Nonprofit Financial Planning Made Easy

Jody Blazek

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WILEY

John Wiley & Sons. Inc.

This book is printed on acid-free paper. ♾

Published by John Wiley & Sons, Inc., Hoboken, New Jersey.

Published simultaneously in Canada.

Library of Congress Cataloging-in-Publication Data:

Blazek, Jody.
Nonprofit financial planning made easy/Jody Blazek.
p. cm.—(Wiley nonprofit law, finance, and management series)
Includes bibliographical references and index.
ISBN 978-0-471-71527-6 (pbk.)
1. Nonprofit organizations—Finance. 2. Nonprofit organizations—Accounting. 3. Nonprofit organizations—Management. I. Title
HG4027.65.B553 2008
658.15—dc22
2007044832

Printed in the United States of America

10 9 8 7 6 5 4 3 2 1

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EXHIBITS

About the Author

Jody Blazek is a partner in Blazek & Vetterling LLP, a Houston CPA firm focusing on tax and financial services for exempt organizations and the individuals who create, fund, and work with them. BV provides tax compliance, auditing, and planning services to over 500 nonprofit organizations, including schools, churches, museums, human service organizations, business leagues, private foundations, garden clubs, fraternities, research institutes, civic associations, cultural organizations, and others.

Jody began her professional career at KPMG, then Peat, Marwick, Mitchell & Co. Her concentration on exempt organizations began in 1969, when she studied and advised clients about the Tax Reform Act that completely revamped the taxation of charities and created private foundations. From 1972 to 1981, she gained nonprofit management experience as treasurer of the Menil Interests, where she worked with John and Dominique de Menil to plan the Menil Collection, the Rothko Chapel, and other projects of the Menil Foundation. She reentered public practice in 1981 to found the firm she now serves.

She is the author of six books in the Wiley Nonprofit Series: *IRS Form 1023 Preparation Guide* (March, 2005), *IRS Form 990 Tax Preparation Guide for Nonprofits* (2001, online version, 2004), *Tax Planning and Compliance for Tax-Exempt Organizations,* 4th edition (2004), *Financial Planning for Nonprofit Organizations* (1996), *Private Foundations: Tax Law and Compliance, 2nd edition* (2003), and *The Legal Answer Book for Private Foundations* (2001), coauthored with Bruce R. Hopkins.

Jody serves on the Financial Accounting and Transparency Group created by Independent Sector to support the Panel on the Nonprofit Sector's reports to the Senate Finance Committee. For that project, she also works with Foundation Financial Officers' Group to provide technical assistance and support to the Form 990-PF Reform Committee.

She is past chair of the AICPA Tax-Exempt Organizations Resource Panel and a member of the 990 and 1023 Task Forces. She serves on the national editorial board of Tax Analysts' The Exempt Organization Tax Review. She serves on the Community Service Committee of the Houston Chapter of Certified Public Accountants and is a founding director of Texas Accountants and Lawyers for the Arts and the Houston Artists Fund. She is a member of the board of the Gulf Coast Institute, the Anchorage Foundations, and the Main Street Coalition Council. She is a frequent speaker at nonprofit symposia, including those sponsored by the Conference of Southwest Foundations; Association of Small Foundations; AICPA; Arizona, New York, Washington, Maryland, and Texas Societies of CPAs; the University of Texas School of Law; United Way of the Texas Gulf Coast; Professional Education Systems, and Nonprofit Resource Center, among others.

Jody received her BBA from the University of Texas at Austin in 1964 and took selected tax courses at South Texas School of Law. She and her husband, David Crossley, nurture two sons, Austin and Jay Blazek Crossley.

Preface

Financial planning contributes significantly to the success of a nonprofit organization and allows it to better accomplish its mission. Planning tasks are challenging and too often are overlooked. In this time of shrinking governmental support for nonprofit organizations, astute use of available resources following a well-developed financial plan may be the key to a nonprofit's survival.

The concepts and techniques presented in this book can simplify the efforts of financial managers and board members to be fiscally responsible, or accountable, to the organization's private and governmental funders, to its clients, to the community in which it operates, and to the society benefiting from its work.

The nonprofit world to a great extent embodies selfless groups of persons working to help others in a wide context. The groups through which they work are clustered in three distinct types:

1. Charitable organizations: churches, soup kitchens, universities, museums, and research institutes.
2. Associations and community organizations: civic leagues, business leagues, labor unions, and social clubs.
3. Public sector: governments, municipalities, agencies, and public boards that work with nonprofits.

