The Nonprofit Quarterly Summer 2008 Dog Day Finances, Chasing after the Right Stuff Volume 15, Issue 2

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THE Nonprofit QUARTERLY

Dog Day Finances, Chasing after the Right Stuff

Miller: The real consequences of financial decisions

State Study: Hobbling the human-service agency

Ostrower: On board self-dealing

Paul Light: Governance fads and fashions

Volume 15, Issue 2

THE Nonprofit QUARTERLY

Summer 2008

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The *Nonprofit Quarterly*'s overarching editorial goal is to strengthen the role of nonprofit organizations to activate democracy.

NPQ believes that open societies require venues for individuals to undertake public projects together that are larger than friends and family but smaller than the state and that range from community arts and group homes to environmental advocacy. Nonprofits naturally fill this role, particularly when their efforts engage the ideas, energy, and speech of members of their community. While generating resources encouraged by tax exemption is useful to support this work, *NPQ* believes that in a democratic society the essential role of nonprofit organizations is rooted in the First Amendment and the Universal Declaration of Human Rights, not the tax code or the market economy.

We live in a world that needs more of what nonprofits can achieve. We know that our communities hold untapped courage, compassion, and support and that nonprofits are uniquely positioned to build relationships and understanding. *NPQ* is committed to provide a forum for the critical thinking and exploration needed to help nonprofits stay true to this democratic calling—and to achieve their potential as effective, powerful, and influential organizations in concert with their constituencies.

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Ruth McCambridge, Executive Director

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Welcome

Dog days: the period between July and September when heat and stagnation hit. It's also just about when you'll page through this magazine for the first time. But we know that many nonprofits will suffer from not only the heat of the season but also the heat of the "kitchen," so to speak, as they look at their midyear budgets and their plans amid a weak economy. This issue's cover depicts a position we all might find enviable: in a choice paradise like the featured Labrador surrounded by tennis balls. In this issue, we've addressed a host of concerns to help get you—if not to the heavenly tennis balls—at least to a place where your organization can grasp its situation and continue its vital work more effectively.

Is it time to get moving on the plans that you've shepherded carefully over the past year, such as building a new facility, diversifying funding, or gaining additional government contracts? In our lead article, Clara Miller helps readers question the pros and cons of these strategies, and there are more cons than you might think (see page 10). As a board member, you may have perused an organization's midyear reports and wondered what to make of them. Kay Snowden offers a board member's guide to surpluses and deficits so you can make sense of your organization's bottom line (see page 18).

This issue also brings back the insightful and iconoclastic Paul Light, who questions the grave pronouncements about governance reform that wash over nonprofits like waves of dense rhetoric. Light asserts that much of the governance dialogue has been recycled and, further, that it is often reflective of a mix of conflicting models. The result is less than useful—and often ignored.

If you've opened these pages and are disappointed not to find our recurring Nonprofit Ethicist column, its author is on assignment across the pond for the summer. Fortunately, his colleague Dr. Conflict is on call to address all manner of nonprofit ailments, including petty bitterness, back biting, name calling, and more (see page 8). Most of us have worked in organizations where these behaviors can take hold of work culture and shake it till we're cross-eyed. But thankfully, the doctor is in.

Finally, on the table of contents pages, we've provided an expanded explanation of what *NPQ* is all about. We regularly speak and write about active democracy, but what does that really mean? Since it informs everything we do, we thought we'd offer a concise explanation. We believe that the role of nonprofits in democracies is fundamental to the sector's identity and its relationship to those it serves. Let us know what you think about the statement and how it fits into your view of the sector and your organizational management approach.

Letters to the Editor

A Coach on Coaching

Thanks for your excellent article on coaching ["A Leader's Guide to Executive Coaching," by David Coleman, the *Nonprofit Quarterly*, spring 2008]. Over the past several years, we have conducted executive coaching to enhance our executive search practice and have found it to be very effective. In some cases, we have suggested coaching for staff members currently in a position rather than searching for a replacement. It surprises executives that we have "talked ourselves out of a search assignment," but after coaching an incumbent to a higher level of productivity and leadership, these coachees have seen the benefit. We need to invest in people, and build on their strengths. In each coaching assignment, the biggest thrill is to see how coachees respond to having someone listen and believe in them and to see willingness to improve.

Jean Crawford
President, crawfordconnect
Toronto, Ontario

Thank you for *NPQ*'s recent article on executive coaching by David Coleman. It provides an excellent overview of the benefits and concerns of using executive coaching.

I would like to mention three additional areas where I have found executive coaching to be particularly effective: staff retention and succession planning; coaching as a management approach; and coaching to create strong development teams involving staff and board volunteers.

Once upon a time, a good fundraiser was synonymous with a good face-to-face solicitor, and the process of executive recruitment and related talent management was much more straightforward: find the stars, offer them attractive compensation and turn them loose. But the development process has become far more complex; it now involves research, moves management, careful matching of a prospect with the right organizational solicitor, solid operational systems to ensure timely and sensitive record keeping, and follow-up to be competitive. A successful fundraising organization can no longer rely on a star-quality executive, but rather needs an inspired (and inspiring) leader, a clear and decisive manager and team builder in order to ensure sustained success and a strategic approach to longer-term financial needs and sources.

Executive coaching is an essential and effective professional development tool to help successful "stars" develop interpersonal and management skills to manage departments and more focused teams and to advance a larger, more complex agenda forward internally and with key external influentials. Executive coaching can provide an individual insight and self-knowledge that enables rapid and specific self-development as well as the ability to identify and develop team members' capabilities.

When used to manage staff and to build teams, the "coach approach" has proven quite effective in quickly focusing and mobilizing teams toward a shared organizational goal. Each participant identifies for himself a personal vision and objectives and aligns himself with the larger institutional benefit.

Development operations that use executive coaching are more attractive to new leadership candidates, help leadership and management work together as a team more effectively, and help retain talented staff members who have professional development and career advancement needs that are clearly identified, understood, and included as a systematic and ongoing process. All become part of a development culture that is more healthy and productive.

Christopher Lytle
Senior Partner, Steven Ast
Philanthropy Executive Search Corp.
Stamford, CT

Community Building

Mr. Traynor's pedigree in the field of community building is commendable, as is the author's emphasis on the need to deepen community involvement in revitalization efforts ["The Bright Future of Community Building," by Bill Traynor, *NPQ*, spring 2008 issue]. But Traynor sells short the "Alinsky style" community organizing when he blithely suggests that the approach was developed in response to community development corporation (CDC) deficiencies and that the organizing approach promotes rigid structures that are limited to tactical power building to "confront entrenched interests." His depiction of community organizing as calling forth an elite, all-or-nothing leadership is just plain misperceived.

Over the past quarter-century, I have worked to fund community organizing in a variety of forms as a foundation program officer, program director, and interim foundation director. I have charted the growth and mutations of this democratic craft and tracked the latest literature on community-based organizing. In addition, these positions have given me direct access to attend meetings and actions, and as a consequence, I've followed dozens of organizations from conception to maturity. I have also seen the impact of these community-based organizing networks on neighborhoods, cities, counties, states, and even in national legislative forums.

Congregation-based organizations (CBOs) as promoted by organizing networks like Gamaliel Foundation, PICO, the Industrial Areas Foundation, and Direct Action and Research Training (DART) promote a broad-based multiethnic leadership now touching more than 1 percent of the U.S. population through communities. This is an enormous achievement. Congregation-based organizing improves on its rootstock of neighborhood community organizing by incorporating interfaith justice values, using congregations as an institutional base for membership and action and becoming multi-issue in its exercise of power. Their leadership is project-based, flexible, and constantly changing. These organizations continually reach out to new members and tackle multiple issues at any given time. At their best, modern CBOs have integrated themselves into the deliberations of successive administrations on the city, county, and state level on a variety of issues impacting low-income communities, including schools, community development, employment opportunity and services for seniors and children. Since CBOs have demonstrated life expectancies of more than 25 years, members are encouraged to plan strategically not "tactically" as during the days of neighborhood-based organizing.

Ironically, many of the characteristics Traynor describes—without the market-based biases—have become defining hallmarks of these networks of CBOs. The focus on one-to-one relationship building (for purposes of political action and social change) promotes increasing levels of engagement. Members shift from being simply informed to taking action to improve communities. The structural adaptability of these organizations is illustrated by the variety of issues they can tackle, the diversity of environments in which they thrive, and the longevity of their successes.

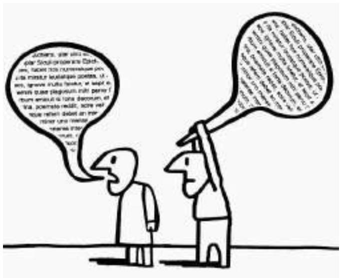
In my experience, the current iteration of community organizing is best understood as a directed social network and should be analyzed from this paradigm if its workings and true power are to be understood. In parallel, to understand its growth and emergence beyond its neighborhood origins, what is popularly called complexity theory seems to fit best.

Ronald White
Building Utopia Consulting
Columbia, MD

Welcome to *NPQ*

As a new subscriber to *NPQ*, I recently received the winter 2007 issue. I sincerely want to congratulate Rick Cohen on his astonishingly well-researched and written pieces on nonprofit whistle-blowing and the United Way's Community Impact Agenda. They alone were worth the subscription price.

Jack Shakely
Rancho Mirage, CA



Dr. Conflict

by Mark Light

Dear Dr. Conflict,
I am the leader of a large nonprofit. As a child, I was taught that the best way to solve a disagreement is for the folks involved to get together and sort it out. I just tell people to leave me alone and go solve the problem themselves. Guess what? No conflict! That's the easy way to deal with these things.

No Problems Here

Dear No Problems Here,
Where Dr. Conflict grew up, your approach was called "whistling past the graveyard." You simply whistle a happy tune when walking past the cemetery to create the illusion that there aren't any ghosts. But the ghosts are there. Just watch The Sixth Sense. *I'm not surprised that your organization appears to have no conflict but wonder how many lawsuits are under way for unresolved conflicts that you ignored.*

There are three primary reasons that conflicts arise.[1] First are incompatible goals, such as when Dr. Conflict's wife wants help with the chores but Dr. Conflict wants a beer.[2] Second is interference with goals, such as when Dr. Conflict's wife pours the beer down the sink because Dr. Conflict won't help.[3]

Third, conflicts arise because of scarce resources, including power. In essence, those with the power force the ones without it to acquiesce, often with a threat like, "If you tell the boss, you'll be sorry." Though you might like to think that the "folks" have resolved their conflicts à la kumbayah, there's a much better chance that people have been coerced into silence. Maybe everyone is involved, maybe only one person. But you won't know unless you get involved. Dr. Conflict is not suggesting that you have to be the one to intervene—training your staff in conflict management and getting people to third-party mediation might be a better choice—but burying your head in the sand is not the answer.

To be fair, sometimes avoiding conflict is a good idea, especially when your safety is involved or the conflict doesn't matter to you. And avoidance may work for a while, but if power is at play, it can lead to an explosion, and sometimes a violent one. No wonder almost two-thirds of human resource professionals report that their company has experienced some sort of violence in recent years.[4] Yes, it could be another bad-hair day for someone; it could also be something much worse. But if you keep your door closed, how do you know?

Dr. Conflict recommends that you stop avoiding conflict in your organization. The three things you can count on in life are death, taxes, and conflict . . . and maybe direct-mail appeals. Simply telling people to leave you alone until they've resolved their differences forces conflicts underground where it's very dark and people can get into trouble very quickly. Conflicts don't disappear by simply whistling them away. Just ask Dr. Conflict's wife.

Dear Dr. Conflict,
I am so angry! I just had a meeting with my executive committee about my annual adjustment. Not only was it months overdue, but they gave me less than I put in the budget. And I was very careful about the amount I budgeted. I'm doing a great job, and I showed the committee members how I stacked up against my peers. What went wrong? Does my board want me to leave? What should I do now? Should I threaten to quit?

Underpaid

Dear Underpaid,
Dr. Conflict wonders whether you look both ways before crossing the street. Is your last will and testament in order, your bequest to your favorite nonprofit inked, life insurance paid up, final arrangements planned? Including a number for your compensation in the budget before your board approves it is like saying, "Come here, bus, flatten me like a pancake. I'm ready to die!"

And yet Dr. Conflict sympathizes with your situation. You tried to get the board to deal with your compensation three months before the end of the fiscal year, but the board didn't pay attention. You asked repeatedly; how many times do you have to ask, for goodness sake? Rather than cause a *dustup, you got the budget approved even with its unfinished business.*

You ask what went wrong, so here's the bad news: You let the board shirk its responsibilities. Moreover, once you began the new fiscal year and started using that budget, you lost your leverage to get the matter addressed as part of a bigger picture and allowed the urgency to dissipate. Why worry now, hakuna matata*!*

The shame is that you did so many things right: You benchmarked your performance and your compensation against your peers; you came up with a number that was a fit with the data and the budget. But what you didn't do is hold your board accountable for doing its job. You wouldn't let the board overlook other potential catastrophes; why should your compensation be exempt?[5]

To be sure, some readers are thinking, "Wait a second here, I work for the board. Who am I to tell board members what to do? They're my bosses." Nonsense. As the executive director, you are at the center of the board's success.[6] *Dr. Conflict does not deny that working with your board is tough; governance is a world of "strange loops and tangled hierarchies," after all.*[7] *But your board depends on you even if it never says so directly. As one successful executive said to Dr. Conflict, "The board is my shepherd, I shall not ignore."*[8]

Now on to your other questions: If your board wanted you to leave, it would ignore you for a long time, the executive committee would fire you without notice, and the rest of the board would read about it in the newspaper.[9] *The board will let you know if it's time to leave; don't play the wounded bird.*

But what should you do now? Don't give up. There's no rule that says you can ask for raises only once a year. Wait a couple of months, and then reopen the discussion. If you don't get what you want, try again every three or four months. Astonishingly, even though half of nonprofit executives want more compensation, only one out of four executives has ever asked for a raise.[10] *You can be the exception to the rule. Asking for a raise is just like asking for a major gift; it takes planning and cultivation, but just like all fundraising, the biggest single error you'll make is not asking. Dr. Conflict hastens to add that this will not work with teenagers.*

Finally, you ask whether to threaten to quit. For a threat to be credible, you have to be able to deliver and be willing to deliver, and the other party has to care if you deliver. That's what makes threats so dangerous. Threats almost always make things worse and are usually self-fulfilling prophesies. Moreover, people naturally resist threats and often find ways to get even. Watch out, your board members just might call your bluff and fire you instead. Dr. Conflict learned this the hard way by once threatening to withhold affections from his wife, which she quickly accepted as a generous offer of kindness.

Endnotes

1. W. W. Wilmot and J. L. Hocker, *Interpersonal Conflict*, 7th ed. Boston: McGraw-Hill, 2007.
2. Dr. Conflict hopes that no one (especially his wife) would think that he would ever put a beer ahead of doing chores.
3. Recognizing that it would be right to help, Dr. Conflict would wisely apologize and ask his wife what he could do to compensate for his failings. In the conflict lexicon, this technique is commonly called *accommodation*, which helps you reduce your costs when you know you're going to lose. As Dr. Conflict likes to say, "If you're going to eat crow, eat it fresh."
4. E. Esen, "SHRM Workplace Violence Survey," Society for Human Resource Management, 2004.
5. Jeanne Peters and Timothy Wolfred argue that a "series of successive, short-tenure executives can do lingering harm to an agency's culture and performance." In other words, what Dr. Conflict calls a catastrophe. J. Peters & T. Wolfred. *Daring to lead: Nonprofit executive directors and their work experience*. San Francisco: CompassPoint Nonprofit Services (2001).
6. P. F. Drucker, "Lessons for Successful Nonprofit Governance," *Nonprofit Management and Leadership*, vol. 1, no. 1, 1990, pp. 7–14; R. Herman and R. Heimovics, "The Nonprofit Executive: Leader of the Board," *Nonprofit Management and Leadership*, vol. 1, no. 2, 1990, pp. 167–180; M. Light, *The Strategic Board: The Step-by-Step Guide to High-Impact Governance*. New York: Wiley, 2001; P. Light, *Pathways to Nonprofit Excellence*. Washington: Brookings Institution Press, 2002; and B. Nanus and S.M. Dobbs, *Leaders Who Make a Difference: Essential Strategies for Meeting the Nonprofit Challenge*, 1st ed. San Francisco: Jossey-Bass, 1999.
7. M. Middleton, "Nonprofit Boards of Directors: Beyond the Governance Function," in W. W. Powell, ed., *The Nonprofit Sector: A Research Handbook*. New Haven: Yale University Press, 1987, p. 149.
8. Dr. Conflict heard this from Deborah Dailey, the CEO and president of Hospice of Dayton.
9. Dr. Conflict kids you not; this sort of thing happens regularly, especially in agencies with executive committees empowered to act on behalf of the board between meetings. See M. Light, *Executive Committee*. Washington: BoardSource, 2004.
10. J. Bell, R. Moyers, and T. Wolfred, *Daring to Lead 2006: A National Study of Nonprofit Executive Leadership*. San Francisco; Washington: CompassPoint Nonprofit Services, Eugene and Agnes E. Meyer Foundation, 2006.

Dr. Conflict is the nom de plume of Mark Light. In addition to his work with First Light Group (www.firstlightgroup.com), he teaches at Case Western Reserve University and Antioch University McGregor. Along with his stimulating home life, he gets regular doses of conflict with the Dayton Mediation Center.

What conflicts are vexing you? Send your questions to Dr. Conflict at conflict@npqmag.org. The doctor will respond discreetly, and your questions will help others who face similar situations.

Truth or Consequences: The Implications of Financial Decisions

by Clara Miller

The conventional wisdom often falls short of describing reality and may lead organizations and funders to make strategic errors that undermine organizational effectiveness for decades.

Does a diversified revenue base make for a more profitable—and therefore sustainable—nonprofit? Does government funding create big financial problems? Does owning a facility improve an organization's financial health?

In a recent study, the Nonprofit Finance Fund set out to test these nuggets of conventional wisdom. We analyzed IRS Form 990s from 1,085 youth-serving organizations in five states with annual expenses of greater than $1 million. Unsurprisingly, the findings show that the conventional wisdom often falls short of describing reality and may lead organizations and funders to make strategic errors that undermine organizational effectiveness for decades.

Does a Diverse Revenue Base Improve Financial Health?

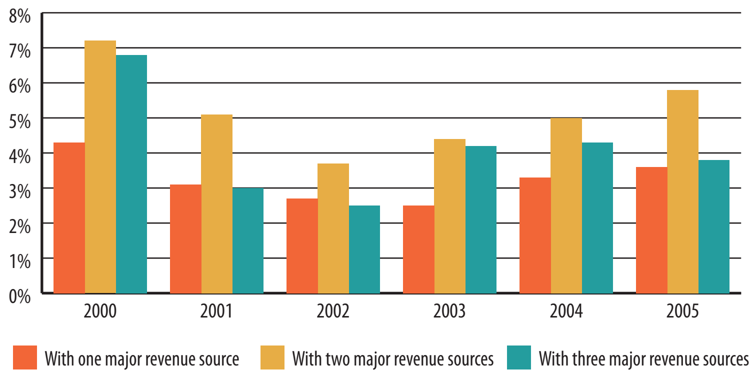
In the nonprofit sector, it seems almost axiomatic that diversified revenue improves financial health. But in figure 1 (on page 12), we see that the proposition is more complicated than the question suggests. In fact, based on this sample, it appears that where revenue diversity is concerned, there can be too much of a good thing.

For each of the years between 2000 and 2005, we took the entire sample and compared the number of major revenue sources with levels of organizational profitability. When we talk about a revenue source, we talk in terms of category; government contracts, for instance, would be one source, charitable contributions another, "endowment" income a third. Profitability is defined as the positive change in net assets as a percentage of total expenses. Figure 1 (on page 12) indicates that in each of those six years, organizations with only one major revenue source are less profitable than those with two. For the organizations with one major revenue source, the percentage of profitability is between 2.5 percent and 4.3 percent; with two revenue sources, profitability is between 3.7 percent and 7.2 percent (which is a similar range to what a reasonably profitable for-profit business of similar size might expect). It makes sense that having a second line of business would improve profitability, because many nonprofits lose money on their mission-related

Clara Miller is the president and CEO of Nonprofit Finance Fund (NFF), a community-development financial institution that provides direct-loan financing and financial advice to nonprofits nationwide. The NFF analysis team for this study included Paul Bennett, Catherine Gill, Garret Brinkerhoff, and Jennifer Talansky.

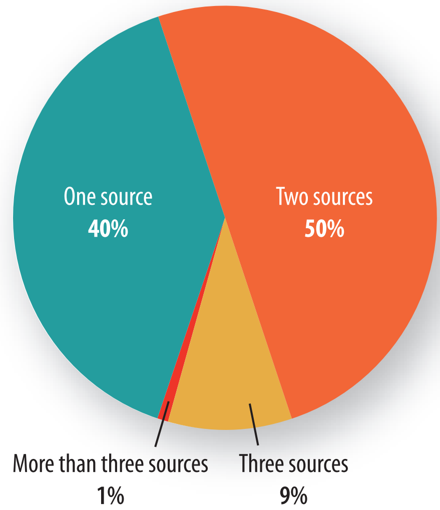

ulriksen

Figure 1
Profitability by Number of Revenue Sources



Source: 2008 Nonprofit Finance Fund

Figure 2
% of Agencies Receiving Revenue from Major Sources



Source: 2008 Nonprofit Finance Fund

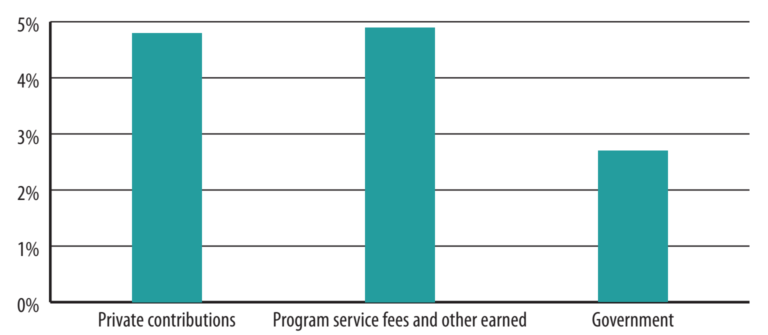
business (which may be dominated by earned revenue from government contracts, tuition, ticket sales, and similar sources). These primary sources of revenue, in which the payer (as opposed to a third party) pays for the delivery of services, typically cover less than the full cost of providing the service. Thus, a second source of revenue, usually fundraising, is required just to achieve break-even operations.

It is easy to conclude that two revenue sources are better than one, but interestingly, more isn't necessarily better. When organizations have a third major revenue source, profitability declines and, in some cases, to levels below that of organizations with only one primary source. This likely happens because a third line of business creates complexity and drives up internal costs, boosting the overall cost structure. Thus, even with the increased revenue, net revenue (or profitability) declines. This is especially true when a third line of business involves new activities. Mission-driven organizations don't always appreciate the need for the new skills, systems, and capital that comes with starting yet another business line.

Thus, the analysis indicates that some level of funding diversity is good, but overdoing it may increase costs and complicate operations, which can in turn decrease profitability.

In any event, the question may be moot, because when we looked at the true extent of diversification among nonprofits in the sample, we found that nonprofit managers pretty reliably emulate Adam Smith's *homo economus*: they seek the greatest gain for the least effort (see figure 2, page 12). Recognizing that two lines of business are plenty of work, few venture into three or more.

Figure 3
Profitability by Primary Revenue Source



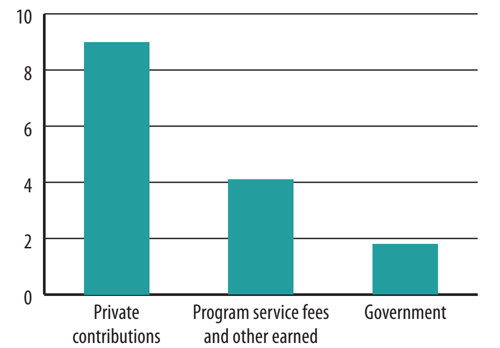
Source: 2008 Nonprofit Finance Fund

Does Government Funding Lead to Financial Problems?

