of best practice.

*Preventing or Catching Fraud Without an Audit.* The primary ways that organizations prevent fraud, regardless of budget size, are in segregating financial duties and creating a culture of financial ethics and transparency. The only difference for small nonprofits like YAN is that having enough people among whom to segregate financial duties is a greater challenge. By engaging the office manager for accounting clerk functions, the contract bookkeeper for review, reconciliation, and statement preparation, and both the executive director and the treasurer for review and signatures, YAN can effectively prevent one person from having unchecked access to its resources. Requiring dual signatures on large checks and having the payroll company send the payroll report of all funds distributed directly to the volunteer treasurer are two ways that YAN can segregate duties. With lots of nonprofit experience between them, YAN's treasurer and contract bookkeeper can help the organization document these and other simple accounting polices and procedures that ensure adequate internal controls.

It is the job of the organization's leaders—both staff and volunteer—to establish and maintain a culture of financial transparency. At its essence, this is about how carefully we collect and share financial information with a broad array of internal and external stakeholders. As a founding leader whose passions are in programmatic work, YAN's executive has to consciously reflect on what attitudes and practices about money she is modeling for her staff and board.

A fundamental assumption of the auditing process is that the organization has the capacity—be it achieved through its staff or through a combination of staff, contractors, and volunteers—to produce its own year-end financial statements in accordance with generally accepted accounting principles. Small and emerging organizations that intend to accomplish their intended impacts with paid staff and scaled up organizational structures have to work up to this capacity, just as they have to work up to the *financial* capacity to afford an audit. (Those that intend to be all volunteer or very small indefinitely may never desire audit-readiness.) The strategies outlined above will not only position an organization as serious about financial accountability and transparency, they are also necessary steps in the journey towards sufficient financial capacity to warrant an annual audit.


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# Online Volunteering Enters Middle Age


by Jayne Cravens


THE TIME IS LONG GONE TO CALL online volunteering, also known as virtual volunteering, a new or upcoming practice. In fact, the practice is more than 30 years old: Project Gutenberg (www.gutenberg.org) is probably the oldest example. This endeavor, now a nonprofit, was established in 1971, decades before public access to the digital highway became the norm. Through the contributions of online volunteers like transcribers, editors, researchers, and tech support, it provides electronic versions of many classic works such as *Les Miserables*, *Dracula*, and *Alice's Adventures in Wonderland*, as well as textbooks and other published materials with expired copyrights.

Online volunteering became more common among nonprofit organizations in the late 1990s, with widespread use of the Internet. Impact Online, now VolunteerMatch, began soliciting "virtual volunteers" to help with its new volunteer recruitment site in 1994. CompassPoint Nonprofit Services in San Francisco, formerly the Nonprofit Support Center, hosted one of the first presentations about online volunteering in 1995. Organizations' early efforts with online volunteering were chronicled at the Virtual Volunteering Project (www.serviceleader.org/old/vv), a research endeavor at the University of Texas at Austin that spent more than four years identifying and studying organizations with online volunteers and documenting practices that other organizations could adopt. By the end of 1999, the project had to abandon its comprehensive listing of organizations with online volunteers, as the list had grown into the many hundreds and was no longer possible to accurately maintain.

There are now thousands of nonprofits that involve volunteers through the Internet in some way. For instance, organizations are sending newsletters via e-mail to volunteers who provide service onsite, sponsoring online communities for volunteers to talk about their service activities, providing Web-based platforms for volunteers to log in their service hours, and, of course, volunteering online.

Online volunteering means volunteer activities that are completed, in whole or in part, via the Internet, usually in support of or through a nonprofit organization. Examples of online volunteering include: translation, research, Web design, data analyses, database construction, online discussion facilitation or moderation, proposal writing, issue advocacy, production of articles, online mentoring/coaching/tutoring, professional advice, curriculum development, publication design, video editing, podcast development—the list of online volunteering activities is as long as a listing of onsite service possibilities. As can be seen from even this partial list, most online volunteer activities are not directly tech-related. Also, traditional onsite volunteers who engage online with organizations they support, such as through an online discussion group, can also be considered online volunteers, since some of their service is happening online.

Involving volunteers online is a flourishing and growing practice. The organizations that do so vary tremendously in terms of agency staff size, agency age, and mission focus, ranging from large and long-established nonprofits such as Greenpeace, the World Food Program, and the American Cancer Society to relatively new, smaller organizations such as Perverted-Justice (which works to catch online pedophiles), Blogher (a new nonprofit that promotes blogging by women), and Knowbility (a nonprofit that promotes education and employment access to people with disabilities). To see examples of the hundreds of organizations involving online volunteers, visit the virtual volunteering section of VolunteerMatch (www.volunteermatch.org) and the UN's Online Volunteering service (www.onlinevolunteering.org), as well as the archives of the Virtual Volunteering Project (www.serviceleader.org/old/vv). Online volunteering is also a frequent

## Research: Online Volunteering

Research and academic journal articles regarding or directly relating to online volunteering are listed here:

• www.coyotecommunications.com/volunteer/ovresearch.html. Links are provided on this Web page to all publications or ordering information.

Some of the research available includes:

• "Involving International Online Volunteers: Factors for Success, Organizational Benefits, and New Views of Community," by Jayne Cravens, MSc. In conjunction with the Institute for Volunteering Research's November 2005 conference, "Volunteering Research: Frontiers and Horizons," research was undertaken to assess current common practices among organizations successfully involving international online volunteers, to explore the role online volunteering may play in building a more cohesive global community, and to assess the relationship between involving online volunteers and building organizational capacities. Published in *The International Journal of Volunteer Administration* (*IJOVA*) in July 2006.

• "Power to the Edges: Trends and Opportunities in Online Civic Engagement," Final Edition 1.0, by Jillaine Smith, Martin Kearns, and Allison Fine. This paper explores trends and strategies related to the current (as of May 2005) and future state of online activism, fundraising, and democracy. The report concludes with a series of findings and recommendations for the ways that organizations, individuals, and philanthropic groups can help build such cultures. Commissioned by the USA-based Philanthropy for Active Civic Engagement (PACE).

• Vic Murray and Yvonne Harrison of the University of Victoria produced "Virtual Volunteering: Current Status and Future Prospects" regarding online volunteering in Canada, with findings applicable for online volunteering in other countries.

• The Virtual Volunteering Project, based at the University of Texas at Austin, the first extensive research project regarding online volunteering, 1996–2001.

topic among practitioners on the CYBERVPM discussion group (groups.yahoo.com/group/cybervpm/).