Hopefully, many people working in this broad range of nonprofits will find in this book a good prescription for their organization's fiscal health.

My experiences as an accountant serving nonprofit organizations inspired me to develop checklists and forms to encourage the use of financial planning. When my firm is engaged to perform traditional accounting services for a nonprofit organization, such as preparation of the annual Form 990 or performance of an annual audit, we often find that the organization needs financial management assistance beyond the specific task we are engaged to perform. Also, when our help is sought to help overcome unexpected financial problems, we often find the nonprofit managers could have averted the crisis with adequate advanced planning.

In Chapter 1, I seek to dispel myths that can hamper a nonprofit's financial success. Nonprofits can profit, or accumulate revenues in excess of expenditures, so long as such resources are devoted to improving the fashion in which the nonprofit accomplishes its exempt purposes. While surpluses shouldn't exceed that amount reasonably needed to assure financial stability, funds can be saved to finance future plans. A nonprofit can set aside funds to expand programs, self-insure risks, build a new building, establish a new location, or simply provide adequate working capital. The primary distinction between a for-profit and a nonprofit is that the latter has no owners. The nonprofit does not distribute its profits, if any, to any private individuals—its creators, insiders, or those who govern it. It can, however, and should accumulate sufficient working capital from surplus income to assure uninterrupted and viable program delivery.

In pursuit of financial stability, a nonprofit can conduct its financial affairs in a business-like fashion as long as its managers understand the ways in which it is different from a for-profit business. Both need strategic plans based on clearly defined goals, with a focus on accountability, productivity, and profitability. To be fiscally successful, both need skilled financial managers. In evaluating a nonprofit's staffing budgets, it is interesting and can be useful to observe whether the organization considers financial personnel equally as important as its program officers. Seeking pro bono volunteer financial services is not always cost effective in the long run.

The fiduciaries of a nonprofit have special responsibilities. Whether labeled as directors, trustees, elders, or commissioners, they are the financial stewards ultimately accountable to those constituents the nonprofit is organized to serve. The common denominator for this stewardship role is selflessness. The beauty of the U.S. philanthropic community is its extensive network of generous volunteers who expect no monetary compensation in return for their efforts. The challenge, however, is to design an organizational structure for the nonprofit within which this great human resource can efficiently function.

Chapter 2 explores the roles of the board members, the staff, and the volunteers. The objective is to define tasks clearly and establish an adequate financial management structure with checks and balances and built-in warning signs to spotlight problem areas. A checklist of issues a fiduciary should consider in fulfilling his or her duty to oversee and guide the organization and its managers is provided. Also, the important distinction between inside and outside accountants is explained to aid in understanding the need for separation of their roles to achieve suitable fiscal oversight and controls. This book should prove particularly useful to the many well-meaning volunteer accountants, lawyers, and other professionals who have little or no experience with nonprofit organizations.

For some years, I have collected examples of poor financial planning by nonprofit organizations. Fundraising events are perfect specimens for such analysis. My favorite example, found some years ago in a now yellowed and undated newspaper clipping, is the story of a small college in Massachusetts. The school spent $40,000 printing 10,000 copies of a cookbook with recipes contributed by local and state politicians; the idea being to raise money and bring some attention to the college. Instead of selling the hoped-for 10,000 copies, only 3,000 copies were sold and the college reportedly was forced to curtail its academic programs to cover deficits from the publishing program.

How could financial planning have improved this situation? First and foremost, the college could have applied the concepts discussed in Chapter 3—it should have prioritized its mission and balanced its available resources. It allocated funds needed for academic programs to “invest” in a risky publishing venture. One can imagine its budgeting procedures were inadequate so that no marketing feasibility study or forecast was conducted in advance and no follow-up promotions were budgeted, as suggested in Chapter 4.

Too many times, I see fundraising events run by well-meaning volunteers with little or no advance planning for financial feasibility. Consider whether fundraising events would actually show a profit if the value of the volunteer time devoted to organizing and presenting such events was quantified. Recently, I saw a group lose money on an event because they were not allowed to serve donated food or drinks as was their past custom. Event planners entered into an agreement to hold the annual gala in a museum without realizing they were required to use approved (and very expensive) caterers. It is often amazing to see, based on the value of fundraising events that the IRS requires the nonprofit to estimate, the narrowness of the margin between the cost of such events and the gross proceeds.

