How to Keep the Money You Earn

Here's how to overcome the lunacy of "use it or lose it" and keep the money you deserve.

BY PETER BRINCKERHOFF

You've read a lot in past issues of *Nonprofit World* about how to spend less, account better, and become empowered as an organization. While that is important, many readers have undoubtedly been preoccupied with one concern: that their funders will take back whatever they don't spend. Funders tend to do that. Too many, sad to say.

The solution is to convince funders that taking away your earnings is both bad policy and a short-term financial gain that results in long-term financial loss to them. The strategies in the following list are designed to let you legally keep what you earn from being taken back by funders, using their rules and regulations. These suggestions have worked for many nonprofits, and one or more may work for you if they fit your funders' regulations. Check first to be sure.

1. HAVE RESTRICTED ACCOUNTS.

One of the best and simplest ways to keep earnings is to put them in a restricted account: an account that's designated, restricted, for a specific purpose, such as a capital account or an endowment (see next section). For funders who want you to spend your money first (United Way being the most notorious example), restricted accounts are often considered off limits. In other cases a business account is set up solely for a new venture and the "profits" are left in the restricted account, only to be used for business-related expenses. If the business has a mission benefit, this can be very smart.

All restricted accounts must be set up by board action and audited as such. They are restricted: You can't just transfer money in and out at will.

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Here is yet another example of why it's essential to know the regulations, rules, and policies of your funders. Will this simple and inexpensive action help you? Find out.

2. FORM AN ENDOWMENT.

One of the characteristics of a financially empowered organization is that it gets at least 5% of its annual income from earnings on its endowment. When you do the arithmetic, that adds up to a lot of money sitting around earning interest and dividends. Won't your funders come after it, saying that you should spend it? Won't your employees ask why they can't have that pile of cash? The answer is: "Probably." So what can you do to protect your nest egg? The simplest thing is to put the money in a restricted account within your current corporation. The account's restrictions limit access to the fund and its earnings to a severe financial crisis (perhaps as defined by 3/4 of the board).

The other solution is to establish a second not-for-profit that is designed to hold funds for your main organization. If you want the second

organization to be more flexible, and potentially hold property and lease it to the main not-for-profit, you'll probably need to form the second corporation as a related but *uncontrolled* organization to meet your funder's regulations about contracting between your different corporations. In that case you would be giving your money away to an organization you don't technically control. How do you ensure that some future endowment board won't start giving your money to some other not-for-profit? You make your "donation" to the second corporation, the one housing your endowment, a restricted donation, requiring the funds and their earnings be used for your organization by name.

Another reason to set up an endowment corporation (usually called a foundation) is that endowments are a competitive advantage in fundraising. Larger and more sophisticated donors know all about funders wanting your net revenues, your profits. They want some assurance that their donations won't go that way, and a second corporation provides that assurance.

3. KNOW ALL YOUR COSTS.

How does knowing your costs preserve your profits? Knowing all your costs assures that you only declare the profits that you really have. Most nonprofits have annual audits, and so the profits of the entire corporation are going to be easily seen. But where a lot of organizations fail is in the area of assigning those costs properly to a particular grant or contract, and the resulting *appearance* of a net revenue causes the funder to ask for money back, money that is not legitimately the funder's. Usually these end-of-grant accountings aren't done by an auditor but by internal staff. If a fixed amount for overhead is used, you know the costs are wrong. If depreciation, or the rent on a building that's owned and paid for, or the executive director's time, aren't accounted for and included, the resulting payback to the funder is an unnecessary loss.

Endowments are a competitive advantage in fundraising.

For example: An organization bids for and is awarded a $140,000 contract to run a midnight basketball league. The funder pays only for documentable costs associated with the league, or up to 15% overhead. Any unspent funds have to be returned. The organization uses a fixed percentage of 12% internally for its administrative contribution, but in this case the overhead for the new program is more in the area of 19%. In addition, in its bid, the organization doesn't include the costs of transportation to and from the courts for staff and some players who would be bussed, since the buses are funded by another program and are "not busy" at night.