Many who are new to online volunteering have the impression that it will replace onsite volunteering, that those who contribute online are new to community service, and that the majority of online volunteers are in their 20s. But according to research by the Virtual Volunteering Project in the late 1990s, as well as further research and anecdotal evidence since then from various organizations (see sidebar), the overwhelming majority of online volunteers also volunteer in onsite settings, often for the same organization they are helping online. Online volunteers also come from all age groups (usually starting over age 13), from various educational and work backgrounds, and from various geographies and ethnicities. There is some evidence that there are slightly more women who volunteer online than men. Of course, each organization will have a different breakdown as far as online volunteer demographics, but it's important to keep in mind that one cannot make sweeping generalizations about who online volunteers are, or will be.

The appealing features of online volunteering for individuals are many:

• it's another way for a person to help causes they believe in;

• it's a way for those who can't volunteer onsite because of constraints in leaving their home or workplace;

• it provides a way for people with disabilities and mobility/transport problems to volunteer;

• it can allow people to help organizations that are important to them when onsite opportunities are not available; and

• it can allow people to help others in a geographic region that they cannot travel to or do not live in.

Organizations involve volunteers via the Internet because:

• onsite volunteers have asked to volunteer this way in addition to their face-to-face service;

• online volunteers may have skills and expertise or sophisticated hardware or software that nonprofits may not have, but need;

• just as with onsite volunteers, online volunteers help stretch staff resources even further, often allowing onsite staff to serve more people and undertake more activities;

• online volunteering allows for the participation of people who find onsite volunteering difficult or impossible because of a disability, home obligation, transportation difficulties, or work schedule, which in turn allows an organization to benefit from the additional talent and resources of more, and a greater diversity of, volunteers; and

• online volunteers don't require physical accommodations (no desk, no chair, no parking place).

### Getting Personal & Transparent

Online interactions with volunteers can often feel quite personal. This is because many people are more willing to share information, feelings, and criticisms online than they are face-to-face. Also, volunteers can more easily share information about their interests and background (such as family and work photos) over the Internet than, say, at an onsite volunteer luncheon.

In addition, involving volunteers through the Internet is done most successfully by organizations focused on making volunteers collaborative partners in how the organization operates. This often means actually giving volunteers more to do and requiring a greater volunteer commitment. These organizations' successful volunteer involvement is focused on acknowledging and listening to the feedback from volunteers.





They are making volunteers feel included and energized—not with pins or mugs or luncheons, but through greater and more meaningful involvement and ongoing, interactive support.

Therefore, in learning to work with volunteers online, nonprofit staff must learn how to interact with people on a more transparent, personal level than they may be used to with traditional onsite volunteers.

### Positioning for Success

There are a number of ways that organizational leadership can encourage and support staff in embracing online volunteering, mostly through incorporating Internet use into traditional volunteer management:

• Ensure that all staff, particularly those who currently engage with volunteers, have reliable access to the Internet and are supported to use the Internet regularly to research information and engage in online communities relating to their work. If staff aren't experienced using the Internet as part of their work already, it's going to be quite difficult for them to feel comfortable working with volunteers online.

• Ensure that staff master the basics of traditional volunteer management and are involving onsite volunteers successfully. Research shows that most of the challenges in involving online volunteers relate to traditional management practice.

• Encourage staff to regularly communicate with current volunteers using e-mail and to commit to responding to e-mails from volunteers quickly.

• Encourage the staff person primarily responsible for managing volunteers to create an online community for current volunteers to talk about their service. This gets both the staff person and current volunteers used to interacting with one another online.

• Support your volunteer manager in creating a robust volunteer-related section on your organization's Web site, featuring complete information on how volunteers are recruited, screened, trained, and supported at your organization; details on how community members can express interest in volunteering; and a listing of what volunteers do at your organization. This may be a challenge, not because of a lack of technical know-how, but because the manager has not had to provide this information in writing before. This task is essential, however, to get a volunteer manager used to thinking of online activities as part of his or her job responsibilities—it will make the transition into involving online volunteers much more natural down the road.

You may find, as your organization engages in these activities, that online volunteering is already happening at your organization—for instance, a volunteer who is designing a new brochure for your organization may be undertaking some of this assignment from his or her home or work computer, and interacting with a staff person by e-mail as the project progresses. Because the volunteer is seen onsite, no one may ever have thought of the person as *also* an online volunteer.

### Safety & Confidentiality Concerns

Staff may express reluctance to involve volunteers online out of a misplaced fear of the Internet as being inherently dangerous. However, the Internet is no more dangerous than the offline, face-to-face world. Just as there are any number of things that can be done to protect people in face-to-face interactions, there are many things an organization can do to ensure everyone's safety, as well as the safety of its information, online. The Virtual Volunteering Project details various safety measures that can be undertaken here: www.serviceleader.org/old/vv/safety/.

It must also be noted that a volunteer, online or onsite, is no more likely to share confidential information inappropriately than a paid staff member if the volunteer undergoes the same training and experiences the same management as a paid staff member regarding confidentiality. In short, confidentiality is a training issue; all staff, whether paid or volunteer, whether onsite or online, needs to have training on what can and cannot be shared with the public.

### Keys to Success

In research about involving online volunteers, several recommendations emerge as common to successful programs regarding the role of staff in volunteer management, and these recommendations are easily applied to working with *all* volunteers, including those onsite. The following practices are especially appreciated by younger volunteers and those new to service onsite at a nonprofit:

- providing clearly defined, well-written, detailed online volunteering assignments, where expectations and needs are explicit;
- stressing in the assignment how the tasks will help the organization and the people or areas served;
- providing a quick response to all volunteer applicants and promptly approving or rejecting applications;
- promptly providing detailed next steps for the assignment to approved applicants;
- being ready to put online volunteers to work immediately *before* recruitment begins;
- responding to all e-mails from accepted and active volunteers quickly and regularly (most organizations successfully involving online volunteers adhere to a 48-hour rule);
- ensuring online volunteers feel they are a part of the organization's mission and understand how their contribution helps an organization; and
- ensuring online volunteers feel as recognized as onsite, face-to-face volunteers and long-term volunteers.

### Conclusion

Research and practice show that the keys to success in involving online volunteers have little to do with technology and everything to do with people skills, management style, and transparency. Organizations that successfully involve online volunteers do not think of volunteers in two different groups; they are all volunteers, often the same volunteers, and the management of all these volunteers is fully integrated, responsive, and transparent, fueling volunteers' enthusiasm for further service. Organizations successfully involving online volunteers represent innovation through their management, not their technology.