The dominant source of revenue is more important in predicting profitability than the number and diversity of sources. Figure 3 shows that organizations dominated by either nongovernmental earned revenue or charitable contributions outstripped by a factor of two the profitability of those relying on government

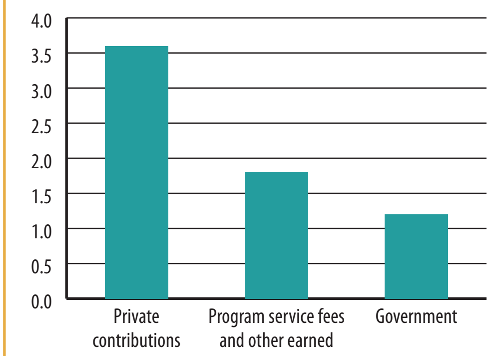
The more reliant organizations are on government revenue, the less cash they have on hand.

Figure 4
Months of Cash and Investments by Primary Revenue Source



Source: 2008 Nonprofit Finance Fund

Figure 5
Months of Unrestricted Liquid Net Assets by Primary Revenue Source



Source: 2008 Nonprofit Finance Fund

revenue. The median agency funded by earned revenue or private contributions operates at almost a 5 percent margin, while the median agency funded by government produced narrower margins of 2 percent to 3 percent.

Thus, if your organization's primary source of revenue is government, you are going to be half as profitable as organizations whose primary source of revenue comes from program service fees or private contributions. And when it comes to cash availability, this disparity becomes even more discouraging for government contract-dominated organizations. Figures 4 and 5 provide a fascinating picture of the correlation between government funding and liquidity.

Figure 4 indicates that if your primary revenue source is private contributions, you are likely to have, on average, nine months of cash and investments in the bank. Contrast this with a youth-serving organization that relies primarily on government, which has less than two months' worth of cash and investments. While hardly rolling in cash, even those relying on service fees have, on average, four months of cash and investments on hand. This shows that source matters.

Of course, in nonprofit land not all cash is fungible, because we routinely restrict cash with respect to purpose and timing. To address these restrictions, we peer into organizations' net assets, particularly at the levels of unrestricted liquid net assets (see figure 5). The median "liquid" net assets—our best measure of potentially deployable cash—are reduced by half for those dependent on contributions (to 3.5 months) or service fees (to 1.7 months) and for those relying on government sources, it declines to just more than four weeks of liquidity. In other words, if all revenue stopped, predominantly government-funded organizations (and remember, these are often the organizations that serve the poorest and frailest among us), could carry on for about a month.

One contributing factor here is that government funders may regulate nonprofit contractors in ways they would not regulate for-profit contractors, including in some cases (and this happens most frequently at the state level) requiring that available cash be spent on current services before reimbursement is released.

Our clients have two frequent complaints about government funders: (1) they don't pay enough, and (2) they don't pay on time. We explored the latter issue by looking at average accounts receivable at fiscal year-end 2005 (see figure 6, on page 15). Results show that in Illinois and Texas, the higher your reliance on government funding, the higher your accounts receivable as a percentage of total assets; but in California, Florida, and New York, we found the opposite.

In fact the more reliant you are, the lower the level of accounts receivable And even at 12 percent for Illinois and at 6 percent for Texas, accounts receivable is not overwhelmingly high. In standard business terms, an accounts-receivable level of 10 percent is generally supportable with cash reserves or a line of credit. That said, if we couple government contractors' low liquidity with other possible business drivers—such as an overstressed back office, which might not have billed all of its receivables—we fill out the picture.

Figure 7 further reflects the effect on liquidity. Once again, the picture is that the more reliant organizations are on government revenue, the less cash they have on hand. In every state, cash reserves are best for organizations less reliant on government and worst for those most reliant. In Texas, in fact, the median organization that relies heavily on government funding experienced negative "liquid" net assets.

Low liquidity engenders organizational stress (often diagnosed as capacity issues), since cash is the lifeblood of a healthy, risk-ready enterprise. Without it, a crisis atmosphere prevails. You can't make payroll, fund costs and equipment repairs, and make needed replacements. As a result, this situation leads to frequent facilities crises. In turn you put off training staff and neglect maintaining quality. Staff members may believe that they should job-hunt or employees may burn out from spending too much time in crisis mode. If you don't get rid of that underlying cause, no amount of well-intentioned capacity building will help.

The implications of inadequate capital structure—especially cash availability—are serious. Government-dependent and cash-poor nonprofits simply can't absorb much risk. As Wall Street risk guru Peter Bernstein says, "Risk means not having cash when you need it." Harvard University and Wal-Mart may not be managerially perfect, but they have enough cash to cover bumps in the road. And in the current environment, we need only look at Wall Street institutions to know that cash availability makes the difference for all businesses regardless of size or sector.

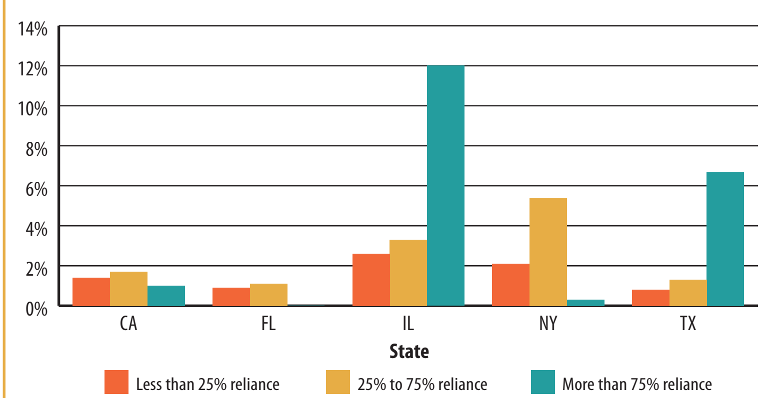
So is government funding a problem? Our results indicate that high dependence on government funding produces low levels of profitability and liquidity, foreshadowing myriad capacity and morale problems and little ability to absorb risk. We should be particularly concerned because organizations that suffer from these challenges are exactly those that serve groups also unable to absorb risk: the poor, the disabled, orphans, and the elderly. Not only are their lives hanging in the balance, their safety net is tattered, financially unready to absorb predictable and reasonable levels of risk on their behalf.

Does Facility Ownership Promote Stability?

Nonprofits often have a host of reasons to justify a property purchase: "If we build it, they will come."; "The city will sell it to us for a dollar."; "It will be cheaper than renting, and we will build equity."; and "We can rent out the extra space."

Figure 6

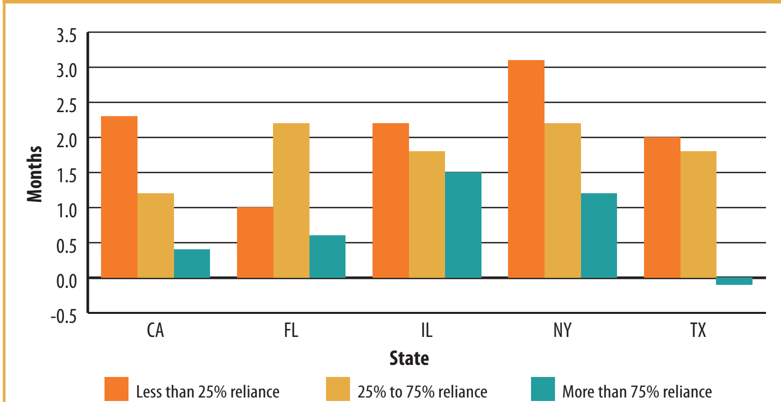
Accounts Receivable as % of Total Assets at Year End by Reliance on Government Revnue (2005)



Source: 2008 Nonprofit Finance Fund

Figure 7

Months of Unrestricted Liquid Net Assets by Reliance on Government Revenue (2005)



Source: 2008 Nonprofit Finance Fund

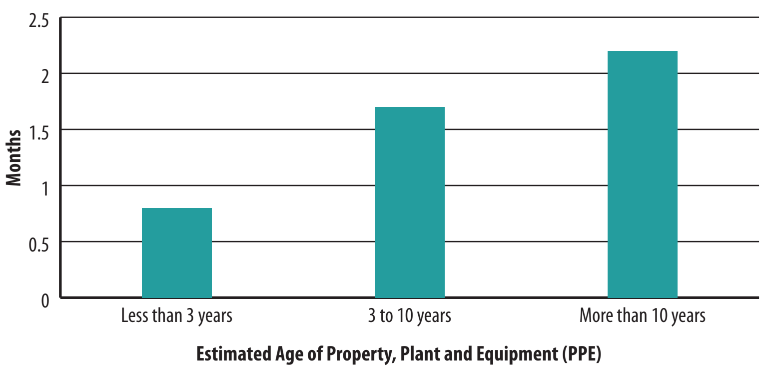
But here's a secret: when you increase your fixed costs, you have to increase your reliable revenue. This fact is strangely elusive to many in our sector—and often with regrettable results. Numerous mission- and program-related motivations prompt nonprofits to own property, but the improved financial health that results from ownership is often elusive (see "Owning Real Estate: A Deeper Look" on page 16).

One thing's for sure: building ownership is pervasive among youth-serving organizations. In this study, we found that almost 90 percent of responding organizations appeared to own real estate. This pattern runs counter to that of for-profit business, where 90 percent of the square footage occupied by U.S. corporations is leased. Among for-profits, a building is simply a means to an end, not a naming opportunity or a chance to get into

As Wall Street risk guru Peter Bernstein says, "Risk means not having cash when you need it."

Figure 8

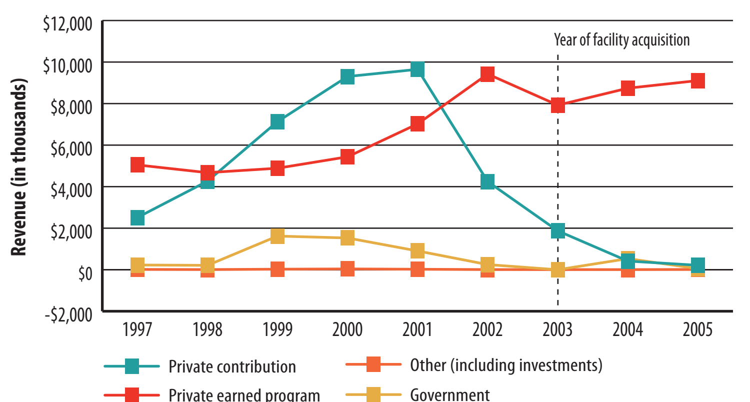
Months of Unrestricted Liquid Net Assets by Estimated Age of PPE



Source: 2008 Nonprofit Finance Fund

Figure 9

Revenue by Source



Source: 2008 Nonprofit Finance Fund

Owning Real Estate: A Deeper Look

To look more closely at the issues of nonprofit building ownership, the Nonprofit Finance Fund chose one youth-serving agency that acquired its building in 2003 to explore in detail (see figure 9). This case illustrates a common dynamic in which an agency decides to convert its business into a real estate–dominated balance sheet rather than a payroll-focused balance sheet.

If you think of risk as not having cash when you need it, this tells a profound story. This story is typical for nonprofits, where acquiring a building means financial difficulty. Here the acquiring organization still has a highly variable revenue stream: that is, it's in wonderful shape one year but starving the next. With its property acquisition, it gets into a situation where it has a fixed-cost structure that is poorly matched to the variability of its revenue. And it may have underestimated the effect of "funder burnout" and the need for working capital to beef up marketing and fundraising after the construction is over. Thus it faces financial challenges it can't manage.

Even when they are successful, most capital campaigns take an average of four years to complete—the increase in private contributions reflects this trend—but as soon as the campaign is over, contributions take a serious dive and practically disappear.

In the case of this nonprofit, there is a bright spot in terms of private earned program revenues. In 2002–2003, fees take a small dip, probably because the organization suspends operations (or moves to less accessible "swing space") during the building construction, but fees subsequently recover and increase again. So if you build, some might come—but it takes a while, and making the program and finances work in the new building will cost you!

A difficult irony is that many nonprofits think of owning a building in the same way many of us think about owning a house.

the real estate business (unless real estate management is a core business). These companies want the most appropriate, well-located space at the lowest cost, preferably turnkey. And if their market or business changes, they want flexibility. But nonprofits have a different perspective.

Referring to the points we've made previously about the critical importance for nonprofits having cash on hand, we consider the effect of building ownership on liquidity. Figure 8 shows that the organizations in this study that bought buildings depressed their liquidity for years afterward. The column on the left demonstrates that organizations that have owned their real estate for less than three years have less than a month of unrestricted liquid net assets and, even 10 years later, the median organization has just barely more than two months of cash. This is a portrait of organizations that are "house poor": asset rich but liquidity starved. "Water, water every where, nor any drop to drink," as Samuel Taylor Coleridge writes in the "Rime of the Ancient Mariner."

A difficult irony is that many nonprofits think of owning a building in the same way many of us think about owning a house. It is a rite of passage, something deeply emotional. Americans believe that homeownership can help us build standing and wealth—and in the case of a residence, that's often true. We have a variety of government programs and tax advantages that make it so. In many cases it's also about turf, and springs from a thirst for freedom and control that land ownership implies. We imagine that we want ownership of our communities, and have access to the wealth—and revenue—we help create. And that is where reality can depart from conventional wisdom.

Now, that does not mean that from a programmatic point of view property ownership is always bad or unwise. But from a purely business point of view—one that is green-eyeshade-friendly—there is a greater likelihood that owning and operating real estate will leech an organization's time, money, and attention from programs and, by increasing fixed costs and decreasing liquidity, will limit its programmatic and financial flexibility and ability to absorb risk.

There is a greater likelihood that owning and operating real estate will limit your programmatic and financial flexibility.

Conclusion

While pattern recognition is helpful in predicting and planning your organization's financial future, both funders and nonprofits may use time-honored assumptions and rules of thumb that are well meaning but misleading. A fresh look at some 990 data is helpful in guiding us toward a more nuanced view. And while this article explored only youth-serving organizations, we believe that the findings can be generalized for a variety of nonprofits, including arts organizations, charter schools, social-service agencies, and others.

Has your organization encountered any of these situations? How did you manage them? What advice would you give to other *NPQ* readers? Let us know at feedback@npqmag.org. Reprints of this article may be ordered from http://store.nonprofitquarterly.org, using code 150202.

A Board's Guide *to* Surpluses *and* Deficits

by Kay Snowden

An *occasional* year in which the organization sustains a deficit is not necessarily a harbinger of the organization's demise.

A COUPLE OF YEARS AGO, I WAS APPROACHED by a board member of the church I attended, who noted that the organization was ending the year with an approximate $20,000 deficit relative to a budget of slightly more than $400,000. The board member had been assured by the treasurer that the deficit wasn't a problem because there was plenty of money to pay the bills. What did I think?

KAY SNOWDEN is the client services manager for fiscal sponsorship at Third Sector New England, where she focuses on building the capacity and financial literacy of small nonprofits in southern New England.

This kind of question generally requires information from more than one report or source. In this case, I looked at the fund balance at the bottom of the "statement of financial position," or balance sheet. Sometimes referred to as "unrestricted net assets," the fund balance for a nonprofit is analogous to equity on a corporation's balance sheet or an individual's net worth. If you run a surplus for several years, you accumulate a positive fund balance. That balance may be enough to cover a year in which you run a deficit. You can still end up with a positive fund balance. From year to year, an organization's revenue and expenses may fluctuate, so an *occasional* year in which the organization sustains a

PHOTOGRAPH © SAGEL & KRANEFELD/ZEFA/CORBIS deficit is not necessarily a harbinger of the organization's demise.

Like many other nonprofits, the net assets of the church in question were separated into "unrestricted" and "temporarily restricted" on the organization's balance sheet. The reason the bank balance was sufficient to pay the bills was that it included both unrestricted and "temporarily restricted" funds, which are restricted by either purpose or time by the donor.[1] Frequently, grants made to nonprofits have such restrictions: funds collected for a youth field trip or member contributions paid in advance for the next fiscal year are examples of temporarily restricted funds for a church. It is permissible to commingle restricted and unrestricted funds in a single bank account, but it's dangerous to borrow from temporarily restricted funds to cover general operating deficits or advance cash to cover cash flow needs. The amount of cash in your organization's bank account is important, but it should not be confused with an operating surplus.

After determining whether the fund balance is sufficient to cover the organization's operating deficit, I'd want to understand whether a dangerous trend or something less worrisome is in play. Has the congregation shrunk, or was there an unusual event—say, the costs associated with a search for a new director—that created this deficit? What is the organization's history over the past three to five years? Too often, when revenues stagnate or decline, organizations whittle away once-healthy fund balances. On the other hand, expenses nearly always increase.

Sometimes it's more than whittling. A human-service organization that provides temporary housing and supportive programs for clients with mental health issues had two years of record-breaking deficits and wiped out a fund balance in excess of $250,000. This is a case of what I'd call "magical thinking." You count on a regular city grant to support a key program. The grant isn't renewed, but the needs of your constituents haven't gone away. You continue to provide services with high hopes of tapping new revenue sources to fill the gap. Program staff often has little involvement with billing and may be unaware of revenue shortfalls. In this organization, staff and board members were aware of the loss of the grant, but there was a kind of psychological disconnect. An astute board member

Understanding Budget Surpluses and Deficits

1. **Determining your budget surplus or deficit.** To interpret your operating surplus or deficit, you need the following:
   - a beginning fund balance and temporarily restricted net assets (from the balance sheet);
   - a detailed (and realistic) budget; and
   - year-to-date revenue and expenses by program, or at least separated into activities funded by restricted funds and those funded out of unrestricted funds.

2. **Considering your surplus options.** If you have a surplus, consider the following:
   - How much of the surplus is restricted and to what activities? Does your organization use any restricted funds to cover expenses that fall outside the restrictions (and are therefore not allowable expenses)?
   - How does your organization plan to use the surplus?
   - Are programs that are funded under contracts or restricted grants operating at the level of activity expected by the funders?
   - How much additional revenue do you need for the year? Is the amount realistic?

3. **Considering your deficit options.** If you have a deficit, consider the following:
   - Is the deficit covered by the beginning unrestricted fund balance (i.e., accumulated surpluses from previous years)?
   - Is the deficit a result of the timing of revenue recognition (e.g., recording a multiyear grant all in one year)?
   - Are there dangerous spending or resource trends underlying the deficit?
   - If you work with contracts, do you bill out properly? Does your reimbursement cover *all* the costs of providing contracted services?
   - Have you built the revenue side of the budget realistically?

The amount of cash in your organization's bank account is important, but it should not be confused with an operating surplus.

If your organization runs a deficit, you *should* be concerned and not accept easy reassurance that everything's OK.

of this organization confessed, "We knew it was a fictitious budget, but we approved it anyway."

Another organization with which I work has run a deficit this year of more than $200,000, and board members are periodically reminded that it is nothing to be concerned about. Their operations don't fluctuate wildly from year to year; in this case, the answer lies in the practices that nonprofits follow when revenue is "recognized," or recorded as revenue. Financial Accounting Standards Board standards require nonprofits to record *unrestricted* grants and contributions as revenue when a funder or donor makes a commitment to the organization, not when the money is actually received. The grants that this organization relies on to cover the current year's expenses were awarded (and received) before the year began; thus it had a big surplus in 2007 and a comparable deficit in 2008.

For the board, the key is to realistically assess the likelihood of sustaining its work at this level. Was the grant a onetime-only windfall for activities that are expected to be ongoing? What efforts will replace it? Even if the work it funded was short term, does the organization have plans to reduce or replace the amount of overhead and indirect costs it covered?

I don't want to give the wrong impression here: if your organization runs a deficit, you *should* be concerned and not accept easy reassurance that everything's OK. But it's more problematic to assume that a surplus indicates good financial health. The "bottom line" is often *not* the bottom line for nonprofits.

As illustrated in the previous example, the rules regarding revenue recognition are one culprit, and make it particularly difficult to review financials throughout the year. The accounting treatment is different for unrestricted grants, for temporarily restricted grants, for special events revenue, and for contract revenue.

Many nonprofits work under cost reimbursement contracts, often with government agencies. Contract revenue is recorded when services are provided, which means that your program will be perfectly in balance (as long as you charge only reimbursable expenses to the program). Sounds simple, right? Most of these contracts are for fixed amounts, so look at the spending rate not only to ensure that you don't spend it down more quickly than your budget calls for but also that you can provide the level of service required and cover all your costs, including overhead and indirect costs. If not, you run the risk of charging some of the costs to another funding source and putting that one in a deficit situation. There may already be costs associated with providing the service that are not allowable, meaning that those expenses need to be paid for with other funds, often your precious unrestricted funds. One form of this problem occurs when the allowed overhead rate doesn't come close to covering your actual overhead. The board should ensure that contracts reflect the true cost of providing the service as much as possible.

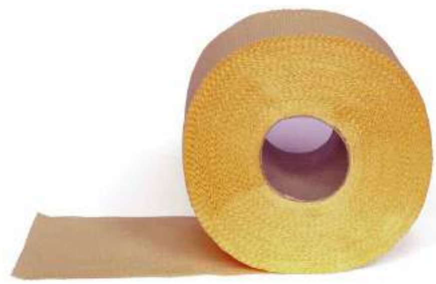
In addition to the statement of revenue and expenses (which summarizes the excess of revenue over expenses as the "bottom line") and the balance sheet (with its unrestricted fund balance), you need to be armed with a detailed organizational budget so that you can (1) monitor the variance between actual and budgeted amounts, and (2) keep on top of revenue. I am especially suspicious of balanced budgets: how likely is it that projected income will be *exactly* equal to projected expenses? When it comes to budgeting revenue, nonprofits are incredibly susceptible to magical thinking.

Case in point: Knowing little about the intricacies of housing finance, I reviewed the budget of a community development corporation (CDC). The CDC had just received a line-of-credit increase from its bank, indicating that the bankers thought the organization was financially healthy. It was going to reverse the prior year's shortfall with a hefty development fee for one of its projects. As I read the previous year's audit report, I noticed that over the prior few years the auditor had prudently written off development fees of more than a million dollars. I then asked management about the prospects for actually receiving the development fees in the current year's budget and quickly learned that things did not look good. This is a particularly dramatic example, but I've seen this magical thinking in numerous organizations and among the most financially astute people I know. There's no malicious intent here; people who are committed to programs want these programs to work, and it's awfully easy to bridge the revenue-expense gap with an overly optimistic projection of revenue.

But if you don't pay attention to changes outside your organization that may affect revenue, such as reimbursement rates, you can start a year with a sound budget and end up with a disastrous deficit. A charter school learned only three months before the end of the school year that its tuition reimbursement from the state would fall more than $200,000 short of the amount the state itself had projected. The reason: the reimbursement formula was based on enrollment in the charter school and average per-pupil spending by the local school district. The school district had encountered a budget crisis and cut spending as enrollment grew, which doubled the impact on its average per-pupil spending. Fortunately, the charter had a strong relationship with a local foundation that allowed the school to use a grant intended for capital purposes to fund the operating loss. From then on, the head of school paid careful attention to the town's budget developments.

From the outside, of course, it's easy to be the stern voice of financial control. All organizations should be conservative in their revenue projections and run a surplus every year, just as we should all have spotless houses and raise well-behaved children. But the real world of compelling needs and limited resources is much more challenging. What's an organization to do? Ask the tough questions, know where the gaps lie and what's being done to fund them, and have a plan for the next step if funding doesn't come through. Timing is critical; a modest budget cut made early on can leave your organization much more viable than a drastic cut made too late.

When it comes to budgeting revenue, nonprofits are incredibly susceptible to magical thinking.



Endnotes

1. There are also permanently restricted funds, such as endowment funds. In this article, restricted funds refer only to temporarily restricted funds.

How does your board approach deficits and surpluses? Let us know at feedback@npqmag.org. Reprints of this article may be ordered from http://store.nonprofitquarterly.org, using code 150203.

On the Edge:
The Financial Health of Human-Service Providers

Many human-service and health-focused nonprofit organizations, particularly community-based organizations, do not recover the full cost of services, which translates into deficits that put them at risk.

Editors' note: *This article is based on excerpts from "Financial Health of Providers in the Massachusetts Human Service System" commissioned by the Commonwealth of Massachusetts Executive Office of Health and Human Services and is authored by DMA Health Strategies, October 2007.*[1]

THE MORTGAGE CRISIS AND THE TURBULENCE of financial markets have gotten the attention of policy makers, who fear that additional failures in these sectors could push the country further into recession. In light of these housing and banking failures, who is analyzing the health of the nonprofit sector? Particularly for human-service organizations, a similar exploration into nonprofit financial health would help to understand why so many nonprofits consistently live on the financial edge.

Policy makers at the Massachusetts Executive Office of Health and Human Services (EOHHS) recently commissioned a study to bring objective analysis to bear on indications that the overall financial stability of purchase-of-service (POS) providers is at risk. The study identifies reasons for differences in financial health and explores the relationship between the state's purchasing practices and providers' financial health. The study highlights why so many nonprofits are financially fragile: many

PHOTOGRAPH © IMAGE100/CORBIS

The state depends on these organizations to deliver high-quality care, and conversely the financial stability of these organizations depends largely on state purchasing practices.

