

Financial Management of CED Organizations

Momentum's approach could be just what your organization needs

By Walter Hossli

I've been really lucky when it comes to money. Not that I've got a lot of it, personally. But I've always had a good sense for numbers, especially how big one number is relative to another. So I can see the forest when others focus on the trees. I'm also married to an accountant. She helps me approach money pragmatically and understand it primarily as a tool, not as a moral issue and even less as a mystery.

That doesn't make financial management easy. It does make it a standard part of our daily discussions here at Momentum, a charitable organization in Calgary, Alberta concerned with developing sustainable livelihoods with people living on low incomes. No question, sound financial management is one reason Momentum has grown from around \$300,000 in revenues 20 years ago to over \$5 million today.* We've become one of the big success stories in Canada's community economic development (CED) sector, in large part because we've learned how to take money seriously.

*Organizations incorporate in many different ways, and they have a number of options for filing under the Income Tax Act. Depending on how your nonprofit, social enterprise, or social business is incorporated and files, quite different rules may apply to the generation of surplus and the results of doing so.

Unlike the Momentum of 20 years ago, we are no longer limited to applying for funding for this or that project, and then spending the money according to funders' dictates. We no longer undervalue the work of staff members or the organization. We don't worry if we can make payroll every month. Today, despite all its growth, Momentum is financially stable and can invest money strategically: we gather and use resources to accomplish the goals of our business plan.

So what makes us different? We have followed four steps to sound financial management. The steps are

1. Cost properly
2. Build surpluses
3. Build reserves

Number 4 is organizational culture, the step without which you can't do 1, 2, or 3: recognize financial management as a key task that requires a high degree of professionalism from your Board, Finance Committee, senior staff, and program managers.

As you probably see, these steps are not a quick solution to financial sustainability. They are a solution for the long haul. If you follow them, though, your organization will be able to achieve performance and independence at no cost to its spirit or passion. In fact, I'll bet they'll both grow on account of good financial management.

The Great Challenge - Undesignated Income

As much as we nonprofits, or community benefit organizations, like to imagine ourselves modeling the private sector, at the end of the day, we do business according to a paradigm that is very different from theirs.

The private sector is bottom-line oriented. It strives to maximize shareholder value from selling goods and services for as much as the market will bear and by tightly controlling costs. It goes into debt at the front end in order to get production rolling and then repays creditors with the revenue from transactions. It allocates its revenue without having to consider the sources of that revenue, the customers.

Compare that to nonprofits. We as a sector are top-line oriented. We do only what we have money for. We usually incur expenses after we have secured revenue. So controlling expenses is built in because we know how much we have in the bank. Debt is possible but only in very specific circumstances. If we don't have the money, even the best ideas can't go forward. What's more, most of our money comes with strings attached. It has to be used as the terms of the contract prescribe. Unless something like a software upgrade is specified in some program budget, we probably can't pay for it, even though it would make us more efficient.

- Finance generally comes third in a nonprofit's development:
- We develop the organization's mission, so we and everybody else knows what we're about.
 - Next we develop concrete programs to accomplish that mission.
 - Then we go find the money necessary to carry out those programs.

So what's the biggest financial challenge we in this sector have to face? To generate undesigned revenue. Our challenge is to generate resources that we can allocate strategically to achieve our mission, without having to convince a funder first. This has to be our constant preoccupation – and it's a problem that the private sector simply doesn't have.

To use accountant speak, to move the organization forward we have to build a balance sheet that has a base of unrestricted net assets. Let's go to Step 1.

1. Cost Properly

In my experience, many nonprofits don't know the real costs of projects, or how to cost out a project properly. Yet until you know the true costs of a program or project, you don't know how much to charge for it in your proposal or grant application.

When the private sector costs goods or services, say a cup of coffee, it includes lines for ingredients (coffee, dairy, cup, etc.), overhead (labour, rent, marketing, general and administration), and for an operating profit. The service cost equals the fee charged to the customer. Then, the more cups of coffee the business sells, the more money it makes. (See Diagram 1.)

Compare that with what our sector tends to do. We cost the ingredients and the overheads. But we underestimate our General and Administration (G & A). To make things worse, we don't even insert a line for operating profit – because we're not supposed to make one, right? Consequently, the service cost is greater than the customer fee. Consequently, the more coffee we sell, the more money we lose. (See Diagram 2.)