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# Preparing an Organization to Sustain Capable Leadership

by Karen Gaskins Jones

EFFECTIVE ORGANIZATIONAL leaders are likely to possess deep knowledge of issues in and around the organization. For instance, they will know the full range of players in their environments as well as the dynamics between them, and their tenure, influence, and reliability as partners. They are likely to know what long-term funding sources are thinking about doing in their program area and, for that matter, what those contributors like to eat at lunchtime and by whom they might be influenced. All of this knowledge is colored by their personal perceptions; and it is all grist for the mill in the stakeholder balancing act that is part and parcel of the job of a nonprofit leader. This is part of the reason executive departures can be so disruptive: if the executive is the sole holder of the organizational reins (or if too much is invested in that one position), it can cause the organization to stagger.

Of course, there are alternatives to leaving our organizations vulnerable to lurching from one leader to another. We could fill the organization with leaders (with and without positional power) who are effective, knowledgeable, and aligned around the organization's mission and strategy. What are the stakes—the risks—involved with not doing so?

Try this exercise in projection. What do you think happens next?

- The executive director has been exhausted by the demands of her job. She had planned to stay five years but leaves after two, saying she wants to spend more time with her family. At a meeting of the United Way's review committee, her departure comes up as an issue that argues against the agency's already tenuous position (the United Way is cutting its affiliate agency roster). A local foundation officer sits on this committee and wonders what this means for the agency. Should she delay the review of their grant?
- A small organization attracts young and enthusiastic staff people but there is little room to exercise their intelligence because the executive likes to hold decisions closely. Suggestions for changes in the way they do business are met with a glazed look, and there is a good deal of turnover. The leader, although not the founder, is well known as a passionate advocate—the board defers to him. He becomes seriously ill and is ordered by his doctor to leave.
- An executive director leaves unexpectedly, and a board member who has been involved with the organization for some time takes on the role of interim executive director. Once he is in the position, it becomes clear that the new ED cares for the organization and its mission but lacks some vital skills. When some of the board members become aware that the health of the organization is eroding, they begin to panic. Others defend the interim, lauding him for his self-sacrifice.

When such things happen in nonprofits, it usually means that attention to leadership development (and its impact on sustainability) has been inadequately addressed. The often unseen and unintended consequences may include a host of missed opportunities and organizational missteps. Hence, when the pool of capable organizational leaders is not continually nurtured, the organization may stagnate in the short term and become vulnerable in the long term.

### Leadership Change Means a Change in Perception & Practice

The mental model that predominates nonprofit succession planning might be likened to the transition of one head of state to another. Nonprofits can end up with a new cabinet (middle management and board), a new fiscal policy, and even an entirely new program as a result. No wonder the simple act of replacing one person is so charged. Consider further whether this is a legitimate approach in an organization that is supposed to be the expression of collective values and intent.

One philosophically different approach to single-leader succession planning involves the continuous cultivation of leaders among staff, board members, and volunteers in order to have a cadre of people prepared to fill different leadership roles.

An investment in leadership development entails inviting and building talent at every level and sharing expertise, contacts, and decision-making authority. In this way you create a depth of institutional will, knowledge, and memory that can survive the transition of one individual, however remarkable. Not only will this benefit your single organization, but the broader cultivation of diverse and talented leaders will enhance the nonprofit sector's influence and effectiveness within communities served and within our society.

## The Leader Development & Succession Landscape

If your nonprofit organization clings to a one-leader model, it risks enormous disequilibrium in the loss of the nuanced understanding of and influence on the environment that was referenced earlier in this article. Suddenly you could experience a cascade of events: funders falter waiting to see how the new executive works out; productive partnerships are neglected and lost; cash flow tenuously managed hits the skids.

How do you avoid these setbacks? Below are three strategies that can provide equilibrium during leadership changes and, in general, grow the leadership capacity of the organization over time.

## Risk Management

If a leader is lost on a fairly abrupt basis, the immediate questions within the organization are often:

- Who knows how to do that function?
- Who understands what the immediate organization/program needs are—and how to meet those needs and commitments?
- If someone else on staff takes on these additional responsibilities, what other parts of the organization may suffer?

The proposed risk management strategy for dealing with the unplanned absence of a leader is to create an emergency succession plan. This is a plan that can be implemented when there is the temporary absence of a person in a key position on staff or on the board. For example, if there is only one person who deals with a program or fiscal responsibility, what would happen to the organization if that person were unexpectedly unable to perform that function for one month? For three to six months?

An emergency succession plan is the minimum level of investment in a *leader development approach* to protecting your organization and cultivating talent. With the discussion of how to cover key positions (e.g., executive director, program director, comptroller, other important administrative positions), issues of cross-training, development, and growth opportunities become a part of performance management conversations and of the strategic goals for the organization.

To ensure the organization can operate effectively during times of unplanned change, plan for the change to occur. Build a strategy to ensure that there is some redundancy in the organization and that people with the right knowledge and skills are ready to assume responsibility if key leaders leave unexpectedly.

## A Strategic Approach to Leader Development

Once this minimal risk prevention step has been taken, the next level of investment is to think about the longer-term cultivation of the staff and board. This cultivation can be keyed to strategic and business plans. Even if such plans do not exist, the organization generally will have some method to determine its focus, goals, and its strategies for accomplishing those goals. Make sure that you have taken this trajectory into account when you think about leader development:

- What kind of competencies will staff need in the near and far future?
- What talents and capacities are there among staff and board members that might be further built for the good of the organization?

Then consider again the function of teams and cross-training to create redundancies of skill, knowledge, and relationships.

With clear intention to cultivate a pool of board and staff leaders with diverse talents and experience, the organization becomes more deliberate in creating opportunities to educate, train, or expand the awareness of individuals for different aspects of the work. It becomes a cultural norm to expect curiosity, engagement, and excellence from every leader in the organization. What can aid in this?

- Policies and practices designed to link people's work directly to the organization's mission and vision, and to increase their ability to fulfill increasing levels of responsibility to sustain the organization.
- Excellent information flow that provides open access to information about the organization's position in the community and with funders, its financial realities, and its benchmarks, as well as its strategic questions.
- Opportunities for people to exercise their leadership in ways that are challenging.
- Individual and collective behavioral norms to foster mutual respect, as well as recognition of their talents and experiences.
- Behaviors and practices to reinforce mutual accountability for the outcomes of their work together.
- A willingness to experiment and learn together—to seek better ways of delivering services and products—and heighten their effectiveness in working together.