Figure 1
Human-Service Providers by Total Revenue
FY03–FY05 Average

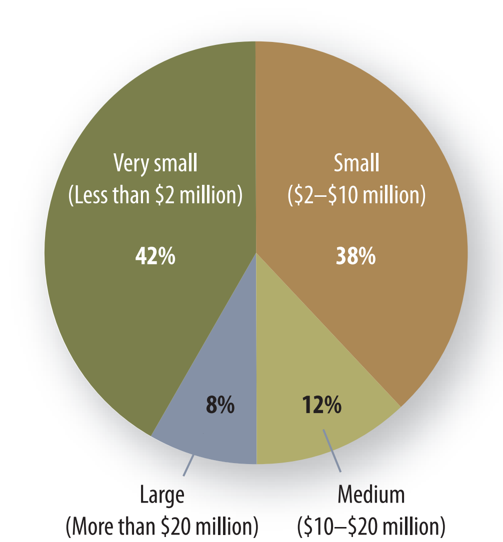
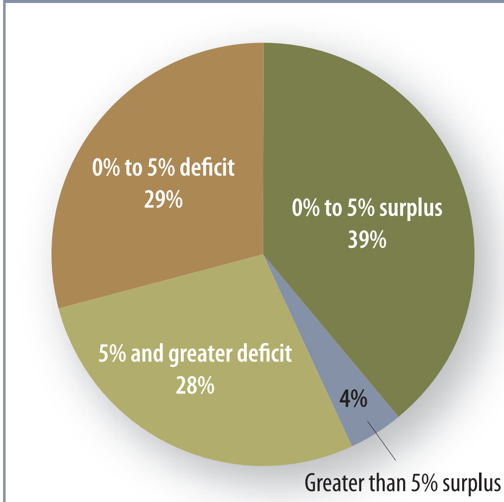


Figure 3
Profitability on Commonwealth Activities
FY03–FY05 Average

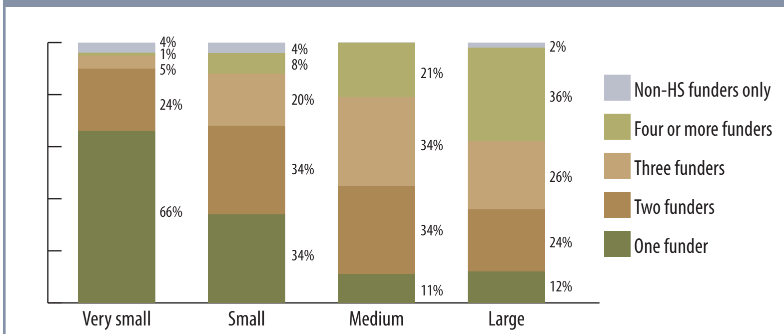


N= 620 in 2003, 614 in 2004, 612 in 2005
Source: UFR Schedule A, FY03, FY04, FY05

human-service and health-focused nonprofit organizations, particularly community-based organizations, do not recover the full cost of services, which translates into deficits that put them at risk.

In fiscal year 2007, EOHHS and its 16 agencies purchased more than $2.4 billion in services from its network of 1,100–plus largely nonprofit providers, which in turn delivered care and support to more than 1 million state residents. Services include homes for adults with chronic mental illness or cognitive and physical disabilities, public health, substance abuse treatment, juvenile justice, child welfare, family support programs, and other social services.

Figure 2
Number of Human-Service Funding Sources by Organization Size
Average of FY03, FY04, and FY05 Distributions



N= 620 in 2003, 614 in 2004, 612 in 2005
Source: UFR Schedule A, FY03, FY04, FY05

The Funding System

Since the 1960s and 1970s, when Massachusetts was a leader in developing strategies to move individuals out of institutional settings and into less restrictive, more humane community environments, the state and human-service organizations have become interdependent. Over the past several decades, the choice to purchase these services reflects the state's determination that noninstitutional community settings best serve human-services clients. Further, privately operated community settings generally afford the state and the public a higher degree of cost-effectiveness, program diversity, and creativity than the state alone can provide.

Total spending has risen from an estimated $25 million (inflation adjusted) in 1974 to the current spending level of $2.4 billion. Today, nearly half of the human-service provider organizations that deliver care under state contracts depend on contract sources for more than 50 percent of their revenue. In short, the state depends on these organizations to deliver high-quality care, and conversely the financial stability of these organizations depends largely on state purchasing practices.

Massachusetts also relies on the human-service industry as a significant force within the larger state economy. These organizations employ more than 185,000 workers, which equals more

Scope and Research Methodology

The study drew on the Uniform Financial Report (UFR) submissions required annually of most purchase-of-service (POS) providers in Massachusetts. The UFR includes the submission of financial statements and detailed program budgets. The analysis reviewed the financial data for the more than 600 providers that derive at least 5 percent of total revenue from the POS system of the Executive Office of Health and Human Services. The sample excluded hospitals, universities, and foundations (whose "core business" does not include the provision of POS services) or Aging Services Access Points (whose role as financial intermediaries skews their financial condition), as well as organizations in which 40 percent or more of total revenue comes from nonprogram sources (since such organizations are substantially different from organizations reliant on program service fees). The final sample of 615 organizations accounts for 87 percent of all POS revenues reported on UFRs and consists of organizations that are representative of the providers on which Massachusetts depends for the delivery of care to vulnerable populations.

than 3 percent of the state's total workforce (and is comparable in size to the state's telecommunications industry). Economic census data indicates that the industry generated $4.6 billion in revenue in 2003, and industry payroll exceeded $2 billion. Worker spending contributes more than $112 million in state and local taxes.

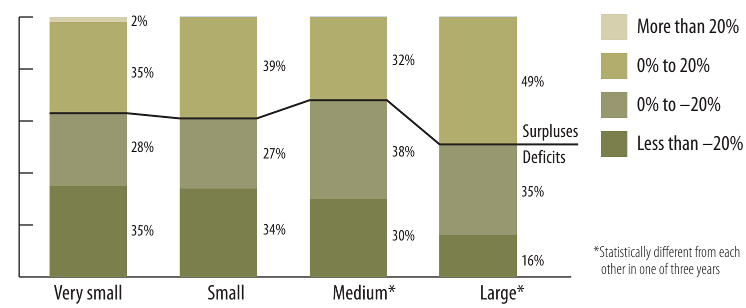
Jobs available in the human-service sector are dispersed throughout Massachusetts. Unlike many commercial industries, nonprofits are often located precisely in the areas that are most in need of jobs. Moreover, many positions are suitable for individuals seeking entry-level, relatively low-skill employment. These factors combine to make this industry critical to the state's overall economy, with particular relevance for communities that often lack viable employment opportunities.

Like for-profit businesses, human-service organizations must meet certain basic requirements to survive: they must have sufficient resources to cover their expenses, they must be solvent, and they must be capable of securing lines of credit. In addition, just like any business, healthy not-for-profit providers must end the year with a modest surplus, which they can reinvest in their organizations. Providers with the adequate resources to operate do not need to constantly manage crises and can devote efforts to innovating, improving, and, when appropriate, expanding services. Stable organizations better attract and retain high-quality staff, which enhances continuity of care, service quality, and administrative efficiency.

Figure 4

Accumulated Surplus or Deficit on Commonwealth Activities by Organization Size

Average of FY03, FY04, and FY05 Distributions



N= Average of 257 for Very small, 234 for Small, 74 for Medium, 50 for Large

Source: UFR Schedule A, FY03, FY04, FY05

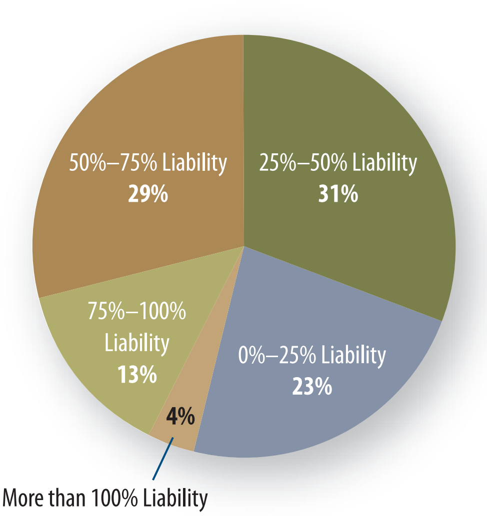
But it is clear that there is a spectrum of financial health among nonprofit organizations. Organizations that are financially healthy and stable include universities and hospitals, which have multiple funding sources, can charge for the full cost of services, have high-overhead reimbursement rates and a healthy base of large and longtime institutional donors. In contrast, many human-service agencies rely on the POS system to fund program services. They are much more financially unstable because of their heavy reliance on restricted funding, low-overhead reimbursement rates, and the need to raise matching and unrestricted funds from typically small donor bases.

The POS system in Massachusetts is funded primarily by line items in the state budget, along with pass-through federal grants from a variety of federal agencies. In many cases, these services are delivered via multiyear contracts with nonprofit organizations that have multiple annual renewals. Often multiyear contract obligations are level-funded throughout the life of the contract and its renewals, despite annual increases in costs. With some exceptions, POS

With some exceptions, POS reimbursement rates generally aren't based on an analysis of actual cost.

Over time, several practices result in a situation in which organizations get paid for a smaller and smaller share of the actual cost of doing business.

Figure 5
Total Liabilities as a Percentage of Total Assets
FY03–FY05 Average



Source: FY03, FY04, FY05 UFR Statement of Position

reimbursement rates generally aren't based on an analysis of actual cost. Rather, a rate in the POS system is typically the maximum obligation of a contract, which is dependent on the availability of state funds divided by the number of units the provider agrees to deliver. Further, many contracts in the POS system are executed on a cost-reimbursement basis in which no rate exists. Under cost-reimbursement contracts, agencies generally dictate exact inputs and costs, and providers have limited incentive for efficiency and innovation.

As indicated by the study's provider advisory group, these factors' impact on providers can take many forms:

- Staff salaries and fringe benefits do not keep pace with increases in overall cost of living.
- The relatively low wages that provider organizations can offer employees limit the level of experience and qualification for many direct-care workers, and also lead to rapid staff turnover and increased replacement costs. Providers may also leave positions vacant in order to realize savings, which can have adverse quality and regulatory implications.
- Providers may defer routine support costs, such as facility maintenance, information systems, and other critical infrastructure investments.

Over time, these practices result in a situation in which organizations get paid for a smaller and smaller share of the actual cost of doing business. Unless these organizations have other financial resources to make up the shortfall, they begin to fall further behind, first running annual deficits and ultimately reporting negative net assets.

The Service Providers

Ninety percent of the providers are tax-exempt 501(c)(3) organizations; most were incorporated in the 1970s and 1980s. Figure 1 (on page 24) shows the breakdown of the sample based on budget size. Nearly 40 percent of

The Next Steps

In January 2008, the Massachusetts Executive Office of Health and Human Services (EOHHS) followed up its groundbreaking 2007 report with "EOHHS Report to Administration and Finance: Recommendations for Reforming the Purchase of Service System." It details EOHHS's proposals to address the challenges created by the purchase-of-service (POS) system—which, according to the report, makes up 10 percent of the Commonwealth's budget—and articulates a framework that EOHHS will use to address these challenges. The principles include the following:

1. **Community first**. Families and individuals are best served in the community, not in institutional settings. The Commonwealth's community system must be stable and capable of meeting the highest standards of care.
2. **A fair wage**. Workers employed in the Commonwealth's POS system must earn a fair wage.
3. **Rate reform**. Rates of reimbursement for community providers must cover the reasonable costs incurred by an efficient and economical provider, must be based on a transparent rate-setting methodology, and should be reviewed regularly for adequacy.
4. **Quality and accountability**. Human-service contracts should focus on achievement of measurable quality and outcome benchmarks and, where relevant, provide incentives for quality and outcome attainment.
5. **Cross-secretariat efficiency and consistency**. The entire POS system should be reviewed for efficiency of management and delivery. Wherever appropriate, business practice, administration, and contract management should be consistent throughout agencies.

organizations have budgets of less than $2 million, and another 35 percent have budgets of between $2 million and $10 million.

As shown in figure 2 (on page 24), 43 percent of providers have revenue from only one EOHHS agency (funding source); 30 percent have revenues from two. Very small and small providers are most likely to have only one or two EOHHS agency funding sources. About 60 percent of providers have a predominant funding source (i.e., one that is 40 percent or more of total revenue). Providers with three EOHHS agency funding sources have higher net incomes than those with two or less. Those with a single or a dominant funding source (representing 40% or more of total revenues) do not report higher net incomes.

Results of the Analysis

This study confirmed that, in many areas, the financial health of human-service providers in Massachusetts is suffering, and state policies have a negative impact on financial health outcomes. The approximately 615 provider respondents show subpar and precarious results in three important areas of financial health: profitability, solvency, and liquidity. As figure 3 (on page 24) shows, the majority of respondents report deficits in state contract activities each year.

Figure 4 (on page 25) shows the distribution of historical surplus and deficit among organizations of different size. Overall, about 60 percent of respondents have cumulative deficits from their state-funded activities in the 2003 to 2005 period.

One of the most statistically significant factors affecting providers' overall ability to break even or generate a surplus is the profitability of a provider's contract with the state. There are several possible explanations for annual and cumulative deficits on state contracts: First, the Commonwealth of Massachusetts limits the surplus a nonprofit can earn in a single year on state contracts to five percent and to 20 percent cumulative. As a result, contracting practices are designed to ensure that annual surplus is nominal. Cost reimbursement contracts, which account for 16 percent of total program revenue, show a consistent negative relationship to financial health. Organizations are not allowed to generate a surplus under this type of contract and are thus unable to build a cushion to fall back on in harder times or to invest in infrastructure or staff training. These organizations also have little incentive to strive for efficiencies because they cannot enjoy the savings. In addition, these organizations may face costs for which they are unable to receive reimbursement, such as principal payments and unanticipated expenses incurred after the deadline for contract amendments. These limitations can lead to program losses and reduce providers' ability to build net assets. As a result, they have fewer resources to support financial stability.

A second possible cause is that EOHHS agencies generally issue multiyear, usually

Recommendations for Contracting with State Agencies

The Executive Office of Health and Human Services released a follow-up report in January 2008 presenting principles for future POS contracts (see related sidebar on page 26). In the meantime, Elizabeth Keating, a visiting assistant professor at Boston College and contributor to the 2007 report, makes the following recommendations for state agencies contracting with human-service providers.

- **Pay 100 percent for contracted services.** This should include (1) reasonable and frequent adjustments for inflation and costs of living; (2) reasonably sufficient overhead rates to fully cover support service costs, such as the cost of reporting on its activities to the state; (3) funds to support necessary infrastructure investments or upgrades; and (4) timely payment.
- **Pass a single nongovernmental organization funding act similar to the Single Audit Act.** Nonprofits spend inordinate amounts of time presenting their case to various governmental agencies using differing forms and applications and then separately reporting on those activities. This is wasteful for everyone involved. Government agencies, especially those within the same executive office, should standardize grant applications and reporting as well as have standard contract applications and reporting.
- **Revise nonprofit accounting standards and regulations.** Nonprofits should engage in fair disclosure as is required for publicly traded firms. This would entail making financial statements and grant reports available to the public, not just select donors. The standard setters and regulators should encourage more consistent accounting practices, such as the use of the Uniform Chart of Accounts and a standardized operating measure that allows for cross-organizational comparisons and sector-wide analysis. A classified balance sheet that distinguishes current from noncurrent assets and liabilities would facilitate better financial analysis of nonprofit health. Nonprofits should be required to provide a management discussion and analysis that explains and interprets financial statements.
- **Require reporting on results-based metrics, from input and activity levels to outputs and outcomes and cost-benefit relationships.** Data on both programmatic and nonprogrammatic endeavors should be reported, ideally in a format that allows for cross-organizational comparisons. This would enable the state to manage human services not just by minimizing cost but by managing value.

Ongoing operating deficits have pushed many providers to the financial limit.

level-funded contracts with repeated annual renewals with few, if any, price increases. In accordance with Operational Service Division guidelines, agencies may renew contracts for up to 11 years. As a result, long periods often elapse with relatively few competitive reprocurements. While an 11-year contract may offer clients and state agencies the benefit of continuity and stability, in recent decades new funding has rarely been available to adjust contract budgets at the time of annual budget negotiations. As the general cost of doing business has increased, state agencies and providers must often modify program staffing and overall program budgets to fit available resources.

Ongoing operating deficits have pushed many providers to the financial limit. Almost half of these providers (45 percent) fail to generate sufficient cash each year to pay for operations. In addition, 60 percent of providers have less than one month of cash on hand at year-end, with one-third having less than 15 days of cash. An organization can survive for several years in this situation by forgoing investments, liquidating assets, or borrowing. But over the long term, the pattern is unsustainable. Unexpected delays in receipt of income can push an organization with limited cash into a crisis situation.

Many providers operate under considerable financial constraints that are exacerbated by limited state funding, translating into low cash balances and inadequate or negative expendable net assets. Some smaller providers may not have access to lines of credit or be able to qualify for mortgages, while a significant percentage of larger providers are heavily leveraged, relying on liabilities rather than net assets to finance their operations. In fact, as figure 5 (on page 26) indicates, almost half of all providers have liabilities that are 50% or more of total assets, while 4 percent have liabilities that exceed total assets (i.e., they are insolvent). Leverage ratios vary significantly with organization size. Organizations under $10 million in total revenues are most likely to be insolvent, while those larger than $10 million are more likely to be highly leveraged.

Certain provider characteristics are associated with better financial health, such as staying in business for a longer period of time and having larger total revenue. Providers that can generate more income from nonprogram sources, such as investments, contributions, and commercial revenue are associated with stronger financial results, since they can augment state surpluses or offset deficits. Not surprisingly, providers that have established adequate cash balances and liquid assets also fare better financially.

Next Steps

Given the vital role that the industry and its workforce play as an economic contributor to the state and as a partner in delivering care to vulnerable citizens, it is in the state's interest to ensure that provider organizations are financially stable and that their workforce is paid a living wage.

The challenges facing Massachusetts and the sector did not develop overnight. They are the result of historic underfunding of providers and the piecemeal, organic evolution of state public policy governing human-service purchasing, reimbursement, and provider performance management.

Endnotes

1. The editors would like to acknowledge the collaboration of EOHHS and DMA in producing this article, which remains the responsibility of *NPQ* editors. In particular, we would like to thank Matt Cornish at EOHHS, Wendy Holt at DMA, and Liz Keating for their input on this article. The DMA research team included Elizabeth Keating, CPA, visiting assistant professor at Boston College; Nancy Kelly, CPA, of Nancy Kelly & Associates; Donald Shepard, Ph.D., Professor at Brandeis University; Wu Zeng, MD, who is completing his doctorate in health-care policy at Brandeis University; Richard Dougherty, Ph.D., of DMA; and Martin Brunswick from ProVentive, Inc. EOHHS would like to acknowledge the work of Annika Grever, POS policy analyst; and Michelle Probert, POS policy analyst in editing the original report as well as the creation of the follow-up report "EOHHS Report to Administration and Finance: Recommendations for Reforming the Purchase of Service System" released in January 2008.

How does your service-provider organization fall on the spectrum of financial health? Let us know at feedback@npqmag.org. Reprints of this article may be ordered from http://store.nonprofitquarterly.org, using code 150204.

It is in the state's interest to ensure that provider organizations are financially stable and that their workforce is paid a living wage.

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Navigating the Path *of* Socially Responsible Investment

by Rick Cohen

The concept of PRIs harkens back to the fertile mind of Benjamin Franklin, who dedicated 2,000 pounds to establish a revolving fund for young artisans.

For many nonprofit organizations with a fund balance, reserve fund, or endowment to invest, the decisions are frequently beyond the knowledge and experience of their executive directors. Most nonprofit leaders run organizations because they know their subject matter fields, not because they're investment whizzes.

But they all know—or ought to know—that it's crucial for nonprofits to consider how they invest their funds and what the options are. The good guidebooks tell nonprofits to earn investment returns and get as much out of every buck as possible instead of letting funds sit idle. Increasingly, they also recommend that nonprofits think about the social purpose of their investments. Why invest in environmentally and socially destructive corporate stock when social-investment funds offer a combination of healthy market returns and contribution to nonprofits' socioeconomic missions?

Although usually thought of as the province of large, endowed nonprofits like universities or foundations, social investment is a tool that every nonprofit can take advantage of by matching its resources with investment possibilities. For quite some time, versions of social investment, such as foundations' "program-related investments" (PRIs), have been in the mix of investment vehicles for some foundations. Since the Tax Reform Act of 1969 allowed PRIs, several foundations have actively made below-market loans and investments, notably the Ford, MacArthur, and David and Lucile Packard foundations, among others.

The concept of PRIs—in which foundations issue debt or equity investments to nonprofit or for-profit entities with a charitable purpose but without the expectation that the investment earns a market-rate return—harkens back to the fertile mind of Benjamin Franklin, who dedicated 2,000 pounds to establish a revolving fund for young artisans,[1] a concept that one might expect to see in the portfolios of major philanthropies today.

By definition and experience, most of foundations' PRIs are predicated on accepting below-market rates of return. According to the *Handbook on Responsible Investment Across Asset Classes*,[2] socially conscious investment need not be structured to earn less than conventional market alternatives. Mission-related investments that achieve market returns constitute another tool to address economic and environmental issues of concern to socially minded institutional and individual investors.

Funded in part by the investment-innovative F.B. Heron Foundation,[3] the new book from the Boston College Center for Corporate Citizenship and the Social Investment Forum lays out a framework for nonprofits large and small to sort through mission-related social-investment options. It is a broader, more robust concept of "responsible investment" than simply making program-related investments. As the *Handbook* notes, the lens is

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Getting the Most out of Organizational Investments

If you think nonprofit finance per se is daunting, putting your nonprofit into the position of being an investor (determining where to place your fund balance, your reserve fund, your endowment if you have one, etc.) or an investment recipient (with a product to pitch to foundations and high–net worth individuals interested in mission-related investments, or MRIs) sometimes feels like walking a circus high-wire without a net.

Let's face it. Plenty of us have a tough enough time just filling out our annual tax forms by April 15, TurboTax notwithstanding. We often find ourselves frozen and bleary-eyed when we sit down with realtors and brokers to buy a home. So don't be down on yourself when the nonprofit discussion moves from debates about cash versus accrual accounting into debates about investing money in social investment funds, community development banks, and local economic development ventures.

Consider it from two perspectives. The first is your nonprofit as an investor. Every nonprofit has resources: short-term resources such as cash, slightly longer-term funds held in perhaps 60-day or 90-day certificates of deposits, maybe other funds that aren't needed so quickly that can be put into longer-term notes or instruments, and perhaps even longer-term investment potentials of reserves or an endowment. Most groups simply invest these resources for maximum returns, but the *Handbook on Responsible Investment Across Asset Classes* tells you that your organization can use its funds for social purposes without sacrificing market-comparable returns.

Use the asset class definitions in the *Handbook* or at www.xigi.net to consider your options, but before you do, ask yourself how investing your resources could contribute to the mission and values of your organization. What are the underlying values and motivations of your nonprofit that could be advanced by investing your funds appropriately? That is a crucial board discussion, the board has to be involved, leading the charge, and buying in.

Then bring in the experts. There are plenty who can help you find products and guide you through the reasonable options, especially if your nonprofit is not a behemoth brimming with fund balances but is simply trying to ensure that all of its funds do good. Conversations with some socially minded bankers might start with the pioneering ShoreBank Corporation (www.shorebankcorp.com/bins/site/templates/splash.asp), the socially responsible investments of Self-Help (www.self-help.org), or the "socially progressive banking" services of Wainwright Bank and Trust Company (https://www.wainwrightbank.com/html/personal/index.html). You can also talk to a socially responsible financial planner or adviser, 222 of whom are listed at the Social Investment Forum Web site (www.socialinvest.org/directory/results.cfm?category=FA). Even if your nonprofit isn't the billion-dollar size of a foundation or university, there are people to call on for advice.

But what if you want to get some of these socially responsible investments? This isn't a fly-by-night game, like mailing out dozens of blind letters of interest to potential funders listed in some foundation directory. Your nonprofit is a candidate for social investment only when it has a business enterprise that warrants equity or loan capital. But be careful. Like most small businesses in general, most nonprofit income-producing ventures fail in short order.

one of "investing in financial products that seek to achieve social and/or environmental goals as well as yield market rate financial returns."