At the end of the contract year, the organization has to return $9,300 because of two things: not documenting the cost of mileage for transportation (gas, maintenance, insurance, and depreciation are legitimate expenses) and not doing timesheets for administrative staff so that the full cost of overhead could be recovered.

Know the regulations of your funders and know all your costs. Use your improved internal financial reporting systems to keep better track of costs, budgets, and contract-by-contract expenses.

4. CREATE SEPARATE CORPORATIONS.

There are several situations in which you'll want to create a second corporation, separated from your main organization. One is the endowment situation discussed earlier. Another reason to create a separate corporation is to house a profitable business or to hold property and lease it at fair market value to the main not-for-profit and retain the profits for later use.

Understand that putting such activities in a separate entity won't "hide" the activity from a savvy funder. In your main not-for-profit's audit, your auditor will have a statement about "related organizations." Thus a funder who knows how to read an audit will figure out what's going on. But the fact that the funds are separate may meet the restrictions of the funder's regulations, and if you can rationalize your actions in a mission-based fashion, this action may solve some of your profit retention problems. We'll discuss different corporate structures in an upcoming issue.

Try to get your funders to move to true contracting for services.

Downlink Update

Peter Brinckerhoff shares other insights in distance-education courses he teaches for the Learning Institute for Nonprofit Organizations. The Learning Institute's Certificate of Excellence in Nonprofit Leadership and Management is based on the following curriculum, delivered to downlink sites across the United States, Canada, Mexico and South America:

Strategic Planning: Charting Your Course

Resource Development: Unleashing Community Generosity

Board Development: Building Passion for Mission

Marketing Is Everyone's Business

Financial Empowerment: More Mission for Your Money

Social Entrepreneurship: Merging Mission and Money

Volunteer Involvement: Attracting and Keeping the Best

Strategic Alliances: Extending Your Reach

The Learning Institute is a program of the Society for Nonprofit Organizations (6314 Odana Road, Suite 1, Madison, Wisconsin 53719). For more information, please call PBS Adult Learning Services at 800-257-2578.

5. MOVE TO CONTRACTS RATHER THAN GRANTS.

This action may not be totally in your control, but it's more likely that a contract will allow you to keep your net revenue than will a grant. Try to get your funders to move to true contracting for services. Work with your state and national trade associations toward this goal. If all your funders would let you keep your earnings, you could ignore items 1 to 4 here. What a great situation that would be!

6. LOBBY LEGISLATORS & CONGRESS.

Make the case with legislators that you earn your money and ought to be able to keep what you don't spend. Ask, "Why should not-for-profits be denied the benefits of capitalism? Let us be social entrepreneurs, take risks, and reap the potential rewards." Talk to funders, legislators, and the press about the lunacy of "use it or lose it" and how it encourages poor spending decisions and results in your organization remaining permanently financially disabled.

Talk to everyone who will listen. Start now. We have 30 years of prejudice and misperceptions to overcome. ■

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These publications are available through the Society for Nonprofit Organizations' *Resource Center Catalog*, included in this issue, or contact the Society at 6314 Odana Road, Suite 1, Madison, Wisconsin 53719 (800-424-7367).

Peter Brinckerhoff is president of Corporate Alternatives, inc. (CAi), a firm specializing in nonprofit organizations (2707 West Washington, Suite C, Springfield, IL 62702). He is the author of Mission-Based Management *and* Financial Empowerment: More Money for More Mission, *from which this article is adapted.* Financial Empowerment *is published by Alpine Guild and available through the Society's Resource Center (see "Selected References"). Brinckerhoff is also a faculty member of the Learning Institute.*

Nonprofit World • Volume 17, Number 4 July/August 1999
Published by the Society for Nonprofit Organizations
6314 Odana Road, Suite 1, Madison, WI 53719 • (800) 424-7367