Leader development is woven into the infrastructure of the organization's systems, policies, and day-to-day practices. Having a budget allocation and other resources earmarked for leader development is another indicator of being intentional about the development of leaders as a core value and practice in the organization. However, the lack of a discretionary budget for outside training should not be considered an insurmountable barrier to development.

To garner broad support for and understanding about the need for a "leader-full" organization, talk it up with internal and external stakeholders. This will help educate stakeholders and motivate their investment in this new direction.

## Managing Leadership Transition from a Position of Strength

Even when an organization makes the previous two levels of commitment, and the departure of a leader is planned, there is still some risk of losing equilibrium during a leadership transition. The board, departing leader, and staff must think carefully about what knowledge, skills, and relationships may still be held by the leader alone and plan to transfer those capacities to other members of existing staff if at all possible. If the new leader comes from outside the organization, she will need time to understand the complex realities of the internal life of the organization and its external influences. The new leader (whether from the outside or promoted from within) will need to depend on a deep and broad array of aligned leadership while her feet are getting wet; this will allow her to get and stay ahead of the curve.

## The Bottom Line

It is important for organizations to prepare for leadership transitions well before they occur. Regardless of the size, age, or type of organization, leader development and succession planning should be linked. Being intentional in the creation of specific leadership goals and strategies to cultivate the talent within an organization often happens in incremental ways that can be transformative over time. Being intentional in the development of an organization's leadership supports its sustainability and, not coincidentally, the collective intelligence it brings to its work.

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# Fleishman's World—an Essay

by Pablo Eisenberg

You have to give Joel Fleishman credit. Professor at Duke University, former President of the foundation Atlantic Philanthropies, and former Chair of the Markle Foundation, he is one of the very few foundation executives, current or past, who has had the interest and courage to write even a moderately critical assessment of the foundation world.

His recent book, *The Foundation: A Great American Secret; How Private Wealth is Changing the World*, is a warm, loving tribute to the large foundations, their donors, and their chief executives. While it neglects small foundations, the role of nonprofits in the philanthropic process, the egregious practices of so many of our philanthropic institutions, and the implications of foundation elitism for our democracy, the book nevertheless does grapple with some of the major issues that threaten the future performance and credibility of the sector.

His perspective is that of a consummate insider, a person who is close and indebted to establishment institutions, such as foundations and universities. He is much more comfortable with these institutions than he is with the world of local communities, grassroots organizations, and activist nonprofits. His views and analysis are probably shared by a large number of his foundation colleagues and their trustees, but they will not resonate with many people who are practitioners, recipients of foundation grants, or observers of foundation practices.

Fleishman's world is one of elite institutions, governed by the wealthiest and most highly paid professionals in our society. These institutions, with very few exceptions, support our civil society institutions in a dispassionate and judicious manner, providing that balance among government, corporate power, and nonprofits that is the essence of our democracy. To him, wealthy donors and their foundations have pursued public policy advocacy to assist the poor, reduce class privileges, and advance the case of progressive social change, as well as to support education, the arts, and the advancement of knowledge. He dismisses those critics who have accused foundations of perpetuating privilege and wealth as simply being Marxist.

This is a view that contradicts the experience of many nonprofits that have sought foundation money to organize and empower their poor or marginal constituencies to change policies and institutions that have been obstacles to social and economic justice. Why is it that the large foundations, with which Fleishman is primarily concerned, have refused to grant more than pennies to tough organizing and constituency mobilizing organizations at the local level, groups associated with Acorn, the Industrial Areas Foundation, PICO, DART, and the other organizing networks, as well as to thousands of other independent advocacy organizations?

Similarly, foundations have grossly underfunded rural organizations that have been trying to attack poverty for years in regions that currently boast a quarter of our country's poor. The Katrina disaster revealed the neglect of nonprofit infrastructures in Alabama, Louisiana, and Mississippi, especially those in low-income and black communities, by foundations which apparently didn't have a serious interest in poverty or justice issues. And one could recite many other instances of foundation neglect.

Contrary to Mr. Fleishman's assertions, foundation money for meaningful policy advocacy is in very short supply, a tiny fraction of the money spent each year by foundations. He apparently has not interviewed the thousands of national, state, and local nonprofits that can't get a dime for their advocacy activities. That is the hole in Fleishman's world. Though he mentions nonprofits in passing, he gives them short shrift. They are only bit players in his cast of characters.

Fleishman's policy world is one where professionals and experts formulate policies and/or lobby Congress or state legislatures. It is a province of polite, muted activism. It is, for the most part, not a world of organizing for power and influence, direct action, and challenges to established institutions like banks, insurance companies, and corporations. It lacks the passion, blood, guts, and anger of the real world.

There is a 'noblesse oblige' quality about his philanthropic world, in which the wealthy and highly paid professionals are entitled to govern without any intrusion from the working classes such as teachers, union members, social workers, ministers, small business people, and community representatives. Fleishman is comfortable with the elite composition of foundation boards. He never questions their lack of diversity. He doesn't seem to care that trustees from different classes and ethnic groups might bring new and useful perspectives to foundation priorities and grantmaking.

He doesn't understand, or refuses to see, the correlation between who serves on foundation boards and recipients of foundation money. It should not be surprising that elite trustees are, for the most part, reluctant to tackle the excesses of corporate America, invest in building the power and influence of marginalized constituencies, challenge establishment institutions, and eliminate the perks, tax advantages, and privileges to which they have become accustomed. You don't have to be a Marxist or a radical to understand this aspect of human nature.

Because of his enthusiastic embrace of foundations and their track records, he tends to dismiss some of their shortcomings. He asserts that much of the criticism of foundations, fueled by recent negative stories in the media, is unjustified. Not more than several hundred foundations, he says, have been guilty of malfeasance. What he doesn't mention is that a large number of foundation trustees have been involved in self-dealing and that many of them receive hefty fees for their so-called charitable service on foundation boards. Hundreds of millions of dollars are spent each year on such fees to people who don't need the money, funds that should be going to financially strapped nonprofit organizations. Nor does he discuss the rapidly growing excessive compensation and benefits provided to CEOs and the inordinately high cost of travel, hotel, other expenses, and inappropriate expenditures incurred by foundation executives. Many foundations, in short, are living high on the hog.