According to the authors, "Foundation and university endowments, pension funds, socially responsible investors including church pension funds and socially responsible mutual funds, high–net worth individuals, nonprofits, and others [can] target investments that create long-term societal wealth while also achieving institutional financial objectives."

Rare is the nonprofit that doesn't diversify its assets. The ingenious approach of the *Handbook* is to offer organizations a schema for examining responsible investment options among various classes of assets that a foundation or other nonprofit might employ. The *Handbook* offers a framework for investments and categorizes them into the following asset classes:

- *Cash and cash equivalents.* The *Handbook* suggests that market-rate returns can be achieved through cash investments in community-oriented banks such as community development finance institutions (CDFIs),[4] community development banks,[5] and community development credit unions (CDCUs).[6]
- *Fixed-income instruments (fixed-return bonds, etc., issued by local governments, corporations, and larger nonprofits).* Investors can target fixed-income investments toward "community development–targeted investments" (for example, asset-backed or mortgage-backed securities for small-business activity or lower-income home purchases), government debt (for example, bonds that would support the creation of "public goods," such as infrastructure improvement or sustainable energy development), and corporate debt (using responsible investment funds such as those offered by Domini Social Investments[7] and Morley Fund Management to invest in corporations that contribute to society and to avoid those that are economically, socially, and environmentally harmful).
- *Public equities (publicly traded stocks of large corporations).* The *Handbook* recommends employing social investment "screens" ("negative screens" to eliminate investments in noxious industries such as arms production, tobacco, alcohol, gambling, etc., and "positive screens" to emphasize and seek investments in companies that contribute to solving environ-

mental and social problems) and pursuing "active ownership" in which investors vote as shareholders and file shareholder resolutions to, for example, promote corporate transparency and accountability.[8]

- *Private equity (investments in unlisted companies such as venture capital investments, "generally only available to institutional investors, venture capitalists, and high-net-worth individuals").* The *Handbook* suggests "product-focused investments" (that is, investment supporting "environmentally and socially beneficial products and services" such as renewable energy or "clean tech") and economically targeted investments to historically underserved communities, such as investments in enterprises owned by women and minorities in lower-income neighborhoods.
- *Real estate.* Investors can look to their real estate portfolio to support affordable and workforce housing, brownfield development,[9] smart-growth projects,[10] and "green construction."[11]

The *Handbook* even takes on more esoteric and specialized asset classes such as investments in hedge funds and commodities to demonstrate how the principles of environmental and social analysis of investment options can be applied to the intersection of nonprofits' missions and goals and satisfy their appetite for market-level financial returns.

Social investment by asset class is no longer unique. A social-capital index offers a somewhat comparable "asset fan"[12] and posts examples of various offerings from nonprofit and for-profit entities. Some of the organizations on the site might seem a little kitschy; for example, one entity pitches a "process tool for any moral agent—individuals and corporations—to use for ethical improvement, coaching and co-creation with self-organizing communities," but plenty of others with social-investment offerings are respected organizations with strong track records of providing social investments, including Enterprise Corporation of the Delta; Affordable Housing Resources in Nashville; BRIDGE Housing Corporation in California; the Housing Assistance Council in Washington, D.C., which works on rural housing nationwide; the community-based Manna in Washington, D.C.; and Mercy Housing's Mercy Loan Fund. All of these nonprofits offer real estate investment opportunities in affordable housing and

Applying a strong analytical lens is crucial to successful responsible investing.

For nonprofits attempting to access charitable endowments these days, it's a different world.

design investment vehicles to capture responsible investment assets. The Rockefeller Foundation has taken this a step further with a large grant to support a "social stock market" for investments in clean technology and other socially and economically desirable products.[13]

However useful the description of asset classes, the *Handbook*'s most important tool is a series of guideposts for each asset class to help investors design an asset–class specific responsible investment strategy. The environmental, social, and governance lenses outlined in the *Handbook* help investors understand how investment options can fit and carry forward their institutional missions. The challenge for investors isn't to select one social fund from Column A and a social enterprise from Column B but to deploy an analytical framework for determining what might constitute responsible investments that fit investors' interests and needs and generate returns comparable to those of the market as measured by accepted market metrics. As the *Handbook* and other valuable recent social investment publications—such as the MRI guide for trustees issued by Rockefeller Philanthropy Advisors[14] makes clear—applying a strong analytical lens is crucial to successful responsible investing.

There is plenty of hyperbole in the social-enterprise field; philanthrocapitalists sometimes revert to a one-size-fits-all notion that nonprofits ought to turn a profit and run like mini-capitalist investment vehicles. Research from the likes of the Ford Foundation's Michael Edwards[15] and analyses by respected organizations such as SEEDCO[16] in New York City should tell nonprofits and investors alike to look before they leap.

But you won't find the outlandish hyperbole in the *Handbook*. It is a technical but accessible tool for guiding nonprofits to understand where they might stand as investors with resources to place and as recipients with investments opportunities to offer. For nonprofits, it may be time to take advantage of the *Handbook*'s advice for institutional investors and add loans and equity to their requests for grants from foundations and others sitting on tax-exempt endowments.[17]

For nonprofits attempting to access charitable endowments these days, it's a different world. In January 2008, at the Davos World Economic Forum, Microsoft Chairman Bill Gates called for a "creative capitalism" that would "stretch the reach of market forces so that more people can make a profit, or gain recognition, for doing work to ease the world's inequities."[18] Not surprisingly, not only did much of the world press take notice, the Gates statement was treated as a serious call to action for Microsoft's corporate brethren and competitors.

The evidence suggests that, proportionally, socially responsible investment growth is outpacing growth in conventional market investments, though the size of the responsible investment share of investment capital is still relatively small. As of 2007, according to the Social Investment Forum, the total volume of professionally managed assets in using some combination of three responsible investment strategies—screening, shareholder advocacy, and community investing—has increased to $2.71 trillion, approximately $1 out of every $9 of professionally managed investment assets. Between 2005 and 2007, that represents an 18 percent growth of socially responsible investment assets, compared with 3 percent growth in all professionally managed investments.[19]

This is not easy stuff, but for nonprofits and investors the *Handbook* is a useful guide for navigating possible responsible investment opportunities and strategies.

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1. Milton Cerny, "Creative Uses of Program Related Investments," International Center for Non-Profit Law, 1999.
2. The Boston College Center for Corporate Citizenship, *Handbook on Responsible Investment Across Asset Classes*, November 2007 (www.primakers.net/files/Handbook_On_Responsible_Investment.pdf).
3. The F.B. Heron Foundation, Mission-Related Investments Web page (www.fbheron.org/mission.html).
4. Information about CDFIs can be found on the Web sites of the Coalition of Community Development Financial Institutions (www.cdfi.org) and the U.S. Department of Treasury's Community Development Financial Institutions Fund (www.cdfifund.gov).
5. The *Handbook* defines community development banks as "typically small- and mid-sized banks . . . focused in low-income urban and suburban markets that larger banks find difficult to serve," citing Liberty

Bank and Trust in New Orleans, Carver Federal Savings Bank in New York City, and the Native American Bancorporation as examples.

6. The National Federation of Community Development Credit Unions provides comprehensive information on CDCUs (www.natfed.org).

7. The Domini Social Investment Fund (www.domini.com) is a winner of *Fast Company*'s "social capitalist" awards.

8. The Interfaith Center on Corporate Responsibility (www.iccr.org) is one of the go-to sources for information on institutional investors' shareholder resolutions. Among the best guides is the publication of Rockefeller Philanthropy Advisors and the As You Sow Foundation, *Unlocking the Power of the Proxy: How Active Foundation Proxy Voting Can Protect Endowments and Boost Philanthropic Missions* (rockpa.org/wp-content/uploads/2007/01/Unlocking%20the%20Power%20of%20Proxy.pdf).

9. The U.S. Department of Housing and Urban Development has long promoted a brownfield economic development initiative (www.hud.gov/offices/cpd/economicdevelopment/programs/bedi/index.cfm), and the Environmental Protection Agency has extensive brownfield information resources (www.epa.gov/brownfields/basic_info.htm).

10. For resources on smart growth, see Smart Growth America (www.smartgrowthamerica.org), the Smart Growth Network (www.smartgrowth.org/Default.asp?res=1280), and the Natural Resources Defense Council (www.nrdc.org/smartgrowth/default.asp).

11. Not surprisingly, there is already a trade association of green developers, the U.S. Green Building Council (www.usgbc.org), and major nonprofit community development intermediaries such as the Local Initiatives Support Corporation (with the LISC Green Development Center, www.smartgrowth.org/library/articles.asp?art=3311) and Enterprise Community Partners (with its Green Communities project, www.greencommunitiesonline.org) have generated models and products for philanthropic and institutional investment.

12. The Xigi Web site (www.xigi.net) shows asset classes such as deposit accounts, certificates of deposit, loan pools and community development bonds, direct domestic lending, direct international lending, community development banks and CDFIs, public equity, private equity, and a strategic grants "asset fan" that goes from conservative (which are generally lower risk and cost) to aggressive (generally higher risk and cost).

13. Jonathan Guthrie, "Rockefeller Backs 'Social' Stock Market," *Financial Times*, March 22, 2008 (www.ft.com/cms/s/9a7da70c-f79f-11dc-ac40-000077b07658,Authorised=false.html?_i_location=http%3A%2F%2Fwww.ft.com%2Fcms%2Fs%2F9a7da70c-f79f-11dc-ac40-000077b07658%2Cs01%3D1.html&_i_referer=http%3A%2F%2Fphilanthropy.com%2Fnews%2F%3Fid%3D4204%26pth%26utm_source%3Dpt%26utm_medium%3Dnewsletter%26utm_content%3Dlefttop).

14. Steve Godeke with Doug Bauer, *Philanthropy's New Passing Gear: Mission Related Investing, a Policy and Implementation Guide for Foundation Trustees* (www.primakers.net/files/MRI_Handbook_for_Trustees_(RPA).pdf).

15. Michael Edwards, *Just Another Emperor: The Myths and Realities of Philanthrocapitalism*, Demos and the Young Foundation, 2008 (www.nonprofitquarterly.org/images/fbfiles/files/Just_Another_Emperor.pdf).

16. Neil Kleiman and Nancy Rosenbaum, *The Limits of Social Enterprise: A Field Study & Case Analysis*, New York: SEEDCO, June 2007 (www.seedco.org/publications/publications/social_enterprise.pdf).

17. As the president of Canada's version of the Council on Foundations noted recently, foundations often sidestep mission-related investment options because nonprofits simply don't ask for anything more than grants (www.socialinvestment.ca/French/documents/HilaryPearsonremarkstoSIOconference.pdf).

18. "A New Approach to Capitalism in the 21st Century: Remarks by Bill Gates," World Economic Forum, 2008 (www.microsoft.com/Presspass/exec/billg/speeches/2008/01-24WEFDavos.mspx).

19. Social Investment Forum, *2007 Report on Socially Responsible Investing Trends in the United States*, Washington, D.C., 2007 (www.socialinvest.org/pdf/SRI_Trends_ExecSummary_2007.pdf).

How has your organization untied the asset allocation knot? Let us know at feedback@npqmag.org. Reprints of this article may be ordered from http://store.nonprofitquarterly.org, using code 150205.

Financial Transactions with Your Board: *Who Is Looking?*

by Francie Ostrower

We have to ask not only whether nonprofit boards have mechanisms in place to avoid malfeasance but also whether they actively serve an organization's mission.

Editors' note: *This article explores an often-overlooked aspect of board behavior whereby boards conduct financial transactions with board members or organizations in which board members have a direct interest. It is largely excerpted from the Urban Institute's report "Nonprofit Governance in the United States: Findings on Performance and Accountability."*[1] *The full report is available at www.urban.org/url.cfm?ID=411479.*

In recent years, policy makers, the media, and the public have increasingly focused on the accountability of nonprofit boards. Legislative reforms have been proposed, nonprofit associations have called on their members to review and strengthen nonprofit governance practices, and the Internal Revenue Service has released "Governance and Related Topics—501(c)(3) Organizations," which includes a series of good-governance recommendations.[2] Accordingly, nonprofits face pressure to become more accountable and transparent to their communities, their constituencies, and the public, which in turn has had a profound impact on nonprofits' internal discussion about appropriate board roles and policies.

It is critical that both proposed policy reforms and best-practice guidelines be informed by solid knowledge about how boards currently operate and which factors promote or hinder their performance. To help ensure the availability of such knowledge, in 2005 the Urban Institute conducted the first-ever national representative study of nonprofit governance. More than 5,100 nonprofit organizations of varied size, type, and location participated in the study, making it the largest sample studied to date. The survey covered an array of topics but focused on practices related to current policy proposals and debates. This focus is in keeping with one of the Urban Institute study's primary goals: to draw attention to the links between public policy and nonprofit governance.

In considering nonprofit governance, we have to ask not only whether nonprofit boards have mechanisms in place to avoid malfeasance but also whether they actively serve an organization's mission. These issues are clearly applicable to the controversial area of financial transactions between nonprofits and the members of their boards of directors, one of the topics covered in the Urban Institute's broader report.

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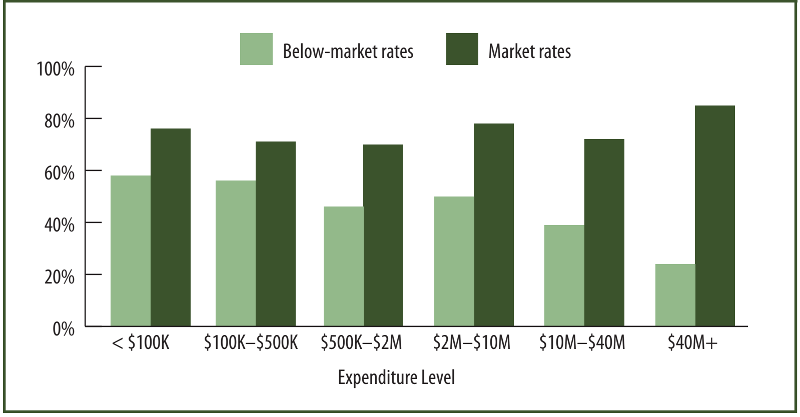
Financial Transactions between Nonprofits and Board Members

Under the law, board members owe a nonprofit a duty of loyalty, which requires them to act in a

Figure 1
Percentage of Organizations Obtaining Goods or Services Below and at Market Rates from Board Members (Organizations involved in Financial Transactions Only)



SOURCE: 2005 Urban Institute *National Survey of Nonprofit Governance*

Nonprofits' purchase of goods and services from board members or their companies raises special concerns about whom such transactions really benefit.

nonprofit's best interest rather than in their own or in anyone else's. The IRS's "Governance and Related Topics" cautions that "in particular, the duty of loyalty requires a director to avoid conflicts of interest that are detrimental to the charity." Against this background, nonprofits' purchase of goods and services from board members or their companies raises special concerns about whom such transactions really benefit. In a guide for board members, one state attorney general's office warns that "caution should be exercised in entering into any business relationship between the organization and a board member, and should be avoided entirely unless the board determines that the transaction is clearly in the charity's best interest."[3]

In 2004 a proposal to restrict nonprofits' ability to engage in these transactions was included in the Senate Finance Committee's draft white paper but met considerable opposition from some nonprofit representatives. The president and CEO of Independent Sector, for instance, warned that prohibiting economic transactions "could be extremely detrimental to a number of charities. . . . Public charities, particularly smaller charities, frequently receive from board members and other disqualified parties goods, services, or the use of property at substantially below market rates." The executive director of the National Council of Nonprofit Associations, which is composed primarily of smaller and midsize nonprofits, voiced a similar objection.[4] There has also been concern about the impact on nonprofits in rural and smaller communities, where a trustee's law firm or bank may be the only one in the area.[5]

But whether public charities should or shouldn't be allowed to engage in financial transactions with board members, there is agreement that such transactions should be transparent to boards and that policies should be in place to ensure that such transactions are in a nonprofit's best interest. The IRS's guidelines are emphatic on this point. They call on boards to "adopt and regularly evaluate a written conflict of interest policy" that, among other things, includes "written procedures for determining whether a relationship, financial interest, or business affiliation results in a conflict of interest" and specifies what is to be done when it does.[6] Further, the IRS has instituted a question on its Form 990 asking nonprofits whether they have a conflict-of-interest policy in place.

Results from the Urban Institute's survey shed light on (1) the scope of such transactions; (2) whether these transactions provide claimed benefits for nonprofits; and (3) how nonprofits' current practices measure up to conflict-of-interest standards from the IRS and others.

Frequency and Consequences of Financial Transactions

According to respondents' self-reports, financial transactions between organizations and board members are extensive, particularly among large nonprofits. Overall, 21 percent of nonprofits reported buying or renting goods, services, or property from a board member or affiliated company during the previous two years. Among nonprofits with more than $10 million in annual expenses, however, the figure climbs to more than 41 percent.[7] But also note that among nonprofits that say they did not engage in transactions with board members or affiliated companies, 75 percent also say they do not require board members to disclose their financial interests in entities doing business with the organization. In effect, respondents may be unaware of transactions that have taken place.

According to respondents, among the 21 percent of nonprofits that engaged in financial transactions with board members or related companies, most obtained goods at market value (74 percent), but a majority (51 percent) report that they obtained goods at below-market rate. Less than 2 percent reported paying above-market cost.[8] Keep in mind too that these are self-reports, so if anything, the figures are likely to underreport transactions resulting in obtaining goods at above-market value or at market value and to over-report transactions resulting in obtaining goods at below-market rate.

Among nonprofits that engaged in financial transactions with board members, small nonprofits were considerably more likely than large ones to obtain goods and services from board members at below-market cost: 58 percent of nonprofits with less than $100,000 in expenses obtained goods or services at below-market rate from a board member, but the percentage drops to a low of 24 percent among nonprofits with more than $40 million in expenses (see figure 1). In contrast, the percentage of nonprofits that received goods or services at market value was more than 70 percent for each size group.[9] The percentage reporting they obtained goods at above-market value was less than 3 percent for each size group.[10]

The study also found no evidence that bans on financial transactions would disproportionately affect rural nonprofits. There was no significant difference between nonprofits inside and outside metropolitan statistical areas either in the percentage engaged in financial transactions or in the perception of how difficult it would be for them were such transactions prohibited.

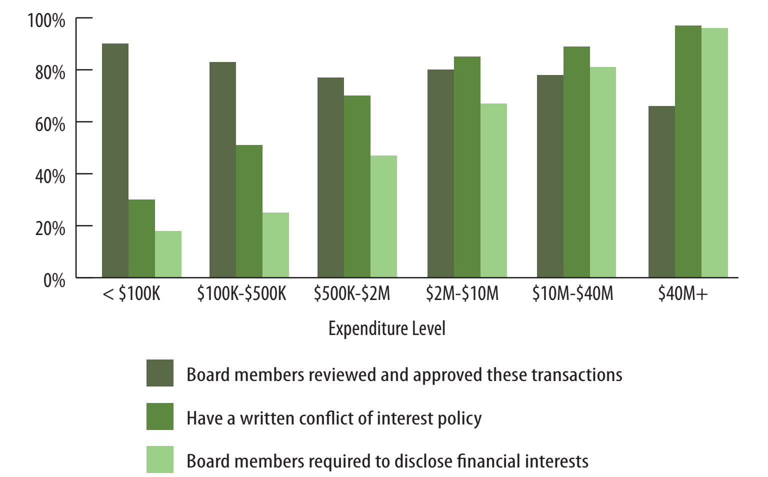
Forty-five percent of nonprofits that engaged in business transactions with trustees said it would be at least somewhat difficult were they prohibited from purchasing or renting goods from board members, but only 17 percent said it would be very difficult. Percentage differences by size were not statistically significant. As one would expect, the comparable figures rise among those who obtained goods or services at below-market rate. Fifty percent said it would be at least somewhat difficult, and 19 percent said it would be very difficult.

Policies to Regulate Financial Transactions and Conflicts of Interest

Among all respondents, only half had a written conflict-of-interest policy, and only 29 percent required disclosure of financial interests. Among nonprofits that reported financial transactions with board members, 60 percent have a conflict-of-interest policy, and 42 percent require board members to disclose the financial interests they have in companies that do business with the nonprofit. As we can see, substantial percentages of nonprofits—including those engaged in financial transactions with board members—do not meet the standards laid out by the IRS and other good-governance guidelines. But the majority of nonprofits engaged in such transactions (82 percent) report that other board members had reviewed and approved the transactions beforehand.

Figure 2

Policies of Organizations that Purchased or Rented Goods or Services from Board Members or Associated Companies



SOURCE: 2005 Urban Institute *National Survey of Nonprofit Governance*

Substantial variations among respondents do exist by size (see figure 2).[11] Larger nonprofits are more likely to have a written conflict-of-interest policy. Among those engaged in financial transactions, almost all nonprofits with more than $40 million in expenses have a written conflict-of-interest policy (97 percent), but the figure decreases to only 30 percent among nonprofits with less than $100,000. Financial disclosure requirements also vary considerably by size. Among nonprofits engaged in financial transactions with board members or associated companies, the percentage that requires disclosure ranges from a low of 18 percent among the smallest nonprofits to a high of 96 percent of nonprofits with more than $40 million in annual expenses. Substantial minorities in the $2-million to $40-million size categories and majorities in all groups of less than $2 million do not require disclosure.

Although formal policies are more common among larger nonprofits, smaller nonprofits are more likely to report that other board members reviewed and approved transactions. Ninety percent of nonprofits with less than $100,000 had other board members review transactions beforehand, but the figure declines to 66 percent among those in the more-than-$40-million category. In

Substantial percentages of nonprofits do not meet the standards laid out by the IRS and other good-governance guidelines.

Our findings show that many nonprofits are engaged in buying or renting goods and services from board members, which sometimes yields savings in terms of below-market rates—but more often, it does not.

the case of smaller nonprofits, one issue is that while board members may review transactions, they often lack written guidelines to inform their review. Among larger nonprofits that have formal policies, significant percentages of nonprofit boards do not review transactions beforehand to ensure that formal policies have been met.

Conclusions and Implications

Our findings demonstrate that substantial variations in boards exist among nonprofits of different type. Given that variation, those proposing policy initiatives and good-governance guidelines to strengthen nonprofits should assess the different impact on various types of nonprofits and weigh them carefully. So, for example, our research supports the argument that prohibiting financial transactions with board members would disproportionately hurt small nonprofits.

Our findings show that many nonprofits are engaged in buying or renting goods and services from board members, which sometimes yields savings in terms of below-market rates—but more often, it does not. Our findings do not tell us whether these practices are in the best interest of a nonprofit, but they strongly confirm that this is an important area in which appropriate policies and procedures need to be in place. Smaller nonprofits that engage in financial transactions need to have more formal mechanisms in place to regulate transactions, and larger organizations need to institute practices more frequently in which board members unrelated to these transactions review transactions for appropriateness. Furthermore, research is needed to examine the content of these policies and procedures and whether they are adequate to ensure that transactions do not undermine board members' duty to act in an organization's best interest and to help inform policy proposals and best-practice guidelines aimed to achieve that goal.

Endnotes

1. Francie Ostrower, "Nonprofit Governance in the United States: Findings on Performance and Accountability from the First National Representative Study," the Urban Institute, June 25, 2007 (www.urban.org/url.cfm?ID=411479).
2. Editors' note: The IRS originally released its recommendations in the draft paper "Good Governance Practices for 501(c)(3) Organizations," (www.irs.gov/charities/article/0,,id=178221,00.html), cited in the original Urban Institute report. The IRS has now replaced the paper on its Web site with "Governance and Related Topics—501(c)(3) Organizations." The new IRS paper offers many of the same governance recommendations (www.irs.gov/pub/irs-tege/governance_practices.pdf)
3. New Mexico Attorney General Web page (www.ago.state.nm.us/divs/cons/charities/nmboardguide.htm).
4. "Comments on Discussion Draft on Reforms to Oversight of Charitable Organizations" (www.independentsector.org/PDFs/roundtable.pdf). See also the statement submitted by Audrey R. Alvarado, executive director of the National Council of Nonprofit Associations, to the Senate Finance Committee, which cautions against the "undue hardship" for small and medium-size nonprofits, July 21, 2004 (www.senate.gov/~finance/Roundtable/Audrey_A.pdf).
5. See, for example, Marion R. Fremont-Smith's comments to the Senate Finance Committee, July 13, 2004 (www.senate.gov/~finance/Roundtable/Marion_F.pdf).
6. www.irs.gov/pub/irs-tege/governance_practices.pdf.
7. By size categories, the percentages are as follows: less than $100,000: 15 percent; $100,000 to $500,000: 18 percent; $500,000 to $2 million: 27 percent; $2 million to $10 million: 34 percent; $10 million to $40 million: 42 percent; and more than $40 million: 45 percent.
8. Percentages exceed 100 because nonprofits could engage in multiple financial transactions with board members so that any organization could report up to three categories.
9. Francie Ostrower, "Nonprofit Governance in the United States: Findings on Performance and Accountability from the First National Representative Study," the Urban Institute, June 25, 2007. Note that percentages obtaining goods at market rates and below-market rates exceed 100 because nonprofits could engage in multiple financial transactions with board members, and therefore any nonprofit could report in both categories.
10. See previous endnote.
11. Francie Ostrower, "Nonprofit Governance in the United States: Findings on Performance and Accountability from the First National Representative Study," the Urban Institute, June 25, 2007.