Poorly planned expansion plans can also wreak havoc with a nonprofit’s financial situation. A good example of this problem occurred some years ago when the American Center in Paris announced that it was forced to close its doors 19 months after the opening of a new $41 million building designed by American architect Frank Gehry. The building costs used up the Center’s entire endowment, leaving too little for running the literature, language, and dance classes that had made the center the preeminent showplace for American artistry in Europe.

Investment of the organization’s savings, working capital, and permanent funds is a significant, and often troublesome, issue for nonprofit managers and board members. Chapter 5, entitled “Asset Management,” addresses the questions involved when a nonprofit accumulates resources beyond its immediate operating needs. In seeking restricted funding and longer-term endowment gifts, a nonprofit must be prepared to respect the covenants and safeguard the property. The prudent investor rules can be applied to safeguard the assets. Luckily, financial returns on investments in the past few years have been positive, but it remains to be seen how hedge funds and other alternative investments will fare during a downturn in the financial markets. If one doubts the need for diversification of investments, the subprime mortgage debacle rocking the investment community during 2007 should be recalled.

In addition to checklists and models to be used in setting financial priorities and allocating precious resources, the reader will find a brief, but thorough, description of the elements of an accounting system in Chapter 6. This chapter should be required reading for all new board members and trustees. To meet their fiduciary responsibility to judge the organization's fiscal condition means they must be able—at least once a year—to read the financial statements. It is not sufficient, in my opinion, for the board treasurer to simply report to the assembled board members that "everything is okay, so you need not read the auditor's report." Post-SOX policies that require an audit committee and thorough review of financial reports to the board are not required for nonprofits, as discussed in Chapter 2, but prudent nonprofits now adopt such governance practices.

I understand that many nonprofit managers and volunteer board members lack financial training and have a fairly high level of avoidance or denial of their ability to understand a balance sheet or cash flow report. To dispel this lack of basic knowledge, Chapter 6 explains the fashion in which financial information is accumulated and presented. Understanding basic terms like *accrual method, restricted funds,* and *receivables* can lead to improved financial decisions. I've noticed that the attitude of persons newly trained to understand financial statements is similar to the mood of clients who deliver their annual income tax data to the firm—a necessary evil has been conquered and overcome.

Beyond basic accounting lies financial analysis applied with the special financial tools explained in Chapter 7. Before approving the cookbook project mentioned above, for example, the board or finance committee members will ask to see the projected sales analysis and marketing plans to hopefully recognize it was grossly inaccurate. When asked to approve a proposed increase in the annual tuition, a private school trustee will ask what the direct per-student cost is and want to know the amount of unapplied variable overhead costs that must be covered. After studying Chapter 7, a financial planner will know why cost accounting is useful in answering such questions. Once one knows how to read the financial statements with an understanding of what makes up each category, ratio analysis can be applied to compare and analyze the numbers. Some financial disasters can be averted when more board members know how to measure the nonprofit's acid test and other financial ratios explained in the section Financial Indicators to Critique Performance.

Financial pressures on nonprofits will continue. Undoubtedly, in the next few years, Congress will be looking for ways to reduce budget deficits resulting from the Iraq war while providing funding for health care for the uninsured. Unfortunately, some federal programs will be reduced, with consequential reduction of many state and local government programs. As nonprofits begin to search for alternative sources of funding, some may be caught in the crossfire. Income-producing activities designed to replace funding cutbacks may be subject to constraints and taxes by the governments that need to raise funds.

Those who govern and manage a nonprofit organization must always be cognizant of the reasons why the nonprofit is permitted tax exemptions for federal and local tax and other purposes. Chapter 8 explains the rationale behind granting tax exemptions and requirements for maintaining the special status. Some associated with a nonprofit organization might want to regularly use Exhibit 8.1, Suitability Checklist for Tax-Exempt Status, to test for ongoing qualification. Before undertaking income-producing programs such as those described in the previous paragraph, the impact of the activity on tax status should be examined.

In completing a marketing questionnaire for this book, I was asked to choose my favorite parts of this book and to describe those that could prove most useful to a nonprofit's financial managers. My answer is that the most unique information is contained in Chapter 1—the notion that a nonprofit organization must "profit" to be financially successful. This concept alone can improve the fiscal health of a nonprofit. Adopting the attitude that the organization can function in a business-like fashion with efficient fiscal systems, well-paid personnel, and balanced resources and vision can improve the results. Certainly, to defend against what some call the "War on Nonprofits," the organization's managers can arm themselves with the tools and techniques of financial planning presented in this book.