Fleishman believes the media is largely responsible for much of the public criticism that followed recent foundation scandals and the investigations by the Senate Finance Committee. He does not acknowledge that, for the past decade, the media has been the major accountability mechanism for the nonprofit world, far more effective than the federal government, the state regulatory agencies, and the totally inadequate attempts by philanthropy at self-reform. Instead of criticizing them, he should be praising their efforts. If anything, one could argue that the media has been too soft on foundations. An analysis in 2006 by Foundation Works, sponsored by the Packard Foundation, revealed that only 1% of all stories about philanthropy and foundations published between 1990 and 2004 were negative.

Surprisingly, as an experienced academic, he never discusses the merits of a payout increase (foundations are currently required to spend out a minimum of 5% of their assets, but not solely in grants), whether it might be beneficial to nonprofits and the taxpayers who support philanthropy. He does, however, commendably mention the lack of general operating support as one of the major weaknesses in foundation grantmaking but claims that foundations' reluctance to give general support is changing. Yet he provides no data to support this contention. In fact, to this day, only 20% of all foundation money is distributed in the form of general support. Nonprofits are still crying out for this vital funding to the deaf ears of an insensitive donor community. The leaders of our major foundations have made only half-hearted efforts to change this practice.

Is it possible to reconcile Fleishman's view that foundations are the major contributor to America's polyarchy—the existence of a multiplicity of independent power centers—while they are at the same time a source of one of this country's reigning oligarchies? What does this imply for American democracy? Is the prospective growth of mega-foundations like the Gates and other family foundations governed by a handful of family members a danger to our democratic institutions? Can they be held accountable without changes in their governance structures or by placing limits on their size and the way they operate? These are questions that Fleishman and the nonprofit sector as a whole have not addressed. It is time that they do so.

Fleishman does offer a number of recommendations to strengthen the sector. Foremost is his strong pitch for greater transparency and for self-reform.

For him, transparency and public accountability are the key to the growth, legitimacy, and future effectiveness of philanthropy. But there is little evidence that transparency by itself is sufficient to bring about genuine reforms. Foundations may divulge much more information about their operations, yet may not be willing to modify their practices. Openness and transparency may be a precondition to change: they are not the determining factor. The desire and will to alter behavior, public pressure, and political action are the forces that bring about change. This is the weakness in his recipe for change.

Although advocating more effective monitoring and policing of the sector, either by existing regulatory agencies or a new quasi-governmental national nonprofit, he fears new government intrusion and regulations, asserting that self-reform is the only blueprint for achieving public accountability and needed changes. His plea for self-reform is unlikely to produce much of a difference. Those of us who have been working in and around the nonprofit sector for as many as forty years have rarely seen philanthropic self-reform work. It's an easy concept to promote, particularly to organizations that don't want any shake-up of their cozy world, but it is extraordinarily difficult to implement. An accountability system that depends solely or primarily on self-reform is doomed to failure.

Foundations do not want new regulations that could eliminate the loophole permitting illegal self-dealing; set a low cap on trustee fees; limit the high costs of travel, hotels, and other expenses for foundation executives; and curtail other inappropriate expenditures. They are not about to change these practices through self-reform. Only new federal and/or state regulations can assure such changes.

The transparency and accountability measures that Fleishman promotes are procedural in nature, not substantive. The reason for his approach is that he is satisfied with foundations as they are. He sees no need for any transformation. It is fine that they are governed by an elite group of wealthy people and highly paid establishment professionals, regardless of their impact on democracy. There is no reason to change foundation priorities, even though the overwhelming majority of funds go to establishment institutions of higher education, health, the arts, and culture and only a sliver goes to low-income and poverty-related organizations, community empowerment groups, advocacy activities, rural entities, and watchdog institutions.

Fleishman's world is a rarified place of well intended institutions that do a lot of good but don't get to the heart of many of our societal problems and dysfunctional systems. Its celebration of foundations downplays the important role that nonprofits have played in creating almost all the social and institutional changes in our history. It ignores the poverty, class tensions, social and economic inequities, political corruption, and corporate excesses that shake the pillars of our democracy.

No, his world is not yours or mine, so far removed from our fundamental concerns and needs, so irrelevant to much of our civil society.

**Pablo Eisenberg** is a senior fellow at the Georgetown Public Policy Institute, a regular columnist for the Chronicle of Philanthropy, and the author of *Challenges to Nonprofits and Foundations: The Courage to Change*.



In the Next Issue

Boards are always a top issue among NPQ readers, so don't miss the Summer 2007 issue of NPQ on governance. Also included in this issue will be a special supplement on nonprofit risk management.

The Nonprofit Quarterly

## Advertising Index

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|---|---|---|
| ABA Publishing | IFC | www.ababooks.org |
| AccuFund | 67 | www.accufund.com |
| Adobe | 15 | www.adobe.com/nonprofit |
| Alliance for Nonprofit Excellence | 46 | www.npexcellence.org |
| AltaMira Press | 67 | www.altamirapress.org |
| AmeriMail Corporation | 48 | www.amerimailcorp.com |
| Bay Path College | 43 | www.baypath.edu |
| Blackbaud | OBC | www.blackbaud.com/attention |
| Boston University | 47 | www.bu.edu/met/fundraising |
| Brody Weiser Burns | 56 | www.brodyweiser.com |
| Charity First | 33 | www.charityfirst.com |
| Click and Pledge | 57 | www.clickandpledge.com |
| Clifton, Gunderson, LLP | 7 | www.cliftoncpa.com |
| Craigslist Foundation | 23 | www.craigslistfoundation.org |
| DonorPerfect | 63 | www.donorperfect.com |
| Duquesne University | 44 | www.leadership.duq.edu/comm |
| Duke University | 48 | www.learnmore.duke.edu/nonprofit |
| execSearches.com | 56 | www.execSearches.com |
| Harvard Business School | IBC | www.exed.hbs.edu |
| Heller School | 45 | www.heller.brandeis.edu |
| Milano The New School | 41 | www.milano.newschool.edu |
| Nonprofit Quarterly, the | 34, 46, 64, 74 | www.nonprofitquarterly.org |
| Sage Software | 10, 11 | www.sagesoftware.com/nonprofit |
| Saybrook Graduate School | 47 | www.saybrook.edu |
| St. Mary's University | 44 | www.smumn.edu/phildev |
| Third Sector New England | 71 | www.tsne.org |
| University of Dallas | 37 | www.thedallasmba.com |
| Wainwright Bank & Trust | 13 | www.equalexchange.com/eecd |
| Walden University | 39 | www.waldenu.edu |





# ARNOVA Abstracts

### ADVOCACY

Scott, W. Richard; Sarah Deschenes; Kathryn Hopkins, Anne Newman & Milbrey McLaughlin (2006) Advocacy organizations and the field of youth services: Ongoing efforts to restructure a field, *Nonprofit and Voluntary Sector Quarterly* 35(4): 691–714.