Does your organization conduct business with board members? How does it work? Let us know at feedback@npqmag.org. Reprints of this article may be ordered from http://store.nonprofitquarterly.org, using code 150206.

The *Slippery Slope* of Employment Practices Liability

by Charles C. Hewitt

Employment policies are complex, may vary from state to state, and leave plenty of room for missteps that could cost you thousands of dollars.

As an employer, you may think you understand the intricacies of employment discrimination policies, but don't be so sure. Employment policies are complex, may vary from state to state, and leave plenty of room for missteps that could cost you thousands of dollars. But you can protect your organization by knowing the rules, making them clear and available to employees, and seeking counsel before you make an irrevocable move, such as terminating an employee.

Consider this situation. One of your employees has been out of work on disability with a workers' compensation injury, and you have gotten solid advice and service from your workers' compensation provider on how to manage this employee while she is out on leave. Ultimately you're advised that the employee has reached maximum medical improvement (in some states, this is known as a *permanent and*

PHOTOGRAPH © EDDI BOEHNKE/ZEFA/CORBIS

There are several examples of seemingly appropriate terminations by 501(c)(3) nonprofits that failed to withstand scrutiny because of timing.

stationary condition) and cannot return to her job because of a permanent disability. With regret, you terminate her because she now receives workers' compensation vocational rehabilitation benefits and your understanding is that workers' compensation is the exclusive legal remedy for employees who suffer workplace injuries.

But not so fast. If an employer has 15 or more employees, it is subject to the Americans with Disabilities Act (ADA) and/or a state disability accommodation law with a different threshold for applicability. In this case, even though you haven't discriminated against an employee based on a work-related injury in violation of workers' compensation law, you have violated ADA by failing to engage in the "interactive process." That is, you have neglected to determine whether there is any reasonable accommodation that would have allowed the employee to return to work (perhaps she could have returned and taken a different job, for example). Failing to engage in the interactive process prior to terminating a disabled employee is a violation of ADA and subjects you to legal liability resulting from the employee's termination.

OK, so maybe you knew about that issue. But what about the other employment law moguls out there just waiting for you? Let's explore some of the common—and not-so-common—employment-related legal concerns for nonprofits, how to guard against mistakes, what it can cost if you err, and how insurance fits into the picture.

Timing Really Is Everything

Culled from the claims files of the Nonprofits' Insurance Alliance of California (NIAC)and, the Alliance of Nonprofits for Insurance, Risk Retention Group (ANI-RRG), both member companies of the Nonprofits Insurance Alliance Group (NIA Group), here are just a few examples of seemingly appropriate terminations by 501(c)(3) nonprofits that failed to withstand scrutiny because of timing.

- A couple of disruptive employees whose paychecks had been withheld because of their failure to complete work on time filed a complaint about not being paid and were then terminated. The organization gets two strikes on this one! First, most states prohibit withholding paychecks just for poor performance. Second, terminating these two employees *after* they complained resulted in valid claims under the state's whistle-blower laws.
- A poorly performing employee complained of sexual harassment. A thorough investigation concluded that no harassment had taken place. The employee was then terminated on performance grounds alone. The problem, however, was that no contemporaneous documentation of the alleged poor performance existed, so it appeared to the state administrative agency that the termination was a result of the harassment allegation because it followed closely behind the report of it.
- A long-term employee of a day-care facility for the elderly, who was a "mandatory reporter" under state law, filed a report with the state about inadequate staffing at the facility when an elderly client was left unattended and wandered into street traffic. The employee was terminated for not following "internal reporting procedures." (In this case, a warning was the appropriate remedy, not immediate termination.)

What's an Employer to Do?

Let's start with the exposures under Employment Practices Liability (EPL) that give rise to liability claims. Both federal—and most state—laws proscribe the most commonly known unfair employment practices of wrongful termination, sexual harassment, discrimination, and ADA violations. Each of these categories, however, includes some lesser-known prohibitions and strict liabilities.

By now most everyone knows that in most jurisdictions you can't terminate someone based on age, race, gender, or sexual preference. But what if a poor-performing employee is the only one working for your nonprofit that's in a protected category? Termination here may have the *appearance* of discrimination sufficient to subject you to administrative or civil exposure.

You know that sexual harassment is illegal and that procedures need to be in place to train supervisory and management personnel about its ins and outs. But what if you're in a state that imposes *strict liability* on an employer, even if the employer didn't know the harassment occurred? Or what if a party external to your organization, such as a delivery person, makes inappropriate comments to your receptionist or, alternatively, claims that one of your employees has harassed him? That can get you into as much trouble as the typical case.

So what to do? Defense of EPL claims starts with your agency having documented procedures in place that you and your counsel can use to demonstrate to an administrative agency or a court that you intended to be—and were—in compliance. This is best accomplished from the beginning with a robust personnel handbook available to employees that includes policy statements and procedures (see "Twelve Components of a Model Personnel Handbook" on page 46).

The Old Ounce of Prevention

The last, and most-overlooked, step in EPL claim prevention is checking with experienced employment counsel *before* taking a significant personnel action. A poorly drafted employment offer letter can lock you in to a lot more than you planned. And even if it's meant to be a "positive" for employees, an improperly announced new personnel policy or procedure can cause similar problems.

More than anything else, however, every EPL defense lawyer's mantra is that you consult counsel before terminating an employee. A lawyer would have obvious questions about clear documentation of performance issues, protected classes of employees, and compliance with your own policies and procedures, but some circumstances might require further inquiry. Suppose a health issue—whether or not it has been disclosed to an organization—is involved. Is an employee entitled to an ADA accommodation? What about Family and Medical Leave Act entitlement or workers' compensation benefits?

The answer is *always* to check with counsel experienced in employment law. Some lawyers are available on a pro bono basis, so check with your local bar association. A number of directors and officers (D&O) and EPL insurance carriers provide this service to their policy holders, although sometimes on a limited basis. So ask if they do. If they don't, ask for a referral. At ANI-RRG and NIAC, we feel so strongly that members get good advice before they take an important employment action that we have two experienced labor law attorneys dedicated solely to providing preventative advice on this subject to our member-insureds.

The New Pound of Flesh

If you haven't heard or read about it, employment practices law is one of the latest and greatest fertile fields for aggressive plaintiff attorneys. It doesn't matter that you are a charitable nonprofit (particularly if you have good insurance limits). Six-figure jury verdicts have become more frequent, particularly in metropolitan areas where the majority of the nonprofit sector does its work. Need further evidence? Consider this data gathered from 10 recent years of our closed claim files:

- One out of every 100 nonprofits (regardless of size) will have an EPL claim this year.
- Of all claims against directors' and officers' policies, 95 percent are in the EPL category.
- The average cost to defend a party when a claim has some merit is $29,000, and the average loss on those claims is $44,000; the combined average is $73,000.
- Of EPL claims, 40 percent have some merit. When they are deemed to have merit, one in 10 will cost more than $100,000.
- When claims do not have merit, the average cost to defend is only $5,000, thanks to early intervention by experienced employment defense counsel.
- The two largest claims cost $1 million and $400,000, respectively.

Did You Say Something about Insurance?

Unless you have tens or even hundreds of thousands of dollars just sitting around, you should think about how your organization can protect itself from claims of employment discrimination. And you need to consider another issue.

When EPL claims first came into vogue years ago, the insurance industry's knee-jerk reaction was to find a way to exclude the exposure. Smarter heads prevailed, fortunately, so that today EPL coverage is readily available. But like many things, it comes in different shapes and sizes, and not always where you might expect.

Let's talk first about EPL as standalone coverage. It's available and commonly protects the nonprofit from damages claimed as a result of some adverse employment actions. The defense component provides for payment of attorney fees and costs, and the indemnification component provides for payment of actual damages, if there are any. As discussed below, there are exclusions.

It is more common, however, to find EPL

Unless you have tens or even hundreds of thousands of dollars just sitting around, you should think about how your organization can protect itself from claims of employment discrimination.

Always ensure that employees sign a written acknowledgment that they have read and understand your workplace-related policies, or you might as well not have created them in the first place.

Twelve Components of a Model Personnel Handbook

The following are 12 areas that all personnel handbooks should include regarding an organization's policies:

- Introductory statements
- Nondiscrimination and sexual harassment
- Organization and structure
- Training and orientation
- Employee classifications and categories
- Employment policies, including wage and hour regulations
- Benefits disclaimer
- Leaves of absence and time off
- Standards of performance
- Workplace violence prevention and safety
- Search and inspection
- Drug-free workplace

At a minimum, the handbook should include statements regarding at-will employment, introductory or benefit waiting periods, and examples of disciplinary offenses (always prefaced with "including, but not limited to" language). Always ensure that employees sign a written acknowledgment that they have read and understand your workplace-related policies, or you might as well not have created them in the first place.

Next comes training and adherence. Regardless of size, every nonprofit needs to train its management personnel about the employment laws relevant to its jurisdiction and the policies and procedures the agency has adopted. Include any state mandates, such as sexual harassment training, for supervisory personnel. Then, walk the talk! Follow those policies and procedures diligently every day. It's also crucial to include your board members in the training. Because these board members are ultimately responsible for the agency's overall management, they are at risk just as much as executive directors.

coverage as part of nonprofit D&O liability insurance. The components are generally the same as described above. Key issues to consider are detailed below, but beware some tricky provisions, such as one that requires your consent before the carrier settles a claim but makes you responsible for *all* the ongoing legal expenses if you don't accept the carrier's recommendation.

Typical exclusions include fines, penalties, and sanctions (these are uninsurable risks), back wages, multiplied damages, and plaintiff's attorney's fees. Wage and hour claims are a major area of uncovered liability for nonprofits. Properly classifying an employee as exempt from the overtime requirements of the Fair Standards Labor Act (or similar state laws) can be tricky business and sometimes requires extrasensory powers of hindsight. To be properly classified as exempt, an employee must make a threshold salary as defined by federal and state law and pass the duties test of the professional, executive, or administrative exemptions. While most insurance policies do not cover payment of back wages and penalties, a few at least provide some defense costs to cover wage and hour claims.

So what are the key EPL components of a good D&O policy? At a minimum, expect the following elements to be included:

- **Adequate policy limits**. An amount of $1 million is generally adequate for small and medium-size nonprofits. Larger agencies should consider higher limits or an umbrella policy.
- **A broad definition of who is an insured**. The policy should outline not only whether the nonprofit agency is insured but also whether the following parties are insured:
  - Directors and officers
  - Prior directors and officers
  - Committee members
  - Employees and volunteers (volunteers don't have all the federal or state immunities that you might expect)
- **Broad coverage for employment practices liability.** This protection should be included either by endorsement or embedded in the D&O policy itself.
- **Duty to defend.** Does the scope of duty to defend extend to administrative proceedings (where most EPL claims start) or just to suits in civil courts?

- **Advancing of defense costs.** The carrier should pay for defense costs as incurred, not after the nonprofit has paid for them and is seeking reimbursement.

Anything Else?

Before you have occasion to use it, make sure that you understand your policy. Be sure, for example, that you understand *when* you need to report facts that may result in employment practices liability. You may decide, for example, not to report to the insurer an employee grievance filed with your human resources department pertaining to the employee's termination, perhaps believing that no legal claim would develop from it. Unbeknownst to you, however, your policy may require you to report potential claims, including grievances filed with your HR department. By the time the terminated employee files a legal complaint with the district court, the reporting period may have passed and your insurer may in turn deny coverage.

Don't be disappointed if your insurance carrier insists on using defense counsel of its own choosing. It has the right to do so and may have accrued a panel of attorneys experienced in employment law and who understand the nonprofit sector better than most.

While not directly EPL related, make sure your D&O policy also protects you from fiduciary liability claims, such as failure to properly account for grant funds.

If you are unsure about the nature and extent of your EPL coverage, consult your insurance agent or broker. These professionals are usually paid commissions when they place your coverage, and providing appropriate advice is part of what they are paid for—and a service you have a right to expect.

Charles Hewitt is the vice president of claims for the Nonprofits Insurance Alliance Group and has more than 40 years of experience in claims management.

Has your organization faced employment-related claims, and how were they handled? What advice would you give to other *NPQ* readers? Let us know at feedback@npqmag.org. Reprints of this article may be ordered from http://store.nonprofitquarterly.org, using code 150208.

If you are unsure about the nature and extent of your EPL coverage, consult your insurance agent or broker.

The *Nonprofit Quarterly* Insurance and Risk Management Service Providers Directory 2008

The following directory lists insurance and risk management companies. The information was either sent by the service provider or taken from their Web site.

Armfield, Harrison & Thomas Inc.
20 South King St., Leesburg, VA 20175; (703) 737-2212, www.ahtins.com

AH&T makes insurance a comfortable process. Since 1921 the company has been going above and beyond expectations to help clients feel confident and in control of their insurance and risk management programs. We offer the product and services breadth of a national mega brokerage with the detail-oriented, caring, one-on-one attention of a regional brokerage.

Arthur J. Gallagher & Co.
Two Pierce Pl., Itasca, IL 60143-3141; (888) 285-5106, www.ajg.com

The world's fourth-largest insurance brokerage and risks management services firm, AJG—an international service provider—plans, designs, and administers a full array of customized, cost-effective property/casualty insurance and risk management programs. The company also furnishes a broad range of risk management services—including claims and information management, risk control consulting and appraisals—to help corporations and institutions reduce their cost of risk. In addition, the company assists clients in all areas of their employee health/welfare and retirement plans, including plan design, funding and administration.

B. F. Saul Insurance
7501 Wisconsin Ave. Ste. 1500, Bethesda, MD 20814-6522; (301) 986-6007, www.bfsaulinsuance.com

B. F. Saul Insurance has been serving clients in the Washington metropolitan area and throughout the country since 1892. As an independent broker, our primary responsibility is to represent the interests of our clients. Our success is a result of a commitment to personal service, exacting professional standards and a superior knowledge of the marketplace. As a privately held firm, we respect our client's desire for confidential service.

Chapman & Associates
265 N. San Gabriel Blvd., Pasadena, CA 91107-3423; (800) 288-3095, www.chapmanins.com

Founded in 1973, Chapman & Associates is the largest insurance broker in California providing insurance and risk management services exclusively to nonprofit organizations. Exceptional customer service and exclusive Workers' Compensation, Liability and Employee Benefit programs have led over 1,800 social service agencies to choose Chapman. In addition, the C&A Foundation has provided grants in excess of $4 million to these clients since 2000.

CharityFirst
One Market, Spear Tower, Ste. 200, San Francisco, CA 94105; (800) 352-2761, www.charityfirst.com

Charity First has grown into a national network of underwriting offices that insure over 7,000 nonprofit organizations throughout the U.S. Combine this experience with our sole focus on the nonprofit community and it's easy to see why we've become the nonprofit insurance experts.

David Szerlip & Associates
391 Springfield Ave., Berkeley Heights, NJ 07922-1174; (800) 508-3808, davidszerlip.com

Licensed in 30 states, David Szerlip & Associates is a specialty insurance agency, specializing exclusively in property and casualty insurance for nonprofits. We serve a wide range of nonprofit clients, from large international associations to small start-ups.

First Nonprofit Mutual Insurance Co.
111 N Canal St. Ste. 801, Chicago, IL 60606-7204; (800) 526-4352, ww.firstnonprofit.com

At First Nonprofit Insurance Company, we understand that nonprofit organizations are increasingly asked to do more with fewer resources. By offering quality, affordable insurance protection and an array of cost-cutting services, First Nonprofit Insurance helps you protect your organization, your clients, your employees and your volunteers.

Great American Insurance Group
49 E. Fourth St., Dixie Terminal South Building, Ste. 400, Cincinnati, OH 45202-3803; (513) 287-8275, www.greatamericaninsurance.com

Our vision is to deliver financial solutions that fulfill today's needs and tomorrow's dreams—to be a trusted partner delivering long-term value to our customers, employees and investors.

Heffernan Insurance Brokers
12012 S. Shore Blvd., Wellington, FL 33414-6205; (888) 281-6527, www.heffgroup.com

Heffernan Insurance Brokers, formed in 1988, is one of the largest full service insurance brokerage firms in California. The firm provides comprehensive insurance and financial services products to a wide range of business and individuals. Heffernan is headquartered in Walnut Creek, California with additional offices in San Francisco, Petaluma, Palo Alto, Los Angeles, Orange, California; Portland, Oregon; Plantation, Florida and West Palm Beach, Florida.

Irwin Siegel Agency Inc.
PO Box 309, 25 Lake Louise Marie Rd., Rock Hill, NY 12775-0309; (800) 622-8272, www.siegelagency.com

Irwin Siegel Agency, Inc. (ISA) is a leading provider of insurance and risk management services within the Human Services Field. Through over 35 years of experience in the Human Services Field, ISA has the industry knowledge and expertise necessary to provide comprehensive insurance and risk management solutions to provider agencies. Areas include developmental disabilities, community/social services, addiction treatment and behaviorial healthcare.

Markel Insurance Company
4600 Cox Rd., Glen Allen, VA 23060 Phone: 800-416-4364; (804) 965-1724, www.markelinsurance.com

Markel Insurance Company develops and underwrites specialty insurance products and programs for a variety of niche markets, including: children's camps, Boys & Girls clubs, scouts, YMCAs, child care centers, historic homes, human services and nonprofits, museums and private libraries.

National Insurance Professionals Corp.
PO Box 834, Poulsbo, WA 98370-0834; (360) 697-3611, www.nipc.com

A Division of Risk Placement Services, NIPC provides retail and wholesale insurance brokers access to specialty insurance carriers with which they are not contracted directly.

Nonprofits Insurance Alliance Group
PO Box 8507, Santa Cruz, CA 95061-8507; www.insurancefornonprofits.org

A Head for Insurance . . . A Heart for Nonprofits. As 501(c)(3) nonprofits ourselves, we exist solely to provide a stable source of liability insurance to other 501(c)(3) nonprofits. Currently insuring more than 7,500 nonprofits, we provide liability insurance tailored exclusively for 501(c)(3) nonprofits in 21 states and DC. Broad coverage, competitive pricing with free, effective loss control and risk management tools. For further information, Californian nonprofits should refer to NIAC (www.niac.org); others states, Alliance for Nonprofit Insurance, Risk Retention Group (www.ani-rrg.org).

Philadelphia Insurance Companies
One Bala Plaza, Ste. 100, Bala Cynwyd, PA 19004-0950; (800) 873-4552, www.phly.com

Philadelphia Insurance Companies adds value to the risk management process. We offer comprehensive policy forms, custom designed for non-profit organizations' unique exposures. Additionally, our expertise in loss control and claims helps you to maintain lower loss ratios. And, in a market like this, that's what counts! We offer A.M. Best A+ rated security, coupled with exceptional service through our national network of strategically positioned offices.

Public Entity Risk Institute [PERI]
11350 Random Hills Rd., Fairfax, VA 22030-6044; (704) 366-7655, www.riskinstitute.org

Serving as a resource to enhance the practice of risk management throughout organizations and communities, the PERI provides relevant and high quality enterprise risk management information, training, data, and data analysis.

Riverport Insurance Company
PO Box 948, Minneapolis, MN 55440-0948; www.riverportinsurance.com

Serving human service organizations for more than 15 years, Riverport Insurance Company offers exceptional property and liability coverages to nonprofit and for-profit human service organizations.

Unum Provident
Unum is a company of people serving people. As one of the world's leading employee benefits providers, Unum helps protect more than 25 million working people and their families in the event of illness or injury. See www.unum.com.

Corrections to this directory should be sent to info@npqmag.org.

The Shifting Tides of Nonprofit Governance: An Interview with Paul Light

by the editors

The *Nonprofit Quarterly* recently interviewed Paul Light regarding reform of board governance. An expert on nonprofits, Light is a frequent contributor to *NPQ* and has written articles such as "The Spiral of Sustainable Excellence" (*NPQ*, winter 2005 issue).

Nonprofit Quarterly: *You've written about "tides of reform," or philosophies of reform regarding nonprofit board governance. How would you characterize those competing philosophies, and where, if pursued to their logical ends, would they take us in the debate on accountability and board governance?*

Paul Light: The notion of tides of reform is that there can be general agreement about the need for reform but very deep differences about what to do. The tides are clearly coming in on governance reform.

The Internal Revenue Service [IRS] comes out of the scientific management movement and sees this as a compliance issue with a strict set of rules and has an inflexible "We know best attitude." The IRS might not be able to govern itself particularly well, but it loves to govern others. So it's getting into the nonprofit management business, which is way outside its skill set. For those who are interested, the IRS has been on the Government Accountability Office's short list of troubled programs and agencies for more than a decade. Its tax administration systems were put on the list in 1990 even before the list formally existed and its internal modernization effort was listed in 1995. Let's get those issues resolved before the IRS goes any further with its standards movement.

Many nonprofits come out of the liberation management movement, with its emphasis on outcomes and innovation. They argue that a board should be improved as a tool of better performance and that having an engaged board paying attention is important for effectiveness. It is less a requirement and more an enhancement, more a sign of good practice. They're certainly going to comply with the rules, but they're more concerned with what happens inside the board rather than just complying with the rules. They don't want their boards to harangue the organization and set themselves up as an agent of the Internal Revenue Service.

Then you have the war-on-waste perspective: organizations like Charity Navigator that have a specific set of standards that all boards should follow to increase efficiency. They believe that nonprofits waste a great deal of money—and the public generally agrees—but if you have a good board, you'll have efficiency. Their goal is better governance as a way of producing savings. It's almost as if the board must become a little version of the offices of the inspector general that police the federal government—ferreting out fraud, waste, and abuse while remaining distant from the actual program design and delivery.

Finally, there's a fourth philosophy grounded in transparency. Advocates of this relatively recent push want to see more of what the organization does. They're out of the war-on-waste tradition in some ways—transparency creates deterrence—but are more focused on making information available for donors, watchdogs, and citizens to inspect. They're not motivated by the desire to free the organization from needless harassment but are more interested in making the organization visible.

Each of these tides can hook up with the others, but the primary motivations of each differ greatly.

NPQ: *The board-governance debate seems to be never-ending, an interminable conversation that is repeated in nearly every gathering. Is there a light at the end of the tunnel? Is there a bright-line answer that liberates us from the conversation and makes progress toward accountable board governance?*

Light: When you look at management reform, regardless of the sector, there's really nothing new under the sun. You never see something that makes you say, "This is totally new." The reality is, of course, we've been having these conversations from these different perspectives—when you get the IRS there, the Independent Sector there, the Maryland Association of Nonprofit Organizations with its "standards of excellence," the consultants who are working to help organizations improve, the social-enterprise people—they all seem to be talking about the same issue, but they are representing very different philosophies. We have to talk about what good governance produces. The social-enterprise people say, "You need good governance, but don't suppress change and innovation. Don't micromanage," whereas the IRS would say, "Here are the strict rules, and we don't think of differences among the types of organizations."

What's remarkable to me is the amount of time that we spend talking about improving board governance without talking about the very deep differences in what the *good* in *good governance* actually means. The key is to be aware of the different views regarding board governance. This is the sector of niceness; we chat about board governance and don't fight about it.

One way to improve the dialogue is to make the disagreements more visible. The competing philosophies of governance have to be made evident. My general view is in favor of liberation management, where the board role is to improve the performance of the organization, which might involve more board contact with the community. I'd like to see a little more anger in the conferences.

NPQ: *That brings us to the issue of how a nonprofit deals with the community in terms of governance. When the sector addresses board governance roles in terms of nonprofit accountability, there is a gap between a board's role and stewardship of a nonprofit organization as an entity and a board's role in representing and protecting the public or publics that are served by the nonprofit. How does a board reconcile these roles in its efforts to ensure nonprofit accountability?*

Light: I don't think it's necessarily a conflict if you're talking about transparency or having stakeholders sitting on the board, which would represent the community. But that rarely happens. This would engender more flexibility than what you would have in the scientific management approach, which says that there is one best way of doing things. There are different connections to the community you can have, bringing liberation management to the question of the role of the community.