Some readers know that this book is essentially a second edition of a 1995 Wiley book called *Financial Planning for Nonprofit Organizations.* I am particularly grateful to my audit partner, Kay Walther, for updating the accounting and auditing concepts of Chapter 6. My thanks also go to David Nelson, tax principal in my firm, for his updates for Chapter 2. Finally, I marvel at the continued quality of John Wiley & Sons personnel. I thank my editor, Susan McDermott, for encouraging me to update the book, and Natasha Andrews-Noel, production editor, for bringing it to fruition and making it a useful tool.

Jody Blazek
January, 2008

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Introductory Concepts

The key to the financial success of a nonprofit organization is the use of traditional management tools—forecasts and budgets, well designed and timely financial reporting system, good governance, clearly defined line of business (mission), cash flow planning, fiscal controls, and a lot of goodwill.

Financial planning for nonprofits, like a nonprofit's very purpose for existence, is based on the philosophical aspirations of persons joining together to accomplish mutual goals. The very purpose for existence of a nonprofit is based on hope, sometimes on prayer, and almost always on dreams. Dreams can be unrealistic and can make financial planning a risky venture. The challenge is to stretch and balance precious resources to best accomplish the dream. Together, the two functions—performing the mission and providing the requisite resources—work in tandem to sustain the nonprofit's existence.

Although idealistic aims guide the planning process and dictate a nonprofit's priorities, accomplishment of the goal can be enhanced with astute planning. Readers who are familiar with business management will recognize the planning processes discussed in this book. Similar to the income tax rules concerning tax-exempt nonprofits discussed in Chapter 8, financial planning for nonprofit organizations requires acknowledgment that the special character, language, and tools germane to nonprofits be understood alongside language and concepts applicable to for-profits. When working with a nonprofit organization, it is useful to ask what would make it prosper and flourish like a business. You can ask how an entrepreneur would respond if the same situation arose in his or her successful business. You should wonder whether the stockholders, if the nonprofit had any, would ratify the recommendations being proposed by management?

The financial activity of nonprofit organizations has been the subject of much scrutiny and criticism during this decade. The IRS Form 990 filed annually by charities, complete with details of revenues, expenses, assets, activities, compensation of officials, and many other disclosures can be viewed on the Internet.[1] Charity Navigator was formed in 2001 to grade charities.[2] During 2002 and 2003, the *Boston Globe* presented a series on the results of its investigation of private foundation abuses.[3] As the Enron scandal also unfolded during 2002, Congress approved new standards applicable to publicly traded corporations. This so-called Sarbanes-Oxley legislation was enacted to prevent a repeat of the Enron misrepresentations by improving rules of governance and oversight of financial matters.

The Senate Finance Committee, then headed by Senator Charles Grassley, next turned its attention to the nonprofit sector. After a series of hearings, the committee in July 2004 issued a 19-page report outlining a wide range of new standards to improve public accountability and governance of nonprofits. In response, Independent Sector assembled a Panel on the Nonprofit Sector consisting of 175 executives and experts with extensive knowledge of and experience with public charities and private foundations. Drawn from organizations of all sizes serving diverse missions and geographic locations, they advise the Panel as it develops recommendations on how to ensure that nonprofits remain a vibrant, responsive, and effective part of American society. These participants, all of whom have volunteered for this important work, joined one of eight groups:

- The Panel. Twenty-four nonprofit leaders who reflect the reach and diversity of the country's nonprofit organizations
- The Citizen Advisory Group. Nine leaders of America's business, educational, media, political, and religious institutions
- The Expert Advisory Group. Eight of the foremost scholars and practitioners in nonprofit operations
- The Work Groups. More than 100 nonprofit practitioners are taking part in five groups: Governance and Fiduciary Responsibility; Government Oversight and Self-Regulation; Legal Framework; Small Organizations; and Transparency and Financial Accountability.

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[1] At www.guidestar.org.
[2] See www.charitynavigator.org. In June 2007, their site displayed a rating range of one to four stars for over 5,200 charities based on information in their Form 990.
[3] In one example, $250,000 was paid for the wedding of a foundation trustee. On December 30, 2003, in conclusion to its series on foundation practices, the *Boston Globe* reported that "both the Internal Revenue Service and state attorneys general have inadequate resources to provide effective oversight of private foundations."