"This article examines how advocacy organizations bring about new conceptions of youth, influence the organization of the field, and ultimately change the way public policy addresses youth's needs."

### CAPACITY

Rivenbark, William C. & Paul W. Menter (2006) Building results-based management capacity in nonprofit organizations: The role of local government, *Public Performance and Management Review* 29(3): 255–266.

"This article presents a case study on how local government can assist nonprofit organizations with building performance capacity for results-based management in the context of mutual accountability. . . . [L]ocal government can expand the performance capacity in nonprofit organizations with an investment of resources in training and technical assistance and that nonprofits are receptive to results-based management."

### COMMUNITY DEVELOPMENT

Laverack, Glenn (2006) Evaluating community capacity: visual representation and interpretation, *Community Development Journal* 41(3): 266–276.

"The purpose of this paper is to provide an interpretation of programme experiences in the visual representation of strategies used to build community capacity. . . . What is new about this paper is that it provides a discussion about the interpretation of community capacity and in particular the use of the spider web configuration (so called because of the shape it resembles)."

### EDUCATION & CASE STUDIES

Filipovitch, Anthony (2006) Organizational transformation of a community-based clinic, *Nonprofit Management and Leadership* 17(1): 103–115.

In this case "the need for supportive services grew much faster than caseload." This case demonstrates needs "to develop productivity benchmarks that are specific to the group being served," and "for flexibility to go 'off plan' to accomplish a larger goal." It shows "how 'big money' and rapid growth can threaten the sustainability of an organization."

### GIVING & PHILANTHROPY

Backer, Thomas E. (2006) *Nurturing High-Impact Philanthropists: Learning Groups for Donors and Small Foundations*. Encino, CA: Human Interaction Research Institute, 16 pp. Available at http://www.humaninteract.org/images/caseynurturing-doc.pdf

This study "looked at philanthropy learning groups in both Southern and Northern California." It contains "two case studies and six good practices for creating and operating these groups."

Malani, Anup & Eric A. Posner (2006) *The Case for For-Profit Charities*, John M. Ohlin Law & Economics Working Paper No. 304. Chicago: The Law School at the University of Chicago, 26 pp. Available at http://www.law.uchicago.edu/Lawecon/index.html.

The author argue that conditioning tax benefits on the nonprofit form constitutes discriminatory tax treatment. They write, "the charitable activities of many commercial firms suggest that in the absence of discriminatory tax treatment for-profit charities would flourish."

### LAW

Boden, Martha A. (2006) Compassion Inaction: Why President Bush's faith-based initiatives violate the Establishment Clause, *Seattle University Law Review* (29 *Seattle Univ. L. R.* 991).

The author argues that "it is clear the Initiatives fail to safeguard individual recipients against religious coercion . . . [and] the Initiatives effectively force the federal government to supervise the administration of pervasively sectarian organizations."

### MANAGEMENT & GOVERNANCE

Inglis, Sue & Shirley Cleave (2006) A scale to assess board member motivations in nonprofit organizations, *Nonprofit Management and Leadership* 17(1): 83–101.

"The results of the current study support a framework consisting of six components: enhancement of self-worth, learning through community, helping the community, developing individual relationships, unique contributions to the board, and self-healing." The survey instrument was based on prior research and validated by a panel of experts and respondents.

Kissane, Rebecca Joyce (2006) Responsible but Uninformed? Nonprofit executive and program directors' knowledge of welfare reform, *Social Service Review* 80(2): 322–345.

The paper's findings suggest that "the majority of the respondents do not have a comprehensive understanding of the welfare rules. Analyses further suggest that levels of knowledge vary by organizational characteristics (e.g., agency size, main service domain, and type of clientele served) and the directors' views of welfare reform."

### MARKETING

Long, Mary M. & Larry Chiagouris (2006) The role of credibility in shaping attitudes towards nonprofit websites, *International Journal of Nonprofit and Voluntary Sector Marketing* 11(3): 239–249.

A convenience sample of 238 adults in a major metropolitan area who were first time visitors to at least one of two websites responded to a self-administered survey, then navigated through the two websites, were interviewed face-to-face and took a second self-administered survey. The authors confirmed the reliability of a six-item Attitude-Towards-Site scale and correlated this metric with 17 credibility variables for the two organizations.

### SOCIAL ENTERPRISE & SOCIAL ENTREPRENEURSHIP

Cooney, Kate (2006) The institutional and technical structuring of nonprofit ventures: Case study of a U.S. hybrid organization caught between two fields, *Voluntas* 17(2): 143–161.

"[E]mploying key concepts from neo-institutional theory, the author proposes framing nonprofit-business hybrids as organizations positioned in two different organizational fields – each necessitating different internal organizational technologies – to elucidate the structural tensions that can emerge inside the hybrid models."

### THEORY

Brooks, Arthur C. (2006) Efficient nonprofits? *Policy Studies Journal* 34(3): 303–312.

The author argues that "average return-on-investment measures are inadequate for nonprofit organizations, and that nonprofits should seek instead to measure marginal returns to investments in nonprogram areas, such as administration and fundraising." He illustrates his point with data from a national sample of approximately two hundred fifty thousand nonprofits from 2002.

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# The Take-Away

## by the editors


### Dark and Light Matters in the Nonprofit Universe

by Jon Pratt

The United States nonprofit sector continues to grow, now reaching 1.4 million organizations with $2.9 trillion in assets, but what is happening inside these giant aggregations? One large slice of this number, the 500,000 "nonfilers"—the dark matter of the nonprofit universe, organizations with less than $25,000 in revenues that have not been required to file Form 990 with the IRS—are subject to a new requirement of annual electronic filing, and are likely to shrink dramatically by 2010. For the rest of the nonprofit sector, revenues from charitable contributions and government funding are expected to increase, particularly among the largest organizations.

### Organizational Slack (or Goldilocks and the Three Budgets)

by Woods Bowman

How does "slack" impact a nonprofit's ability to do its work? As Goldilocks might have discovered, those cold organizations with too little slack live hand to mouth and are unable to pursue the opportunities in front of them or weather the storms. Those hot organizations with too much tend to lose their dynamism to inflated salaries and expenses. Organizations that are neither too hot nor too cold keep sufficient resources to pursue opportunities and weather changes while staying lean and responsive.