A board that deals solely with its own needs and not with the community is not of much value to the organization. There are certainly absolutes: I think you should have an independent audit committee, an independent fundraising or revenue committee, the board should meet regularly, and it ought to have stakeholders and include people you serve. That keeps the board in touch with reality. It should have some sort of opportunity for an organization and its staff and its clients to make contact with the board without interference from the organization. In terms of connecting to the community, there should be an opportunity for community whistle-blowing.

Rather than having the constituents always go to the media, it might be good for the board to communicate that it's responsible, that you as a citizen can contact the board directly. I've seen a couple of good examples, such as Advocating Change Together, a Minneapolis, Minnesota–based organization that lobbies for the developmentally disabled. Everyone on the board is a developmentally disabled adult. What the organization is saying is, "We're advocating for the developmentally disabled, and the developmentally disabled can speak for themselves."

There's nothing frightening about reserving space on a board for community members and clients. Housing organizations building affordable-housing and antipoverty organizations do this.

On foundations, it would be wonderful if boards reserved a space or two for their grantees, but that will happen when we're both about 3,000 years old. How do you keep the foundation board honest? How do you keep yourself honest with the community? It's a big issue, but foundations ought to embrace it as well.

The boards I've come to admire are the ones that actively seek information among the people they serve. The problem is that foundations are insulated from their communities because their own grantees have a natural interest in telling the foundation what it wants to hear. It would be much better to survey the wider pool of grantees that thought about applying but never did. It's a self-selection problem. You talk to the people who love you for your money.

In a sense, many foundations are like the federal government. When the federal government surveys its customers, it uses a narrow definition of people who have benefited from its programs. They're the winners, they got grants; what do you expect them to say? When you survey only grantees, you're saying you want to hear only the good news. To be honest with itself, a foundation should also ask the nongrantees, the losers, the people who self-selected out of the pool because they think the foundation is on the wrong path.

NPQ: *The most prominent actor on Capitol Hill advocating attention to nonprofit governance and accountability issues—the chief minority tax counsel for the Senate Finance Committee—has announced his departure and will take a position in the private sector. With that departure—and with the change in congressional leadership after the last electoral cycle—what are the future prospects for national attention to nonprofit governance and accountability issues?*

Light: It switches to the House of Representatives. Congressman [Henry] Waxman [of California] will stay on this issue. He's not going to give it up. Like the recent hearings on veterans' groups, this is going to continue. Waxman has a strong history of war-on-waste thinking. He's going to stay right there and will push the IRS and others to be more aggressive.

NPQ: *What do you think about the notion of different "classes" of board members: that is, that some board members should be "governing" board members, while others sit on a board for their stature, prestige, and fundraising abilities?*

Light: I really don't understand it as well as I should. I'm not wild about two-tiered anything. You've got to decide what your board is really about. If you want to create a separate advisory board of bigwigs, that's fine, but the governing board has to be engaged and not consider this a frivolous pay-and-play activity. You have to make that choice. If you want a fundraising board, how are you going to meet the transparency and engagement responsibilities of the board?

Fundraising is best done by facing the organization into the environment and asking people to contribute.

I think fundraising is best done by facing the organization into the environment and asking people to contribute. There are lots of pay-and-play boards with dozens and dozens of members, and they're pretty useless. The quality of the board should be based on its expertise and readiness to engage, not on its pockets. People with a lot of money can be just as engaged as those with modest incomes. The goal should be engagement. I just don't believe you should cut the board into two pieces. I'm pretty much convinced that the maximum board size should be 20, but I would argue against myself if that were made into a one-size-fits-all rule.

NPQ: *Many nonprofits have regular financial transactions with board members—purchasing goods, services, or property from board members—and many nonprofits routinely forgo asking board members to disclose their financial interests in entities that potentially do business with their nonprofits. Conflicts of interest and self-inurement seem to be at the heart of many nonprofit scandals, but the sector is also reluctant to draw a bright line. Where do you come down on the issue of financial transactions with board members?*

Light: I think it's a terrible idea. If board members want to do business with an organization, they should get off the board. I don't see any possible cure for that kind of conflict of interest aside from leaving the board. It's an unsustainable board. The appearance alone of conflict of interest between a board member and the organization is a great risk to an organization's survival. "If you want to do business, fine. But get off my board."

Every once in a while, the conflict pops up in the papers and becomes yet another notch against the sector as a whole. It's a terrible appearance problem. I don't mean to say that everyone who does business with a nonprofit from a board position is corrupt. Maybe they're offering a low-cost service, but still they're doing business with a business that they oversee. There's a conflict in appearance and potentially a conflict in reality. A nonprofit may have been doing it for years, but it needs to accept the fact that the public doesn't like it and the media is watching. Practices that might have been easy 20 years ago aren't tolerated today.

NPQ: *This publication's continuing interest in board governance and nonprofit accountability has always been mixed with an equally significant commitment to the role of the nonprofit* *sector in supporting and promoting democracy in our nation, reflected hopefully by an inclusion of democratic values and practice within the nonprofit sector itself. In the context of board governance and nonprofit accountability, how would you ideally balance board governance and accountability obligations with notions of nonprofits' connections to democracy and questions of democracy within the nonprofit sector itself?*

Light: The only thing that comes to mind is that boards ought to be leaders rather than resisters when it comes to advocacy. The sector needs to have a strong voice in protecting itself from cutbacks and mindless rules, and the board should be mindful of that.

NPQ: *With the unending debate over nonprofit governance, we would presume that there must have been some governance prescriptions offered in all seriousness and sincerity that struck you as utterly silly and ridiculous. Based on what you've heard from advocates lodged in the competing tides of reform, what is the most ludicrous governance prescription you've encountered?*

Light: I've always hated the four-meetings-a-year rule. Why four and not six? Why not one or two? Frankly, if you have a really bad board, I say don't meet at all. Send them a bagel and cream cheese and pretend that you had a meeting. The key is to get a good board, talk to each recruit about your basic philosophy of governance, and put them to work. But it's nonsense to demand frequent meetings with a poorly developed board.

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What governance model does your board use, and does it work well? Let us know at feedback@npqmag.org. Reprints of this article may be ordered from http://store.nonprofitquarterly.org, using code 150209.

Mission Haiku: The Poetry of Mission Statements

by Christopher Finney

Whether you are a grassroots start-up or a generations-old foundation, your mission statement deserves your attention. Mission statements are the cornerstone of both external communication and internal vision. And because mission statements represent the reduction of a complex vision into a few carefully chosen words, they are similar to Japanese haiku, poems that capture concrete images with metaphysical implications in just 17 syllables.

Why Focus on Mission Statements?

Your organization's mission statement deserves to be elegant, precise, and even poetic because these words embody the reason your nonprofit exists. When sailing stormy boardroom seas, a mission statement is your North Star; when discussion gets contentious, you can turn to the mission statement for clarity. And these few words will guide future generations of organizational leaders. A strong mission statement also helps to communicate the core of our work in just a few lines to those external to an organization. But to serve these purposes, mission statements must be carefully crafted. History has seen few more exacting wordsmiths than the great haiku poets, and nonprofits can learn much from them.

Using the Principles of Haiku

Poetry is reductionism at its most powerful, cutting away everything from an image except the content of a few words, but leaving its complexity intact. Haiku, which consists of only three short lines, exemplifies this reductionism. Consider the following haiku by Matsuo Basho, one of the form's preeminent authors, and translated by former U.S. poet laureate Robert Hass.[1]

The old pond—	*furuike ya*
a frog jumps in,	*kawazu tobikomu*
sound of water	*mizu no oto*

With remarkable precision (the original Japanese poem includes only seven words), Basho establishes not only a concrete image but also a sense of our fleeting impact before the immensity of the universe. Without diving too deeply into the pond of literary interpretation, we can see that Basho uses his 17 syllables fully, presenting multiple meanings. In fact, in 1765 the Buddhist priest Moran wrote that this poem "is indescribably mysterious, emancipated, profound and delicate. One can understand it only with years of experience."[2]

Basho's haiku is an excellent example of the multiple levels on which we must employ language to communicate effectively. On the surface, words have denotations; this haiku is about a particular frog that jumps into a particular pond. Poet Chijitsuan Tosai wrote that Basho's haiku "describes a scene exactly as the poet saw it. Not a single syllable is contrived."[3] Your organization's mission statement must be similarly concrete. The first test of a poetic mission statement is whether it conveys the honest, uncontrived truth of an organization's purpose.

On another level, every word has connotations, or suggested meanings. Basho's frog has often been read as evocative of the ephemeral nature of human life. Similarly, every word in your mission statement carries connotations, and those connotations must be carefully managed in order to communicate everything you want (and nothing you don't). Basho's frog evokes solitude and a brief moment in the long course of time; what does your mission statement evoke?

ILLUSTRATION © MICHAEL FINNEY

Creating Mission Statements

On a concrete level, how can we apply the craftsmanship of poetry to mission statements? Think carefully about each word of your mission statement, about the range of denotations and connotations it carries, and about its effect on readers. As you write or revise, consider your mission statement as a poem, where every word is at a premium and every syllable holds meaning. Interpreting an existing mission statement as a poem can provide meaningful insight into your organization's purpose and approach. The Nature Conservancy's mission statement is a good example:

"The mission of The Nature Conservancy is to preserve the plants, animals and natural communities that represent the diversity of life on Earth by protecting the lands and waters they need to survive."

First, the word *preserve* is powerfully precise; *preservation* (as opposed to *conservation*) refers specifically to maintaining natural lands intact, the Nature Conservancy's main mode of action. Second, the Nature Conservancy works to preserve *communities that represent the diversity of life on Earth.* This is an important phrase. Ecological communities consist of all the species that interact in a particular place and time, and communities, not species, are the basic unit of a functional ecosystem. Larger and more complex than individual species but still small enough to be readily preserved, communities are the ideal unit of science-based environmental protection. These communities are said to represent the diversity of life on Earth, because the Nature Conservancy works at a global scale, preserving representative places from diverse ecosystems. Further, life and diversity evoke powerful ethical concepts that are almost universally accepted. Finally, the Nature Conservacy addresses the lands and waters these communities need to survive, underscoring the importance of land preservation, the organization's main program. The Nature Conservancy's mission statement is powerful because its precise language distills the essence of the organization's wide-ranging work and vision into a few key phrases. In doing so, the mission statement provides a banner for environmental protection rooted in science and ethics. If it is well crafted and applied, your organization's mission statement can provide a similar rallying point.

How to Start

As you use haiku to develop the language of your mission statement or use another organization's as a sample, have fun with the process. The mission of the American Library Association (ALA), for example, is as follows:

"The mission of the American Library Association is to provide leadership for the development, promotion, and improvement of library and information services and the profession of librarianship in order to enhance learning and ensure access to information for all."

Two possible haiku to capture this mission statement are the following:

Ensure access to
Information and
Library services

Develop, promote
Improve library service
To enhance learning

The first haiku focuses more strongly on the inclusive nature of quality library services, one result of the ALA's work. The second haiku stresses the ALA's direct work on improving librarianship. Neither poem alone includes the full extent of the American Library Association's mission, but each captures a different understanding of its essence.

Conclusion

If you are writing or rewriting your organization's mission statement, approach the process as if you were composing a purposeful poem, keeping each word's denotations and connotations in mind. If you are reading an existing mission statement, you may recognize imprecise language, and a revision might be in order. The process can even provide an opportunity to engage in a meaningful discussion of your mission. Even if your mission statement is already worded as you want it to read, examine the wording carefully, it will probably conjure the spirit of your organization more clearly than a decade of year-end reports.

Finally, once you have crafted your mission statement and understand it fully, give it life. Make sure everyone involved with your organization knows the mission statement by heart and can use it to describe your work and vision. Sometimes we have only a few seconds to capture the attention of a potential ally, and a poetic mission statement may be the exact vehicle necessary to capture your audience.

Endnotes

1. Robert Hass, *The Essential Haiku: Versions of Basho, Buson, and Issa.* Hopewell: Ecco Press, 1994.
2. Makato Ueda, *Basho and his Interpreters: Selected Hokku with Commentary*. Stanford: Stanford University Press, 1991.
3. Ibid.

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Send us your favorite haiku at feedback@npqmag.org. Reprints of this article may be ordered from http://store.nonprofitquarterly.org, using code 150210.

In response to an online version of Chris Finney's article published earlier this year, readers of the *NPQ e-Newsletter* responded enthusiastically with haiku and other poetic mission statements of their own. Here are their responses:

To make whole again
humanity shattered by
torture; to end it.

—Ali Ghavari
Center for Victims of Torture
Minneapolis, Minnesota

Financial guidance
For visionary leaders
Realize your goals

—Ashley Schweitzer
Nonprofits Assistance Fund
Minneapolis, Minnesota

Jungle discovery
tree frog cures hypertension
compassion profits

—Bradford Kirkman-Liff
School of Health Management and Policy
WP Carrey School of Business, Tempe, Arizona

Do good
Support liberty,
justice
for all

—Steven E. Mayer
JustPhilanthropy.org
Minneapolis, Minnesota

Women and families
Rebuilding, loving, learning
In our safe refuge

—Leslie R. Foster
The Gathering Place: A Refuge
for Rebuilding Lives
Boulder, Colorado

The best medicine
is prevention of illness
Immunizations!

—Lydia McCoy
Colorado Children's Immunization Coalition
Aurora, Colorado

Women on the streets
with so little of their own
Safe at Delores

—Terrell Curtis
The Delores Project
Denver, Colorado

Paint, ink and brushes
Come alive and friendship blooms
I can recover.

—Nancy A. Harris
Colorado Arts of Recovery
Denver, Colorado

Business benefits
Environment benefits
Waste becomes resource

—Jenna Kunde
WasteCap Wisconsin, Inc.
Milwaukee, Wisconsin

Discovery of maritime life
All generations
Educate!

—Pete Helsell
Northwest Maritime Center /
Wooden Boat Foundation
Port Townsend, Washington

Communication,
Building your capacity,
Collaboration.

—Patrick J. Rogers
Institute for Human Services, Inc.
Bath, New York

Trembling in my hand
The smallest monkey on Earth
Exhales his last breath

—Lucy Lerner Wormser
Pacific Primate Sanctuary
Haiku, Maui, Hawaii

Feeling good,
doing better,
finding solutions

—Mitch Bruski
Kenneth Young Center
Elk Grove Village, Illinois

Each fatherless boy
Who needs a mentor
Shall have one

—Richard Aston
Big Buddy
Waitakere City, New Zealand

Election 2008: More Organizations Engaging More Voters

by Bridgette Rongitsch

Like many nonprofits, the Minneapolis Highrise Representative Council (MHRC), found its on-site social services on the chopping block in late 2003. A small, grassroots tenant organization, MHRC represents more than 5,000 low-income, elderly, and disabled residents living in 40 public high-rise buildings throughout Minneapolis. City budget cuts were on the table that would severely undermine MHRC's tenant-led programs, which included a diversity initiative, a tenant crime-watch program, and a resident management program of on-site laundry facilities.

While civic and voter engagement had never been a priority for MHRC, proposed cuts suddenly made community involvement a necessity. Residents realized that they lacked the clout to advocate for their rights and to prevent cuts to services unless public officials knew that they voted in meaningful numbers.

MHRC began to organize. With help from the Minnesota Participation Project (MPP), a nonpartisan voter engagement initiative of the Minnesota Council of Nonprofits, the group mobilized for action through various activities:

- recruited and trained residents to serve as voter registrars in each of 40 high-rise buildings;
- organized community events to discuss the issues facing their residents;
- met individually with each resident and meticulously built lists;
- organized transportation in groups to the polls on Election Day, and
- ensured that elected officials knew about their efforts.

It paid off, big-time. Not only were service cuts taken off the table, but high-rise residents got to know one another better, developing several trusted leaders and advocates for the interests of high-rise residents as a whole. In turn, this experience demonstrated that *who votes matters* and that building power within a nonprofit community can dramatically affect people's lives.

Nonprofit Voter Engagement in 2008

The momentum concerning the 2008 presidential election is palpable. There is a sense that everyone everywhere must be involved in some way, and nonprofits are no exception.

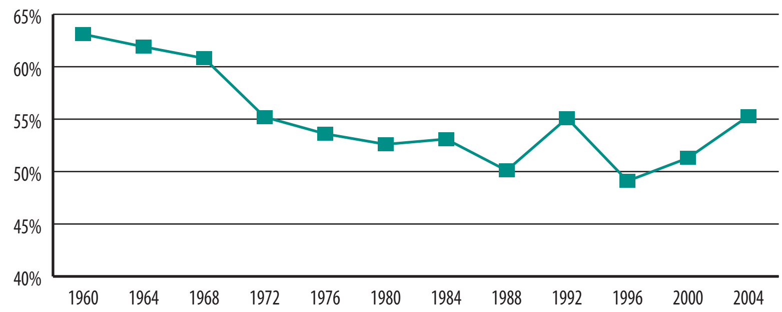
While for years nonprofits with advocacy and social-justice missions have interacted with people and encouraged them to be active and informed voters, a larger set of human-service providers and neighborhood groups has now begun to dip its toes into the veritable ocean of voter and civic engagement opportunities. And like MHRC, these nonprofits have begun to see results, from greater clout for their advocacy efforts to increased empowerment for their communities. The essential flexibility of nonprofit voter engagement means that it can easily be integrated into an organization's daily work and can be effective at both low and high levels of activity.

Most nonprofits lack the time and money to create an entirely new program to engage communities, but they can leverage their inherent civic assets and trusting relationships with their communities to integrate voter engagement into their daily work. A food pantry in Boston, for example, will post "Vote Today" signs in its facility as a reminder, while a community health center in Albuquerque will register all its patients to vote at intake, and a group of nonprofits serving the disability community in Minnesota will host picnic and policy fairs for these nonprofits' self-advocates to meet the candidates running for the statehouse. Regardless of the level of activity, the country's 501(c)(3) nonprofit sector will have an impact in this election. Even starting small can help organizations build their capacity to further integrate voter engagement into their ongoing work.

The Origins of Nonprofit Voter Engagement

Using the connections and goodwill of organizations to engage voters is not a new strategy. During our nation's first century, civic associations such as the Grange (a farm-based group) and the Odd Fellows (an immigrant-based group) played a major role in encouraging voting and activism. They educated members about the issues of the day.

Figure 1: Percentage of Turnout of Voting-Age Population, 1960–2004



Source: Federal Election Commission. Data drawn from Congressional Research Service reports, Election Data Services Inc., and State Election Offices

As more Americans gained the right to vote in the post–Civil War period, political parties increased efforts to depress or dilute voting to help their candidates. Voter suppression took many forms: through property requirements, registration and poll taxes, literacy tests, disqualification based on criminal record, and threats or acts of violence. The League of Women Voters, the National Association for the Advancement of Colored People and a variety of civic reformers led campaigns to expand the franchise: agitating for suffrage, emancipation, and ending wealth and property requirements tied to political participation.

But after the main force of the civil rights movement passed, nonprofit involvement in election activity waned, partly in response to congressional action to inhibit nonprofit participation in elections. During the 1960s, Ford Foundation grants supported several voter registration drives in low-income and minority communities. Some influential members of Congress viewed these efforts as targeted and partisan, specifically those preceding the election of Carl Stokes, the first black mayor of Cleveland. The Tax Reform Act of 1969 increased regulation of all kinds on private foundations, including making it difficult for private foundations to fund voter registration (requiring that any grantee register voters in at least five states). Most nonprofits and foundations felt the chill and stepped away from participation in elections—regardless of what was permissible.

Coincidentally or not, U.S. voter turnout declined to historically low levels during the 1970s (see figure 1). Lower-income and newer Americans were the least likely to vote. The lack of electoral competition, rise of money in politics, and reduced voting age all depressed turnout. The country lost its place among the top 100 democracies in voter turnout, with widening voting participation differences based on income, education, and age.

But by 2000, the tide of nonprofit political inaction began to shift. A deepening frustration with cuts in funding for state and local government services left nonprofits facing a greater demand for services and less funding to accomplish their work. These developments were accompanied by a growing awareness that gaps in voter turnout mirrored widening disparities in income. A number of nonprofits concluded that low voter turnout undercut their missions, services, and advocacy. Without the base of voters to hold elected officials accountable, advocacy became an increasingly defensive exercise.

Enter the presidential elections of 2000 and 2004. Organized voter suppression and a compromised election infrastructure in Florida, Ohio, and elsewhere led to a widespread belief that U.S. democracy was in trouble.

Finally, nonprofits began participating in elections because they realized that their deepest concentration is in lower-turnout districts and that they serve largely underrepresented communities. This wide and deep base among local communities represents millions of unreached potential voters.

Nonpartisanship: Harmful or Helpful?

While conventional wisdom holds that nonprofits are hamstrung by requirements to remain nonpartisan during electoral contests, these requirements are in fact beneficial for nonprofits striving to engage alienated or inactive potential voters. The nonpartisan requirement is a welcome mat for new and younger voters turned off by the overly partisan nature of campaigns. It is this required nonpartisanship that allows 501(c)(3) organizations to work alongside other nonpartisan entities and secretaries of state. These relationships have enormous potential to build a more active democracy by engaging and including all communities.

Early evidence from the new initiatives in nonprofit voter engagement indicates serious untapped potential, but voting isn't enough. Real change requires a wide range of mobilization and engagement efforts. But because elected officials have so much information and awareness about which communities vote, they won't address the issues of nonprofits and communities until these communities turn out to vote in higher numbers. And of course, that increased engagement requires trust in the value of voting but also verification that our voting systems accurately include and count eligible voters.

Since its initial success in 2004, MHRC has continued to make voter and civic engagement a core focus of its work. It coordinates activities with MPP for technical assistance and branded nonpartisan vote materials. Barb Harris, the executive director of MHRC, explains the organization's involvement. "It was no longer enough to speak with residents who were in danger of being evicted and give them the contact information of the person at the housing authority to whom they

In 2008, nonprofits have more resources and options available to engage at any level. The Nonprofit Voter Engagement Network (NVEN) has developed nonpartisan resources, such as *A Human Service Provider's Toolkit to Voter Engagement* and *A Guide to Hosting a Nonprofit Candidate Forum,* among other how-to fact sheets and guides, specifically for 501(c)(3) nonprofits. These materials are free for nonprofits and can be accompanied by free webinar trainings and a national nonprofit voting Web site with jurisdiction-specific election information for all 50 states (see www.nonprofitvote.org). All these guides and trainings are intended not only to instruct nonprofits on how to do the work, but also to make voter engagement easy to integrate into an organization's ongoing work.

could go to plead their individual case," she says. "Minneapolis was in a housing crisis, and we needed to collectively address the fact that there was not enough affordable housing."

In the 2004 presidential race as well as the 2005 mayoral and the 2006 midterm elections, MHRC educated and mobilized its residents. It hosted highly attended candidate forums, including a 2006 forum with the candidates for Minneapolis's hotly contested 5th Congressional District race. Its massive forum turnout shone a spotlight on the issues for Minneapolis's low-income and immigrant populations. Residents had the opportunity to ask candidates questions about affordable housing, safety, transportation, voting rights, and the economy. On Election Day, MHRC mobilized its community with "Vote Today" signs in Korean, Somali, and Spanish. In 2006 those precincts in which MHRC public housing was the only form of public housing available saw turnout gains of as much as 42 percent, far exceeding gains in neighboring precincts or in the city as a whole. And while impressive turnout has certainly helped Minneapolis's homelessness and housing community advocate effectively, Harris says that there is an even more rewarding outcome. "This entire experience has been incredibly motivating to us: to our constituent-led board and staff, it reinforces self-empowerment. Through partnering with other nonprofits in other interest areas to engage voters, we have been reenergized for our work. By participating in this type of leadership and organizing, we become more connected to public life, and you can just see the cynicism and the stigmatism begin to be replaced with empowerment and pride. We come out of the shadows as immigrants, as low-income people, as residents of public housing, and we fight for our rights."

MHRC is one example in a growing movement of hundreds of organizations across the country, along with others like OhioVOTES, Everybody Vote Pennsylvania, and the Michigan Participation Project. These projects provide state-specific materials, training, technical assistance, and mini-grants to their respective state's nonprofit sector. The Nonprofit Voter Engagement Network (NVEN), an organization dedicated to expanding the role of nonprofits in elections, likes to call the nonprofit sector "the sleeping giant" of democracy. This sector has the power to become a catalyst for a dramatic increase in voter participation. Nonpartisan nonprofit voter engagement is at the forefront of revitalizing America's democracy one nonprofit, and one voter, at a time.

Bridgette Rongitsch is the national director for the Nonprofit Voter Engagement Network, a national nonpartisan program of the Minnesota Council of Nonprofits.