### Transactional Analysis, Nonprofit Style: An Interview with Richard Brewster

Managers need to think in more nuanced ways about the transaction costs associated with their funding sources. Developing quality sources of funding that offer both external and internal diversity are key.

### In Search of Sustainable Funding: Is Diversity of Sources Really the Answer?

by William Foster, Ben Dixon, and Matt Hochstetler

How do nonprofit organizations go about setting fundraising strategy? Many, it seems, adopt largely unproven mandates or common wisdom such as "diversify." Noting the relative dearth of detailed pattern-level information on nonprofit funding, the authors set out to provide guideposts based on some initial research into two sub-sectors. A sample of organizations engaged in youth services and environmental advocacy suggests that nonprofits may follow a pattern with respect to the number and nature of funding sources as they grow in size. For more detail and possible implications of this "U-shaped curve," read on.


### In Economic Redevelopment, Nonprofits Should Not Get Stuck in the Bleachers

by Judith Saidel

"It is a radical proposition that there is a place for nonprofits in economic planning. . . . As nonprofits, we're entering into new territory. We shouldn't be afraid or hesitant about this," says one of the leaders of the New York's Nonprofit Executive Roundtable. This article examines two instances in which community or regional planning processes factored in the economic power of the nonprofit sector as part of the overall regional economic plan. Nonprofits are learning that the stakes in economic growth for community wellbeing are enormous for all community members, the opportunities for creative thinking are infinite, and nonprofit leaders must step up to collaborative leadership at these critical moments in regional economic history.

### "How Do Employers Weigh a Candidate's Nonprofit Management Degree When Hiring?"

by the editors

Nonprofit management education is a burgeoning field full of enthusiastic promoters, particularly among those institutions offering them and the students who choose to pursue them. But, what do those who hire in the nonprofit sector think? *NPQ* conducted an informal survey of its readers in which we received a flood of responses, most of which landed somewhere on a fairly short continuum from "I don't look at that type of credential" to "It is (or may be) a benefit on top of relevant experience."

### Now You See It—Now You Don't: Conflict of Interest Demands More Than Just a Policy

by Mel Gill

*NPQ* readers couldn't have been more engaged in an issue when they responded to our request for stories and questions about conflicts of interest. Nonprofit governance expert Mel Gill sorts through readers' quandaries and offers lenses for spotting and addressing conflicts large and small. Many instances of possible conflict of interest are not clear-cut, rather presenting themselves in shades of gray. Gill offers four tests for spotting conflicts and guidance toward crafting solutions.

### Conflict of Interest: Mischief Thou Art Afoot

by Rick Cohen

Some stories of nonprofit conflict of interest seem almost Shakespearean, with casts of tragic heroes, stalwart truth-tellers, greedy villains, and occasionally ineffectual sheriffs and constables. Conflict of interest has captured the attention of the press and the public, but these stories reveal that what is or isn't conflict may be in the eye of the beholder. *NPQ*'s national correspondent tracks some particularly egregious examples of conflict of interest and the difficulties they present in for the organizations, law enforcement, and for the broader nonprofit field.

### Absent the Audit: How Small Nonprofits Can Demonstrate Accountability Without One

by Jeanne Bell and Steve Zimmerman

Small organizations that are not required to have audits often wonder how they can prove they are financially sound, well managed, and good stewards of the resources entrusted to them. Executives and board members of community-based nonprofits are often confused about when to begin having their statements audited and there is enormous diversity of opinion on what this matter. Given this scenario, how should those community-based organizations that don't get an annual audit otherwise demonstrate their fiscal responsibility? Authors Bell and Zimmerman explain what an audit does and does not do, and the critical systems and reports that any organization should have to demonstrate good financial practice.

### Online Volunteering Enters Middle Age

by Jayne Cravens

So what's all the buzz about online volunteering? Isn't that a rather impersonal and unrewarding way to contribute to a cause or organization? And surely, this must be something for the young and tech savvy generation. Jayne Cravens debunks much of what we might assume about the nature and potential benefits of volunteering via the Internet. In the process, she illustrates the shared underlying success factors for online and face-to-face volunteering, as well as how the two can build upon one another.

### Preparing an Organization to Sustain Capable Leadership

by Karen Gaskins Jones

How does an organization develop the capacity to sustain viable leadership over time? How does it become an organization filled with leaders who can effectively move an issue, program or business agenda forward? Karen Gaskins Jones asks readers to think about succession planning as more than the coronation of a single leader. The newer way to think and approach succession planning is to cultivate several leaders that can fulfill different leadership roles. This "leader development" practice is reinforced through policy and an organizational culture that supports the sustainability of capable leaders within an organization.

### Fleishman's World—an Essay

by Pablo Eisenberg

Duke University's Joel Fleishman describes his critique of foundations as a "lover's quarrel," a call for them to be more self-critical, transparent, and effective. According to Pablo Eisenberg, *The Foundation: A Great American Secret; How Private Wealth is Changing the World*, is more Valentine than spat, letting foundations off the hook for what they fail to deliver to society.

### Emotional Returns Sometimes the Most Measurable

by Phil Anthrop

Phil Anthrop focuses his satiric gaze on the tensions inside the Project for Pride in Existence, a successful Phoenix job training organization. What is a smarter communication strategy, documenting outcomes or tugging at the heart? More particularly, what should nonprofits do when their funders are far more interested in vignettes than facts, but still want to be respected in the morning for their rigor about results?

# Classifieds

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and architectural drawings of the new Bennet Pride in Existence Center.

"Really, this is kind of a pointless disagreement about what you wish other people would do with their money," said King. "Ultimately, some organizations will receive donations and others won't, and the ones that do get funded will be those that have figured out how to demonstrate the biggest bang for the buck in the right way."

"Yes, isn't that the question here?" asked Benegas. "The numbers tell us which programs work, and it's our moral responsibility to act accordingly."

"Lupe, you really may not be cut out for this," answered Bennet. "Yes, the participant data are important, and we always include some of your information, so your time has not been wasted."

I was beginning to understand the issue. Benegas opposed creating the new program to recruit 40- to 60-year-old corporate mid-levels to run nonprofit organizations (the "Bravo Careers" program), an infectiously attractive idea to major donors and national foundations—including Mr. Bennet's network of business leaders. Benegas felt that PPE should devote its efforts to the existing youth employment program, since it had had proven success and community benefit. To Benegas the Bravo Careers venture had none, despite its rich ability to attract funds.

"We have to go where the momentum is, you know that," King explained. "Our funders want us to be change agents, and this is how they want us to do it. Outside people have plenty of influence and good ideas. What do you think was more important when the state tripled our job training contract, program numbers or having the Governor bring the Commissioner of Jobs and Training to PPE for a tour?" he challenged.

"No one is telling you to lie, Ms. Benegas. It's a matter of emphasis," said. Bennet.

I tried to stay neutral and supportive, but I'm afraid I cost Benegas her job when I raised the matter of an unusual footnote, 15b, I remembered reading this unusual footnote somewhere in the progress reports Lupe wrote to the Results Foundation. "Lupe, I definitely think you have been successful in making this case to PPE's funders; the Results Foundation specifically cites your 15b outcome calculator in their annual report."

Benegas took a deep breath. "Do you really want to know what that's about, Mr. Anthrop? Then I'll tell you."

"Lupe, I think this has gone far enough," spoke up Joe King in a much louder voice. "Why don't you take a break?"

"Oh no, we've started this, we might as well get everything out in the open," Benegas responded, looking flushed, but determined to tell a long story about exposing untruths. "They want to be seen as scientific investors, but this funding is just shopping cart philanthropy: they want to buy some of these and some of those without really learning anything. The guidelines? The outcome measures? Fake, fake, fake."

Over the next half hour Lupe Benagas confessed her frustrations about developing reams of statistics that she felt were never seriously examined. After five years of this she had begun inserting test phrases into grant reports, including 15b.

Footnote 15b, Benagas confessed, was described in early reports as an automated adjuster for average participating PPE job trainee's income, adding a share of that year's lottery winnings assuming all low-wage workers bought lottery tickets, effectively adding a 1/1,000,000th percentage point to their annual income.

There was silence in the room when she finished, and King quietly said "Lupe, you know I love you, and some day we may look back on this and laugh, but you had best clean out your things and move on."

I was assigned to smooth the waters with the Results Foundation, a task which I failed miserably. When I met with their board chair (and major client of Consolidated Mammon), Sarah Wingate, I thought we might have a quick chuckle and move on, agreeing to keep it quiet. In a rare verbal misstep for me, I said, "Sarah, in a way this will actually turn out to be quite helpful to the Results Foundation, since you've gained a new appreciation of how the foundation has been lax in reading reports and tracking grantees."

Not only were Wingate and the foundation deeply offended by the subterfuge, Wingate announced that the Association of Large Foundations was that same day making public the news that the Results Foundation was receiving its Golden Millionaire award for published annual reports. The press release lauded the foundation's transparency in reporting its complex evaluation criteria—specifically citing the 15b outcome calculator.

I had to call King to tell him that the Results Foundation wanted all their grants from the last nine years back, to be routed through the Scottsdale Community Foundation. And, yes, I'd be sending in my resignation letter to the board that afternoon.

Three years later we've all moved on. I'm back to consulting. Lupe is now at the Arizona Department of Jobs and Training, investigating the Governor's tax-break job creation claims. PPE launched its "Bravo Careers" program to remarkable fanfare and discreetly un-quantified results—a winning fundraising formula. And transparency in evaluation criteria? Mum's the word.

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PHOTO: PETER MCDONALD

# Emotional Returns Sometimes the Most Measurable

by Phil Anthrop

I HAD NO IDEA WHEN I JOINED THE PPE board that an epic battle had been raging for years.

The Project for Pride in Existence was the most highly acclaimed job training organization in Phoenix, so I was thrilled to join the board shortly after I relocated to Arizona to head up Consolidated Mammon's Charitable Gift Fund. They wanted me on the development committee, and I was happy to help.

PPE (as everyone calls it in Phoenix) is one of those organizations that the community just knew was excellent, and it seemed to be everywhere—with corporate sponsors, an appropriately pitched, glitzy-but-gritty annual fundraiser, state and county contracts, and a growing portfolio of local and national foundation grants and major donors.

What could go wrong in an organization lauded for moving long-term underemployed men into $17/hour jobs with benefits? I was headed for my Jeep after the PPE board orientation lunch at the Ritz-Carlton when Lupe Benegas caught up with me.

"I saw you agreed to be on the Development Committee. I think you should know what's actually going on," said PPE's young Deputy Advancement Director. Just then Joe King, PPE's long-time President (a former priest and a community institution in his own right) came up to thank me for joining the board and ask about a mutual acquaintance, so Lupe Banegas shook my hand, gave me a knowing look, and left.

This small interaction was a tip-off—but not about the nature of the issue. That was made painfully clear two weeks later at my first Development Committee meeting, in a screaming match over fundraising strategy between Banegas, Joe King, and Dorrance Bennet, chair of the committee, one of the wealthiest people in Phoenix, and a self-described "business realist."

As I listened to the argument in the PPE President's office, memories of grad school battles between the "quants" and the "pols" filled my head.

The Quantitative side was taken by Benegas. "This is not a rational process! The entire field of philanthropy has spent years discussing outcome measures, but the truth is they get superficial attention. What the hell is going on here?" Benegas wanted PPE to base its public communications and foundation proposals on the organization's carefully documented outcome measures, not on PPE's traditional anecdotes and emotional tugs.

It was refreshing, and actually a little bewildering, to see "business realist" Bennet take the opposite tack:

"Foundations and corporations will never base their decisions on a numerical equivalent of college entrance calculations—a simplistic two-axis grid of GPA and SAT scores. This is why engineers tend to be poor fundraisers: they expect a result based on reason alone! These are humans, for God's sake! With emotions! You have to engage them!

"Do you think $10-million donors considering Yale and Stanford would make this decision based on graduation rates and GPAs?" continued Bennet. "No, they made their pile, and now they're going to enjoy it."

Joe King didn't call himself a "charity realist," but he just as well could have. "Lupe, I know you have a master's degree that was all about measuring results, but what's going on here is different. Ultimately, it's about creating an emotional return on investment," King said. "What is of greatest consequence is how the contributor feels after a donation—and this is true of mega-donors and large foundations as well as for $5 donors."

I could see that Bennet and King were scoring no points with Benegas, who had invested thousands of hours in outcome measures with voluminous documentation, only to be shoved aside by compelling stories of heroic single fathers, DVDs of tearful, employed men,

*Continued on page 79*