Does your organization participate in voter education? Let us know at feedback@npqmag.org. Reprints of this article may be ordered from http://store.nonprofitquarterly.org, using code 150211.

"Greenlining" Foundation Grantmaking: Racial Equality Reporting in California

by Rick Cohen

Remember when the *Atlanta Journal–Constitution* published a pathbreaking series on racial discrimination in awarding home mortgages? *The Color of Money* won a Pulitzer[1] and put juice into community-based organizations, academics, and newspapers uncovering patterns of racial discrimination—or redlining—in bank mortgage and home improvement lending practices. Just as the Home Mortgage Disclosure Act (HMDA) requires banks to report on their mortgages and loans, should philanthropic redlining in U.S. philanthropy be remedied by a mandatory reporting regime?

A California-based advocacy organization has prompted the California state legislature to pass a bill designed to compel large private foundations, much like HMDA does for banks, to report on their grantmaking to nonprofits that are governed by predominantly racial and ethnic boards and executive leadership. As of this writing, the bill has passed only in the House, not in the Senate.

Known as AB 624,[2] the bill has energized foundations in the state and nationally to come down hard on the notion of compulsory reporting on racial and ethnic grantmaking. Here we examine the bill's pros and cons and the positions of the opposing parties and suggest that the lessons learned from this as-yet unfinished legislative battle may be useful to promote more racial and ethnic equity in future foundation grantmaking.

While there may be shortcomings in the legislation as drafted, AB 624 raises important issues that foundations have addressed largely through soft-soap discussions of diversity and caring, but with relatively little substantive progress. The California legislation challenges foundations at their core. Whom do foundations serve? How does philanthropy address racial and social inequities for the billions of dollars currently in foundation coffers and the future trillions likely to flow in? AB 624 will ultimately be signed or vetoed by the governor, but the underlying questions about foundations and racial and ethnic equity remain unanswered.

Greenlining Philanthropic Grantmaking

Based in Berkeley, California, the Greenlining Institute has a 15-year history of supporting efforts to increase investment in low-income and minority neighborhoods. Nationally known for its work in challenging banks on redlining practices, Greenlining has crafted Community Reinvestment Act (CRA) agreements with major financial institutions such as Wachovia and Merrill Lynch. It has similarly challenged corporations and government agencies on their attentiveness to racial and ethnic diversity, generating "diversity scorecards" for bank boards, University of California medical school faculty, and the partners of California's 20 largest law firms.

In 2005, Greenlining generated a diversity report card of sorts for foundations. *Fairness in Philanthropy* examined the grantmaking to minority-led organizations by 49 foundations. Minority-led organizations are defined by the following: "whose staff is 50 percent or more minority; whose board of directors is 50 percent or more minority; and whose mission statement and charitable programs aim to predominantly serve and empower minority communities or populations."

Fairness in Philanthropy[3] caught the attention of California assemblyman Joe Coto, under whose leadership the state's black, Latino, and Asian/Pacific Islander legislative caucuses convened a hearing on the topic.

Investing in a Diverse Democracy, a 2006 follow-up report by Greenlining, concluded that in 2004 a sample of "national independent foundations" gave only 14.7 percent of grant dollars and 7.7 percent of grants to minority-led organizations. California foundations awarded 4 percent of grant dollars and 11.7 percent of grants. Some funders in the Greenlining sample supposedly made no grants to minority-led organizations, and overall totals would have been greatly reduced were it not for the $535 million grant of the Bill and Melinda Gates Foundation to the

United Negro College Fund.[4] Subsequently, and much to the consternation of California and national foundations, Coto introduced the legislation calling for mandatory racial and ethnic reporting on foundation grants.

There is little debate that racial and ethnic minorities have not garnered significant proportions of foundation grantmaking. The Applied Research Center's *Short Changed* report described the increasing gap between the growth of overall U.S. foundation giving and the proportion targeted to racial and ethnic minorities.[5] It noted that among "organizations that promote justice and equity for immigrants and established communities of color . . . funding streams for many such organizations have been reduced to a trickle in recent years." Over the past few decades, racial and ethnic "affinity groups" of foundations have decried shortfalls in grantmaking to their constituencies, such as the recent report from Asian Americans/Pacific Islanders in Philanthropy (AAPIP), which underscored the disparity between an AAPIP population that accounts for 4.5 percent of the U.S. population but only 0.4 percent of foundation grantmaking.[6]

The issue is not whether there should be concern about philanthropic attention and commitment to racial equity in foundations' grantmaking and operations. It is whether AB 624 will bring progress to the sector in terms of increased racial equity or whether it instead sidetracks philanthropy into unproductive metrics and onerous reporting requirements.

AB 624's Foundation Coverage

The proposed legislation would apply to private foundations (as defined by federal tax law), including corporate foundations and perhaps community foundations (if they fit under the undefined term "public operating foundations") if they have assets of more than $250 million and are located in California. As of 2005, the list of covered foundations would number approximately two dozen.[7]

Despite the focus on foundation *grantmaking* to racial and ethnic minorities, the inclusion of large-asset operating foundations that make few grants leaves out many large foundations making grants to California organizations. Despite the state's large foundation sector, 17 of the top 50 (and three of the top ten) grantmakers to California nonprofits are not located in California, notably the Bill and Melinda Gates Foundation and the Ford Foundation, among others.[8] Were the statute to pass, many of the large private and corporate foundations likely to be mandated to comply with the statute operate nationally rather than simply within the state. So a particular foundation might make substantial grants to minority-led organizations outside the state but almost none within it.

The requirements for reporting also exclude foundations' non-U.S. grantmaking. Following September 11, the Iraq war, and international disasters like the tsunami in Southeast Asia, philanthropic grantmakers and all charitable givers have been encouraged to see beyond national boundaries. Beyond the exclusion of international grantmaking per se, what actually constitutes "international" in the twenty-first century? Would grants to entities such as the Save the Children Federation (located in Connecticut) or the United Nations Fund for UNICEF (in New York) count as domestic (because they are located in the United States) and therefore within AB 624's purview, or are they international because they either regrant the funds to non-U.S. entities or use the monies to operate overseas? As drafted, the bill is thus caught in a geographic no-man's land, focused on grantmaking to racial and ethnic communities and organizations, but potentially excluding major categories of grantmakers inside and outside the state as well as certain kinds of international grantmaking.

AB 624's Mandated Reporting

In its journey through the California legislature, the scope of AB 624 has been whittled down. But as of February 2008, the bill called for foundations to report information in three categories:

- "The number of grants and percentage of grant dollars awarded to organizations serving ethnic minority communities and lesbian, gay, bisexual, and transgender communities";
- "the number of grants and percentage of grant dollars awarded to organizations where 50 percent or more of the board members or staff are ethnic minorities or are lesbian, gay, bisexual, or transgender"; and
- "the number of grants and percentage of grant dollars awarded to predominantly low-income communities."

Under the label of "diversity," foundations would also be required to post the information on their Web sites and include it in annual reports.

Foundations in California and nationally have objected to these reporting requirements, arguing that the data collection is costly and burdensome, diverting funds to pay for compliance with the legislation that could otherwise go to these groups. Others contend that this reporting requirement is an improper invasion of government regulation over private funds, conveniently forgetting that foundation assets are tax-exempt dollars, entrusted by the public to foundations' stewardship and distribution for the public's benefit). Still others hint darkly that the enactment of AB 624 will spur foundations to pack up and move out of California.

In the opposition to AB 624, a recurrent theme is that the legislation's required reporting invades the privacy of grantmakers and grant recipients. In practice, however, many foundations routinely require grant applicants to report on their racial and ethnic composition. Grantmakers of Western Pennsylvania, for example, uses the Common Grant Application Format, which specifically asks applicants to list officers and directors for their "diversity spread" (i.e., age, gender, and race),[9] and Associated Grant Makers, the regional association in Massachusetts, uses a reporting process that includes a diversity data form to classify the race and ethnicity of board members, staff, and volunteers."[10]

Historically, foundations have resisted most reporting efforts as unnecessarily burdensome and costly. With the Tax Reform Act of 1969, foundations fought the prospect of increased reporting furiously, but in retrospect had to acknowledge that the 1969 standards resulted in less abuse and higher levels of foundation grant distributions.

Supporters of AB 624 cite a different precedent for the legislation: the 30th anniversary of the Community Reinvestment Act. Three decades ago, banks were adamantly opposed to the enactment of CRA, warning of dire consequences for residential lending practices. But today, major banks begrudgingly accept CRA as a positive contribution to banking practices. The Home Mortgage Disclosure Act of 1975 provides the statistical basis for making CRA a potentially useful tool, which Greenlining uses in its successful CRA work and cites as a "good example" for comparison with the California bill.[11] But is it really?

HMDA compels banks to provide loan data so that regulators and the public can determine whether financial institutions meet the housing credit needs of their communities by generating a "picture of how geographic lending patterns vary depending on the income status and/or racial/ethnic make-up of neighborhoods."[12] Advocacy organizations such as Greenlining and ACORN use HMDA data to determine whether banks have engaged in racial discrimination or neighborhood-based redlining.

But the HMDA parallel with AB 624 is tenuous. HMDA gets at the racial and ethnic minority end users of bank lending, not whether bank lending goes through organizations that are minority led. In contrast, AB 624 calls for tracking not only the racial and ethnic composition of the beneficiaries of foundation grants but also the extent to which foundation grants go to organizations led by people of color. Is the implicit assumption that minority-led organizations produce better results for their constituencies? Perhaps. But as CRA evaluations have shown, while many minority banks are committed to reinvesting in their communities, not all are automatically top-level CRA performers.[13] Being a minority-owned bank does not automatically mean that lending practices will be *significantly* more community oriented than the practices of other banks.

Therein lies the problem of AB 624's emphasis on foundation grantmaking to minority-led organizations. A foundation, for example, might make substantial grants to organizations whose governing board or staff is minority, but these organizations might not have much program emphasis on serving racial or ethnic minorities. Moreover, grants that go to organizations opposed to the racial and ethnic priorities of the Greenlining Institute, such as Ward Connerly's California-based American Civil Rights Institute (whose slogan is "Race has no place in American life or law"),[14] would count in the racial and ethnic column.[15] In other words, the racial-justice content of the grantmaking or the grant recipient organization is not a relevant factor.

Greenlining defends AB 624 as simply a measure to promote foundation transparency on racial and ethnic grantmaking, not a requirement that foundations do more or meet a targeted benchmark. But foundations see the bill's call for mandated transparency as a value judgment that their grantmaking to minority-led organizations and communities is insufficient and should be increased. In foundation grantmaking, the needed measures are not simply which intermediaries receive funding, but rather whether the funding empowers communities to redress institutional and societal inequities. In addition to data on who receives foundation grant dollars, philanthropy needs a more robust set of measures tied to affirmative strategies to promote racial equity.

The Importance of Metrics

The shortcomings of AB 624 should not be construed as letting foundations off the hook for determining who benefits from their nearly $40 billion in annual grantmaking and whether this grantmaking contributes to racial and ethnic equity and social justice. The example of Ward Connerly underscores the need not to eschew racial and ethnic metrics but to ensure that philanthropy is accountable for what it delivers in return for federally tax-exempt funds.

After successfully rolling back some aspects of affirmative action in Michigan, California, and Washington, Connerly recently announced efforts to place similar voter initiatives on the ballot in Colorado, Arizona, Missouri, Nebraska, and Oklahoma.[16] Connerly understands the importance of generating empirical measures for the progress of institutions and of society toward racial justice. Measures provide benchmarks against which progress on social issues can be gauged. By dodging the publicly reportable, the philanthropic sector falls prey to the Connerly vision. If you can't count it and report it, ultimately you won't address it.

Known as Proposition 54, Connerly's Racial Privacy Initiative in California would have banned state government from collecting information about race, ethnicity, or national origin other than in very limited circumstances. Many of the California foundations that have been most vigorously opposed to AB 624 fought against Connerly's proposed ban on collecting racial and ethnic information, making their stance on AB 624 look more self-serving than principled. A CompassPoint survey of California foundation program officers as well as interviews with foundation executives indicated concern about the implications of Propo-

Minority-Led Nonprofits

What does hard research indicate about the greater efficacy of minority-led organizations serving their communities? This is the implicit question of AB 624, which is not answered by the generic response that "diverse" organizations are more effective or innovative entities.[22] Even if the equation "Diversity yields innovation and effectiveness" is correct for generic nonprofits, are racial and ethnic minorities—and other disenfranchised populations—well represented by white or "diverse" organizations, or is it important for people of color to speak for themselves?

While the research may not address this question of empowerment clearly, we know one thing: The nonprofit sector is hardly as diverse—at least in racial and ethnic terms—as the population of the United States, whose workforce is nearing majority-minority status and whose entire population could reach that point as soon as 2050.

In 2005 the Urban Institute conducted a stratified random sample of nonprofits that had filed Form 990s with the IRS and garnered more than 5,100 responses for a 41 percent response rate. In terms of the less-than-diverse composition of those governing tax-exempt 501(c)(3) organizations, the findings on the racial and ethnic composition of nonprofit boards are stunning. Here are the highlights:

- The average nonprofit board is 86 percent white, the median nonprofit board is 96 percent white.
- On average, 7 percent of board members are African American and 3.5 percent Latino (leaving approximately 3.5 percent for all other non-white population groups).
- More than half of all boards are composed of entirely non-Latino whites.
- Even in metropolitan areas, which have more diverse populations, 45 percent of nonprofit boards are all white; outside of metropolitan areas, they are 66 percent white.
- Among nonprofits whose service population is more than 50 percent African American, 18 percent report no African-American board members; for service populations that are 25 percent to 49 percent African American, 36 percent report no African-American board members.
- For nonprofits with service populations that are more than 50 percent Latino, one-third have no Latino board members; for those serving populations that are 25 percent to 49 percent Latino, more than half have no Latino board members.

Despite the substantial response to the survey, the data reflects only a small proportion of the total number of nonprofits in the United States. On the other hand, given that these nonprofits had the motivation to respond to the survey, one can only imagine the even weaker picture of the racial and ethnic composition of decision makers for the total U.S. tax-exempt sector.[23]

Other data on the proportion of nonprofit organizations that are led by people of color reflects the race and ethnicity of only executive directors and raises questions. While the nation's nonprofit community development corporations (CDCs), for example, trace their origins in part to the Title VII nonprofits of the late 1960s, beginning with people-of-color-led groups, today's community development corporations are led by predominantly nonminorities. The 2005 census of Community Development Corporations classified 69 percent of CDC executive directors as white, 22 percent African American, 7 percent Latino, 1 percent Asian American, and 2 percent Native American or Alaskan.[24]

Perhaps these statistics simply reflect the changing demographics of CDC neighborhoods that are no longer as dominated by racial and ethnic populations. But in the community development industry, observers consistently express concern about the inadequate numbers of leadership positions filled by people of color.

The current foundation debate surrounding "diversity" conflates "diversity" with inclusiveness and implicitly assumes that worthwhile, effective nonprofits "affirm . . . human diversity in many forms, encompassing but not limited to ethnicity, race, gender, sexual orientation, age, economic circumstance, disability, geography, and philosophy."[25] Across the sector, diversity and inclusion are mom-and-apple-pie concepts. And for marginalized or disenfranchised communities, this reflects a need for political power, which requires authentically constituent-led, constituent-governed organizations. But while the amorphous way in which foundations use the term *diversity* may be politically palatable, it's increasingly devoid of meaning.

sition 54. Eighty-four percent of foundations considered race, ethnicity, and national origin of grant applicants' clients or constituents as part of their grantmaking decisions, and three-fourths of respondents expressed concern about a ban on collecting racial and ethnic data regarding its implications for foundation strategies, investment priorities, and impact measurements.[17]

The Leadership Conference on Civil Rights expressed the rationale for opposition to Proposition 54 and why foundations ought to understand the implications of their opposition to the bill: "Without data collection, [Proposition 54] would damage the state's ability to address disparities by race and ethnicity in discrimination and hate crimes, health care and disease patterns, and educational resources and academic achievement."[18]

Conservative nonprofit and philanthropic groups such as the Philanthropy Roundtable and the Alliance for Charitable Reform have been outspoken in their opposition to AB 624, but they are from the same ideological stream from which Connerly's initiatives flow. In some cases, they suggest that opposition to the bill should be consistent with opposition to affirmative action and other "liberal" strategies that have addressed our nation's racial problems over the years.[19] Moderate and liberal foundations do themselves a disservice by allowing conservative funders to run interference for the philanthropic sector when instead they should stand up for the need for robust and meaningful data collection to advance the causes of racial and ethnic justice.

Foundations such as the Annie E. Casey Foundation[20] and the Ford Foundation have repeatedly made the case for collection of racial and ethnic data on beneficiaries in foundation grantmaking.[21] Soft-soap palliatives to the California legislature, such as the promise of the three California regional grantmaker associations to conduct new research on how to strengthen grant support for minority-led organizations, seem unconvincing and paltry. They simply buy time rather than recognize the legitimate concerns in the California bill.

The Future of AB 624

As this article goes to press, we learned that the California state senate's Business, Professions and Economic Development Committee held a hearing on May 12 on the proposed legislation to require foundations to report on their racial and ethnic giving and composition. The committee chairperson, Senator Mark Ridley-Thomas, chose not to call for a vote, asking that the authors of the legislation—presumably the Greenlining Institute—work with foundations to find mutually acceptable legislative language.

In the meantime, the Council on Foundations continued its strident opposition to the bill, with several panels devoted to diversity at its May annual conference. But there were a couple of surprises. At a plenary session on the last day of the conference, a representative of the Jessie Smith Noyes Foundation announced its endorsement of the legislation, particularly the issue of grantmaking to minority-led organizations. And Congressman Xavier Becerra reaffirmed what he told the *Nonprofit Quarterly* in the spring 2008 issue that Congress will be looking at how much the grantmaking of foundations benefits racial and ethnic minorities.

The anti-AB 624 foundations have hired heavyweight California lobbyists to work the halls in Sacramento to convince the legislature to pull or reject the bill. If that doesn't work, the lobbying could reach Governor Arnold Schwarzenegger for a veto. With ample foundation opposition to the bill and grantee reticence to say much about the legislation contrary to their funders' positions, the bill may not get much further, potentially even being wrapped up by mid-June. But what happens then? Are the issues underlying AB 624 buried under an avalanche of consultant studies, foundation declarations of their appreciation of the value of diversity, and a few strategically placed grants? The foundation sector would be well advised to view AB624 as a wake-up call for serious attention to racial equity.

Endnotes

1. *The Atlanta Journal–Constitution*, "The Color of Money," May 1–4, 1988 (powerreporting.com/color/color_of_money.pdf).
2. The Greenlining Institute refers to the bill as the Foundation Diversity and Transparency Act, John C. Gamboa, "Tax-Supported Foundations Must Reveal Diversity Data," the *Mercury News*, February 29, 2008 (for the text of AB 624, see www.leginfo.ca.gov/pub/07-08/bill/asm/ab_0601-0650/ab_624_bill_20080303_amended_sen_v96.html).
3. Greenlining Institute, *Investing in a Diverse Democracy: Foundation Giving to Minority-Led Nonprofits*, fall 2006, p. 3. As a matter of disclosure, the National Committee for Responsive Philanthropy (NCRP), for which I served as executive director, originally intended to partner with Greenlining in the 2005 study but withdrew because of the study's research methodology.
4. *Investing in a Diverse Democracy*, p. 5.
5. Will Pittz and Rinku Sen, *Short Changed: Foundation Giving and Communities of Color*, Applied Research Center, spring 2004, pp. 1 and 4.
6. Pronita Gupta and Stefanie Ritoper, *Growing Opportunities: Will Funding Follow the Rise in Foundation Assets and Growth of AAPI Populations?*, Asian Americans Pacific Islanders in Philanthropy, June 2007 (www.aapip.org/pdfs/AAPIP-GOpps4WWW.pdf).
7. The Foundation Center, "Top 50 California Foundations, circa 2005" (foundationcenter.org/findfunders/statistics/pdf/09_top50_aa/2005/ca_05.pdf).
8. The Foundation Center, "Top 50 U.S. Foundations Awarding Grants in the State of California, circa 2005" (foundationcenter.org/findfunders/statistics/pdf/03_fund_geo/2005/50_found_states/f_ca_05.pdf).
9. Grantmakers of Western Pennsylvania, Common Application Grant Format (gwpa2.org/commongrantapplication.pdf), p. 4.
10. Associated Grant Makers, AGM Common Proposal Form (www.agmconnect.org/cpf/CPF_Diversity_Form.xls).
11. Cited in a staff report prepared for the California Assembly Committee on Judiciary, January 15, 2008 (info.sen.ca.gov/pub/07-08/bill/asm/ab_0601-0650/ab_624_cfa_20080114_104234_asm_comm.html).
12. Paul Huck, "Home Mortgage Lending by Applicant Race/Ethnicity: Do HMFA Figures Provide a Distorted Figure?," *Policy Studies*, October 2000, p.2.
13. Ann B. Matasar and Deborah D. Pavelka, "Minority Banks and Minority Communities: Are Minority Banks Good

Foundation Governance

California's AB 624 is aimed not only at foundations' reporting on their grantees but also at their own top staff and board members' diversity by race, ethnicity, gender, and sexual orientation. The limited available information on the staff and board composition of foundations suggests that, even with some improvement over the years in philanthropic "diversity," the billions of dollars of foundation wealth are subject to the decision making of boards that do not reflect the increasing racial and ethnic diversity of this nation:

Who Governs U.S. Foundations

As the table below demonstrates, the proportion of African-American members of foundation boards is much lower than for Fortune 500 corporate boards.[26]

Racial Group	Percentage of Foundation Board Members	Percentage of Fortune 500 Board Members
White	87.7	86.6
African American	6.7	9.1
Latino/Hispanic	3.3	3.2
Asian/Pacific Islander	1.5	1.1
Native American	0.5	0.1

But larger foundations (with assets of more than $250 million) do somewhat better in terms of diversity than do smaller foundations[27] with African Americans comprising 11.1 percent of board members for large foundations versus 6.0 percent for smaller ones.[28]

Who Runs U.S. Foundations

Statistics on foundations responding to Council on Foundations surveys show disproportionately few foundation jobs held by minorities, a trend that only worsens for higher-level positions.

- For all full-time paid foundation staff, 76.8 percent were white in 2006, a slight decrease compared with 77.2 percent in 2005.
- Of paid foundation staff, blacks comprise only 11.4 percent, barely up from 11.1 percent in 2005 (when only 2 percent of full-time paid foundation staff were black males). Latinos account for 5.7 percent, down from 5.9 percent, while Asian/Pacific Islanders account for only 4.8 percent in 2006 and 2005.
- For program officer positions, only 4.2 percent were black men, compared with 12.8 percent black women, 16.3 percent white men, and 52.4 percent white women. Other ethnic and racial groups also lag in employment as program officers: Hispanic men, 3.0 percent; Hispanic women, 4.3 percent; Asian/Pacific-Islander, women 3.8 percent; and Asian/Pacific-Islander, men less than 1 percent.
- For chief executive officers and chief giving officers 1 percent were black men and 1.8 percent were black women, compared with 41.8 percent white men and 51.8 percent white women.[29]

No statistics exist on the socioeconomic demographics or, more broadly, the socioeconomic status of foundation board and staff members. When it comes to running institutions controlling huge concentrations of wealth, are race and ethnicity more or less important than gender, sexual orientation, or class in explaining foundations' grantmaking priorities? At least one study suggests that staff and board diversity follow a foundation's decision to focus grantmaking on communities or issues of "marginalized populations", not the other way around.[30]

There is no question that the concentration of philanthropic wealth under the control of nonminorities reflects the racial and ethnic divides in our society. But the anomaly in AB 624 is that it implicitly sets a higher value on foundation giving to minority-led organizations, notwithstanding that giving institutions are probably less racially, ethnically, and gender- and orientation-diverse than recipient nonprofits. It is a policy conundrum for both the proponents of AB 624, who advocate governmental intervention and mandate, and the defenders of the foundation status quo, whose diversity approaches reflect a framework of "valuing" diversity but do not alter the power relationships within institutional philanthropy.

Neighbors?," *International Advances in Economic Research*, February 2004 (www.entrepreneur.com/tradejournals/article/114523414_2.html).

14. American Civil Rights Institute (www.acri.org/about.html).

15. With only two board members, as stated on its 2006 Form 990 (www.guidestar.org/FinDocuments/2006/522/004/2006-522004697-03302dca-9.pdf), one of whom is Ward Connerly, ACRI meets the AB 624 standard that requires an organization to have 50 percent of its board members be minority members.

16. Peter Slevin, "Affirmative Action Foes Push Ballot Initiatives," the *Washington Post*, March 26, 2008.

17. *Flying Blind: Proposition 54 and Philanthropy*, CompassPoint, 2003.

18. The Civil Rights Coalition for the 21st Century, "Oppose Ward Connerly's So-Called 'Racial Privacy Initiative,' Proposition 54" (www.civilrights.org/campaigns/prop54/fact_sheet.html).

19. For example, see the comments of Heather Richardson Higgins, a leader of the Alliance for Charitable Reform, at the Hudson Institute's Mandating Multicultural Munificence program on April 7, 2008 (www.hudson.org/files/pdf_upload/Transcript_2008_04_07.pdf).

20. For example, *Eliminating Racial &*

Ethnic Disparities: A Funder's Discussion about Strategies and Resources, Annie E. Casey Foundation; and *Race Matters User's Guide*, Annie E. Casey Foundation.

21. Mott and Ford both underwrote the production of *Grantmaking with a Racial Equity Lens*, produced by GrantCraft in partnership with the Philanthropic Initiative for Racial Equity, New York: GrantCraft, 2007.

22. Claudia Dreifus, "In Professor's Model, Diversity = Productivity," the *New York Times*, January 8, 2008 (www.nytimes.com/2008/01/08/science/08conv.html?scp=1&sq=professor%27s+model&st=nyt).

23. Francie C. Ostrower, "Nonprofit Governance in the United States: Findings on Performance and Accountability from the First National Representative Study," Urban Institute, 2007, pp. 17–18.

24. National Congress for Community Economic Development, *Reaching New Heights: Trends and Achievements of Community-Based Development Organizations*, 2005 (www.ncced.org/documents/NCCEDCensus2005FINALReport.pdf), p. 9.

25. Council on Foundations, *Diversity and Inclusion in Philanthropy: Position and Action Steps: Response to California Assembly Bill AB 624*, February 2008, Rev. February 15, 2008, p. 2.

26. Foundation Management Series, 12th ed., pp. 35-38; "2005 Catalyst Census of Woman Board Directors of the Fortune 500" and the Alliance for Board Diversity's "Women and Minorities on Fortune 100 Boards, 2005." Note that the Executive Leadership Council's study of Fortune 500 corporations cites an African-American board member proportion at 8.1 percent.

27. Both the Fortune and foundation figures come from self-reported data by corporations and foundations. One can assume that among the nonreporting corporations and foundations, the diversity figures are even less robust.

28. Council on Foundations, 2004 Foundation Management Survey database.

29. These statistics come from the Council on Foundations' Grantmakers Salary and Benefits Report 2005 and the executive summary of the 2006 edition. The combination of CEOs and chief giving officers in the statistics masks the fact that among CEOs the proportion of positions held by African Americans is even lower than these small proportions indicate.

30. Teresa Odendahl and William A. Diaz, "Independent Foundations in Transition: From Family Vehicles to Major Institutions" in Lynn C. Burbridge, William A. Diaz, Teresa Odendahl, and Aileen Shaw, *The Meaning and Impact of Board and Staff Diversity in the Philanthropic Field: Findings from a National Study*, Joint Affinity Groups, 2002, pp. 89-90.

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What is your take on AB 624? Is what's good for the goose good for the gander? Let us know at feedback@npqmag.org. Reprints of this article may be ordered from http://store.nonprofitquarterly.org, using code 150212.

ARNOVA Abstracts

FINANCE & TAXES

Tinkelman, Daniel & Bairj Donabedian (2007) Street lamps, alleys, ratio analysis, and nonprofit organizations, *Nonprofit Management and Leadership* 18(1): 5–18.

"This article offers an accounting-based framework for evaluating the efficiency of nonprofit organizations using four factors . . . (1) the proportion of revenues actually used in the current year, (2) the proportion of the expenditures allocated to programs, (3) the units of output produced from that spending, and (4) the value of units produced, expressed in terms of an index value."

FOUNDATIONS

Bucechel, Kathleen W. & Esther Handy (2007) "The Road Less Traveled: Funders' Advice on the Path to Nonprofit Sustainability." Hauser Center Working Paper 40. (Cambridge, MA: Hauser Center for Nonprofit Organizations, 18 pp.) Available at http://www.ksg.harvard.edu/hauser/PDF_XLS/workingpapers/workingpaper_40.pdf

This represents the distillation of "48 profiles of initiatives, approaches or strategies designed to foster long term sustainability in organizations" collected in the Capital Ideas survey undertaken in connection with a symposium at the Hauser Center. "The survey indicates that more funders give general operating support than chose to profile it in the initiatives they offered."

FUNDRAISING

McGivern, Mary Ann (2007) Building an online community: A key to fundraising on the Internet, *Grassroots Fundraising Journal* 26(4): 13–15.

This brief how-to article focuses on using listserv groups as a donor base and listserv as a means of reaching them.

McGuire, Suzie (2007) Direct mail lists: Going beyond the inner circle, *Grassroots Fundraising Journal* 26(4): 9–12.

A brief how-to article covering the essentials of choosing a "list professional" [i.e., broker] and choosing the right lists.

Rooney, Patrick (2007) "American Express Charitable Gift Survey" (Indianapolis, IN: Center on Philanthropy at Indiana University, 41 pp.) Available at http://home3.americanexpress.com/corp//pc/2007/pdf/aecgs.pdf

Only 10% of donors give online. "The single largest reason – after not having a computer – that people offered is that they were unaware of online contribution options. . . . Among those who contributed online, one in five (20 percent) said the primary motivation for giving online related to whether the charity actively promoted online giving choices."

GIVING & PHILANTHROPY

Center on Philanthropy at Indiana University (2007) *Bank of America Study of High Net-Worth Philanthropy* (Indianapolis, IN: author, 24 pp.) Available at http://www.philanthropy.iupui.edu/Research/BAC+Study+of+HNW+Philanthropy_102606.pdf **

This study is based on a random survey of over 30,000 households in high net-worth neighborhoods across the country (1,400 responses) in 2006. It shows the objects of giving and correlates of giving as well as responses to questions about who donors consulted in making a gift and what it would take to stimulate them to give more. These donors have much different philanthropic traits compared to the general population. [*Ed. Note: High Net-Worth households are households with incomes of greater than $200,000 or assets in excess of $1,000,000, comprising 3.1 percent of the total households in the U.S.*]

GOVERNANCE & LEADERSHIP

Iecovich, Esther & Hadara Bar-Mor (2007) Relationships between chairpersons and CEOs in nonprofit organizations, *Administration in Social Work* 31 (4): 21–40.

This study "pinpointed several patterns of dominance, specially that CEO's dominance was correlated with organizational and board characteristics, chairperson's characteristics, and degree involvement in the management of the organizations, and the extent to which there were formal and clear role definitions. Number of hours spent by the chairperson working for the organization was the best predictor for CEO dominance."

Stone, Melissa M. & Francie Ostrower (2007) Acting in the public interest? Another look at research on nonprofit governance, *Nonprofit and Voluntary Sector Quarterly* 36(3):416–438.

"The article summarizes the extant empirical literature on nonprofit governance and compares this research to emerging work on public governance." It argues for "taking account of organizational actors beyond those of the board."

LAW

Andrew, Leonard D. & Richard S. Hobish (2007) *Employment Law Guide for Non-Profit Organizations* (White Plains, NY: Pro Bono Partnership, 318 pp.) Available at http://www.probonopartnership.org/PBPGuide/frame.htm **

"Written for leaders who are not experts in nonprofit law, the guide provides guidance for developing human resource and employee handbooks." [*from the Foundation Center Web site*]

MANAGEMENT

Dorf, Paul R. (2007) Compensation in nonprofits: Why variable compensation is an important consideration in the design of effective compensation packages, *Journal for Nonprofit Management* 11(1): www.supportctr.org

Why variable compensation is important; how to set up such a program.

MUTUAL NONPROFITS & MEMBERSHIP ASSOCIATIONS

Brooks, Arthur C. (2008) *Where the Winners Meet: Why Happier, More Successful People Gravitate Toward Associations*. (Chicago: William E. Smith Institute for Association Research) Register to obtain research studies at http://www.smithbucklin.com/smithinstitute/william_smith.cfm

This report reveals that "on average, association members earn higher salaries, like their jobs more and are happier people than those who do not join associations."

Golden, Mark J. (2007) What makes associations remarkable? *Journal of Association Leadership* 4(Spring) pp. 36–45) Available at www.asaecenter.org/PublicationsResources/JALArticleDetail.cfm?ItemNumber=25278

"The article summarizes findings from the report '7 Measures of Success: What Remarkable Associations Do That Others Don't.' Topics covered include customer service, mission, knowledge-based strategy, information sharing, chief executives, accountability, and partnerships." [*from the Foundation Center Web site*]

SOCIAL ENTERPRISE & SOCIAL ENTREPRENEURSHIP

Seedco Policy Center (2007) *The Limits of Social Enterprise: A Field Study & Case Analysis.* (New York: author, 24 pp.) Available at http://www.seedco.org/publications/publications/social_enterprise.pdf

This report raises a warning flag to social enterprise: "Nonprofits striving to meet a "double bottom line" too easily find the effort becomes an impossible double bind, with enterprises established as social-purpose businesses but bankrolled and evaluated as nonprofits." [quote from the *Aspen Philanthropy Letter*, January 2008]

ARNOVA
Association for Research on Nonprofit Organizations and Voluntary Action

ARNOVA is the leading U.S.-based national association—with international members as well—of scholars and practitioners who share interests in generating deeper and fuller knowledge about the nonprofit sector and civil society. This ongoing work of inquiry, conversation, and practical improvement is carried on through its network of over 1000 members, its journal (*Nonprofit and Voluntary Sector Quarterly*), and its annual conference. See www.arnova.org.

The Take-Away

by the editors

Truth or Consequences: The Implications of Financial Decisions
by Clara Miller
Does a diversified revenue base make for a more sustainable nonprofit? Does reliance on government funding create financial problems? Does owning a facility improve an organization's financial health? In a recent study, the Nonprofit Finance Fund strove to prove or disprove these nuggets of conventional wisdom.


Truth or Consequences:
The Implications of Financial Decisions

A Board's Guide to Surpluses and Deficits
by Kay Snowden
When it comes to safeguarding the financial health of a nonprofit, board members face an enormous challenge. It's easy to be the stern voice of financial control from the outside; all organizations should be conservative in their revenue projections and run a surplus every year, just as we should all have spotless houses and raise well-behaved children. But the real world of compelling needs and limited resources is more challenging.


Sinking While Swimming:
The Financial Health of Human-Service Providers

On the Edge: The Financial Health of Human-Service Providers
Recently, Massachusetts policy makers commissioned a study to determine why the overall financial stability of purchase of-service providers is at risk. The study highlights why so many nonprofits are financially fragile: many human-service and health-focused nonprofit organizations, particularly community-based organizations, do not recover the full cost of services, which translates into deficits that put them at risk.

Navigating the Path of Socially Responsible Investment
by Rick Cohen
Focused on grants and grantmaking, nonprofits all too often overlook the potential of social investment. *NPQ* reviews a recent report that defines the investment options most important to nonprofits and provides resources and examples, models, and prototypes from which investors and investees alike can learn.


Navigating the Path of
Socially Responsible Investment

Financial Transactions with Your Board: Who Is Looking?
by Francie Ostrower
Organizations that have financial transactions with their board members walk a fine line where public accountability is concerned, but the practice turns out to be widespread. Excerpted from "Nonprofit Governance in the United States: Findings on Performance and Accountability," author Francie Ostrower explores the benefits and liabilities that arise when nonprofits purchase goods and services from board members.

The Slippery Slope of Employment Practices Liability
by Charles C. Hewitt
Employment policies are complex, may vary from state to state, and leave plenty of room for missteps that could cost you thousands of dollars. You can protect your organization by knowing the rules, making them clear and available to employees, and seeking counsel before you make an irrevocable move. The author walks the reader through the basics, from personnel policies to use of legal counsel to liability insurance, and more.

The Shifting Tides of Nonprofit Governance: An Interview with Paul Light
by the editors
Iconoclast Paul Light is good at cutting through the nonsense that clutters nonprofit management. In this article, he raises questions about the intellectual and theoretical underpinnings of competing and sometimes ineffectual approaches to improving nonprofit board governance. In examining these "tides of reform," Light urges us to move beyond the pablum of rhetoric and politeness.

Mission Haiku: The Poetry of Mission Statements
by Chris Finney
Christopher Finney argues that an organization's mission statement should be elegant, precise, even poetic. Using the principles of haiku, a form of Japanese poetry consisting of only three short lines and 17 syllables, the author encourages those drafting a mission statement to view the exercise like writing a poem, where every word is at a premium and every syllable holds meaning.

Election 2008: More Organizations Engaging More Voters
by Bridgette Rongitsch
For years nonprofits with advocacy and social-justice missions have encouraged an active and informed citizenry. Now, however, human-service providers and neighborhood groups have begun to dip their toes into the ocean of voter and civic engagement. Author Bridgette Rongitsch presents the transition of the Minneapolis High Rise Representative Council, which shifted from basic organizing to building power within a nonprofit community for long-term change.

"Greenlining" Foundation Grantmaking: Racial Equality Reporting in California
by Rick Cohen
A proposed bill in the California legislature would compel the state's large foundations to report on the degree to which their grantmaking goes to racial and ethnic communities and to nonprofits led by people of color. The bill would also require them to report organizational composition by race, ethnicity, gender, and sexual orientation. Greeted by a firestorm of opposition from foundations, the bill faces an uphill battle.

Should foundations—which are governed overwhelmingly by the white and wealthy—be compelled to report on these issues? And equally important, does racial diversity really satisfy the objective of the legislation?

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The nonprofit workplace: What do workers want; the story behind compensation, and the realities of turnover. What do we know and what should you expect? Supplement: Human resource outsourcing.

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new to CAE and added to the sense of anticipation and optimism despite its vagueness.

Feature stories on CAE's new president began to appear in local and national press. CAE had never received so much publicity. Three months into his new position, Sockmaker received a social entrepreneurship award from Stanford University's Graduate School of Business.

Stephanie ended up being tapped for a new position as the chief social innovator and was dispatched to investigate promising approaches in Canada and Eastern Europe. Sockmaker hired his college roommate Jack Holloway as the new CFO, introduced as an expert in capital restructuring (who previously served as a procurement officer for the Coalition Provisional Authority in Iraq).

In the second week, after Stephanie was sent to Bratislava, Slovakia, Sockmaker and Holloway announced a "rapid conversion to a dynamic enterprise accounting format with the capabilities required by the new capital structure. We will never sacrifice short-term liquidity for long-term insolvency."

Four months later, after several postponements, the Nueva Transformación consultants were set to deliver their findings at a special joint board-management team retreat at the Ronald Reagan Ranch in Santa Barbara. Longtime staffers were nervous, since recent consultant interviews were zeroing in on ROI, growth rates, profit margins—measures never discussed under the previous leadership—and asked for program elimination hints. Many were impossible questions to answer, since the dynamic enterprise accounting format had yet to produce a single report, and Holloway had the old Peachtree system purged to prevent identity theft and certain "security issues."

As the former CFO doing her first significant international travel, Stephanie told me that she wondered what was going on, but said, "Honestly, I am so completely inspired by this research and the amazing people I've met, from Calgary to Bucharest, I just need to let the CAE accounting system sort itself out." "Besides, even though I wasn't consulted about changing the software, I'm not worried, because I know there is no way the finance committee would change the endowment asset allocations they set just six months ago."

So how should nonprofit board retreats be organized? thought Sockmaker. Every new leader brings his own style, and understandably wants to show off his knowledge, contacts, and abilities in the best possible light.

Going to scale with 1,200 percent growth in two years and dividing CAE into three "impact centers" with unpronounceable acronyms. Yet the guests and board members were so jazzed that it was exciting and inspiring.

Nothing, however, prepared the old-timers on the board and staff for the opening reception with airport shuttles, valet parking, the lieutenant governor and various B-list celebrities linked to charitable causes, roving trays of sauvignon blanc, a Cuban salsa band—brought in from Stockton—and, later, Nicaraguan cigars and Absinthe.

On the first day of the retreat, there was the Big Presentation: the product of four months of exploration and analysis. Other than the new financial system and about 20 new hires in finance and administration, Sockmaker had been surprisingly hands-off after the first few days. He reduced his number of direct reports and had reduced his time in the office to only two days a week.

Sockmaker's absence and abstraction had only added to the sense of drama: something big was going to happen.

Alas, after all the buildup, the talk was mere puffery. Going to scale with 1,200 percent growth in two years and dividing CAE into three "impact centers" with unpronounceable acronyms. Yet the guests and board members were so jazzed that it was exciting and inspiring. What was not possible was determining precisely which things would change.

That became clear the following Monday, when five of the long-standing programs were eliminated—and their associated staff dismissed—including CAE's two largest sources of revenue. In their place were six new initiatives that no one on program staff had ever heard of.

Two months later, after still no financial reports, Sockmaker abruptly announced he was leaving—within the week. His new post? He was to become the director of the Center for Social Entrepreneurship at Stanford's business school and would train the next generation of social capitalists.

Unfortunately, it was later discovered that an undisclosed but daring investment of CAE's entire endowment into auction-rate securities had gone south about the same time. The buildings had been pledged as collateral, the new programs were without revenue, and the auction-rate securities became suddenly illiquid.

A smaller but wiser CAE is now 30 percent of its former self, with Stephanie recalled from Dubrovnik for emergency cleanup duty. Like a country having second thoughts after its first MBA president, Community Arts Exchange has decided to head back to its roots. If you know of someone with solid nonprofit management experience, please encourage them to apply.

Phil Anthrop is a consultant for foundations in the G8 countries.

To comment on this article, write us at feedback@npqmag.org. Reprints of this article may be ordered from http://store.nonprofitquarterly.org, using code 150213.

Business Discipline and the Take-Charge Leader

by Phil Anthrop

ONE OF THE MOST EXCITING TIMES for any workplace is the arrival of a new CEO, but the day Saul Sockmaker joined Community Arts Exchange (CAE) in Los Angeles, it was positively electrifying. In a parking-lot ceremony under a clear sky, most of the 360 CAE staff joined community leaders and board members to applaud Sockmaker, who ran the 20 miles from his boyhood home carrying his Day One Business Plan, which he had presented during his first interview at CAE.

Sockmaker's hiring was one more step in what the *New York Times* has described as "the trend in the nonprofit sector to recruit successful business executives in the hope that their expertise would instill greater professionalism and financial acumen." Half of CAE's employees would be sacked within six months, but on Sockmaker's first day, everyone was genuinely thrilled.

Community Arts Exchange was a unique 25–year-old visual arts, job training, economic research and HIV-AIDS program with a charter school, sailing camp for children with disabilities, and a large contract with Mammon Bank to train inner-ring suburban single grandparents to become tellers and derivative bond traders. CAE had grown tremendously by the time my sister-in-law Stephanie was hired as CFO three years ago, and I followed (and admired) the organization's progress from afar. Envied by other nonprofits, CAE had slowly socked away a $90 million endowment.

CAE had always been run by its MSW founder, Marion Sandfort, so insiders were curious to see how a business-savvy MBA in charge might change things—especially someone as young

> Community Arts Exchange was a unique 25–year-old visual arts, job training, economic research and HIV-AIDS program with a charter school, sailing camp for children with disabilities, and a large contract with Mammon Bank to train inner-ring suburban single grandparents to become tellers and derivative bond traders.

and gifted as Saul Sockmaker. Board Chair Kate Barnsdorf paid tribute to Sandfort's many accomplishments: "CAE will miss Marion Sandfort's passion for the mission, but today's economy demands a leader with business savvy and innovative approaches to assure CAE's future." Sandfort in turn thanked the board for its support and reflected that she had "tried my best and just used common sense since I didn't have business training."

Sockmaker made a fortune by the time he was 35, taking proceeds from selling his Internet startup to strike it big-time in Miami condos. By 2007 Sockmaker realized he needed to return to California to apply his business expertise by "giving back" to the community, and CAE's board encouraged him to name his price.

In his second day on the job, Sockmaker changed the staff coffee service to a fair-trade dark roast, installed organic carpeting and landscaping for the entrance to the main building, shook the hand of every employee, and gave each one a copy of his Day One Business Plan. Sockmaker read every document drafted by the organization, came early, and stayed late.

At the management team meeting on day three of Sockmaker's tenure, it was clear that a new sheriff was in town. "This enterprise has an incredible mission, but hope is neither a business plan nor a capital structure." Sockmaker began. "In the next 90 days, there will be some restructuring. But first, we are going to do a thorough review of operations and finance. I know there are efficiencies to be gained, and we will, with the help of a consulting team from Nueva Transformación."

The corporate language and focus on capital and enterprise was completely

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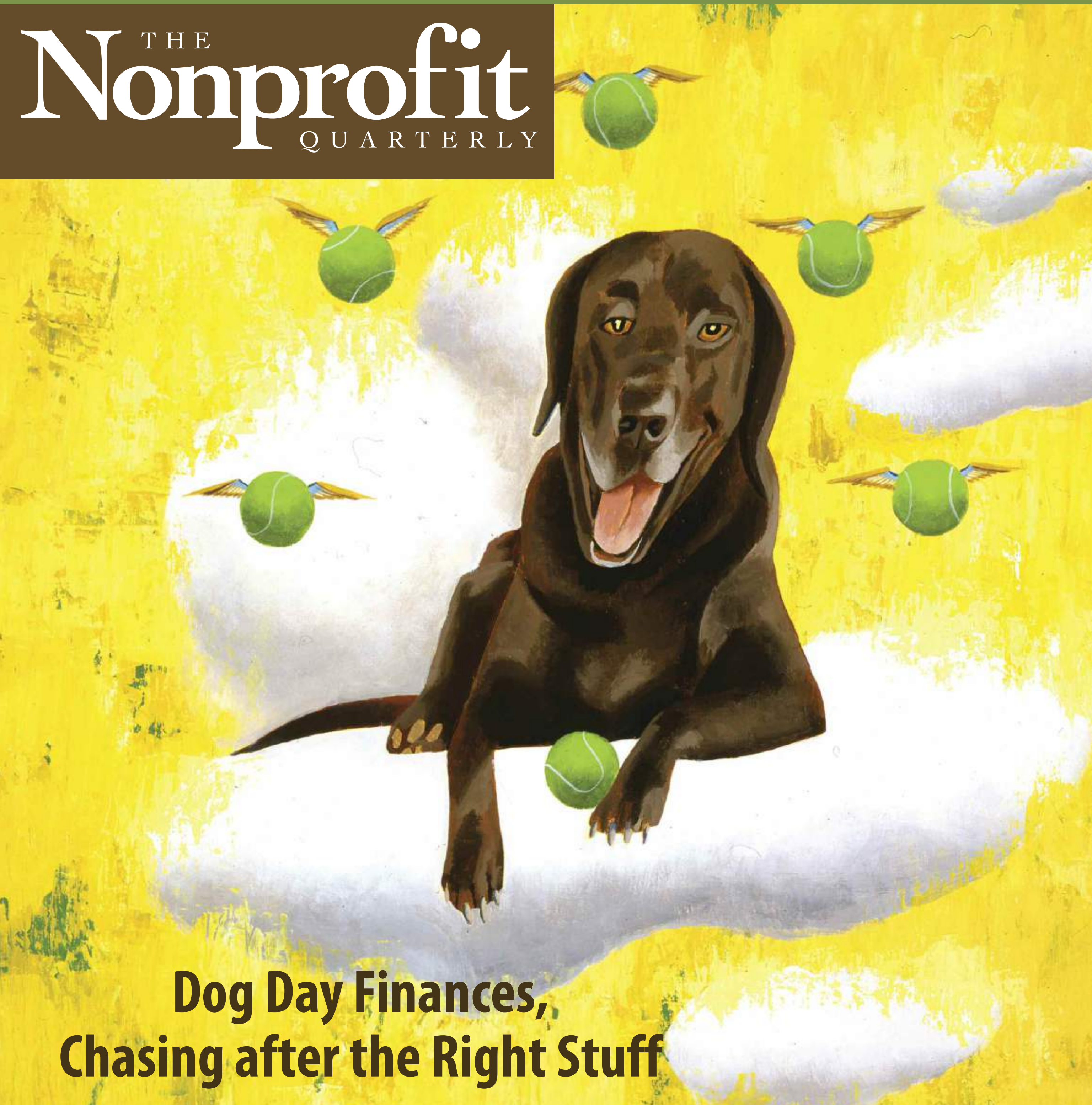

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