What to do? First of all, know your prospective funders. Research their relationship to the nonprofit sector and look for signs of their interest in growing organizational stability. Make sure you have lots of them to choose from. (See sidebar next page, "Diversify, Diversify, Diversify.") Second, make it a policy to build program budgets that always include a 15% admin fee to cover core operating costs. Alternatively, add a charge for core staff that is equivalent to 15% of the total budget.

When charging for staff, remember: never pay less than professional salaries. In our sector it's staff that make the difference. In order to attract the best-qualified people, you have to pay decent salaries.

If you want to offer the best possible service or to do the best possible work, you also have to offer careers. Careers don't happen if people don't have opportunities such as advancement, professional development or simple appreciation. Every aspect of good human resource management is essential first to attract and then to retain the best possible people.

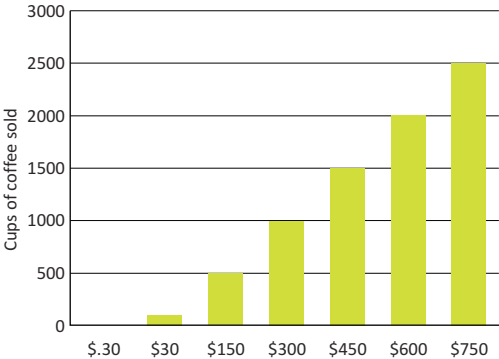
2. Build Surpluses

Proper costing is something you have to work at continually. It gives you a standpoint from which to negotiate boldly with funders who share your commitment to offering high-quality services and for growing the sector. The same applies when you design your costing not just to cover costs, but to have money to cover opportunity costs, cash flow, organizational stability, and innovation – to build surpluses, in other words. Surpluses become undesigned funds, which then can be used to advance your strategic goals and build your reserves.

One way to build surpluses is to bid on competitively-tendered contracts. This may mean going head-to-head with private companies to offer services which governments are purchasing. In such cases it is important to budget for the risk associated with such contracts, for example if they are structured as outcomes-based fee-for-service contracts. These have become increasingly common in Canada.

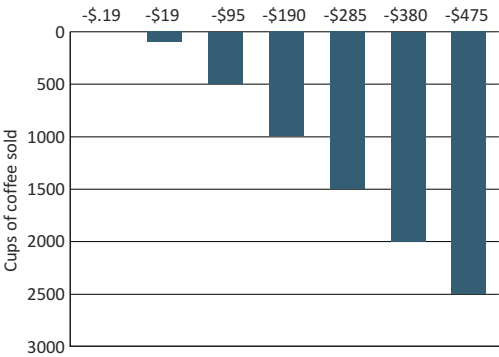
1. For Profit: Service Cost = Customer Fee

Item	Cost	Fee
Ingredients		
Coffee	\$0.12	
Dairy	\$0.05	
Cup, Lid, & Sleeve	\$0.25	
Overhead		
Labour	\$0.90	
Rent	\$0.25	
Marketing	\$0.12	
G & A	\$0.50	
Operating profit	\$0.30	
Service Cost	\$2.49	
Customer Fee		\$2.49



2. Nonprofit: Service Cost often ≠ Customer Fee

Item	Cost	Fee
Ingredients		
Coffee	\$0.12	\$0.12
Dairy	\$0.05	\$0.05
Cup, Lid, & Sleeve	\$0.25	\$0.25
Overhead		
Labour	\$0.90	\$0.90
Rent	\$0.25	\$0.25
Marketing	\$0.12	\$0.12
G & A	\$0.50	\$0.31
Operating profit	\$0.00	
Service Cost	\$2.19	
Customer Fee		\$2.00



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You only get the fee if you achieve results, however, so this takes some guts. The key is to make a distinction in a contract's deliverables. Some are *outcomes*, some are *outputs*. Both are valuable, but the first are more difficult to achieve (and to track) than the second. Outcomes are "riskier," in other words.

What you do is price your contracts so that expenses are covered when you achieve all the program outputs, for example, training program registrants and graduates. That means that whatever percentage of the total contract relates to the achievement of program outcomes (say, 15%) is surplus if you achieve those outcomes – and will not create a loss on the contract if you don't. So say the outcome is that at least 75% of grads are still employed six months after completing the program. If you achieve that, you bill the additional 15% and use it to cover unanticipated costs or other areas of your work that are underfunded.



(above) Adeel understood how the financial system worked in Pakistan, but Canada was a different story. Momentum's Financial Literacy Program helped him to learn it. "I learned the importance of saving each month and putting money aside," he says, first for a home and now for the education of his children. Photo courtesy of Momentum.

Diversify, Diversify, Diversify

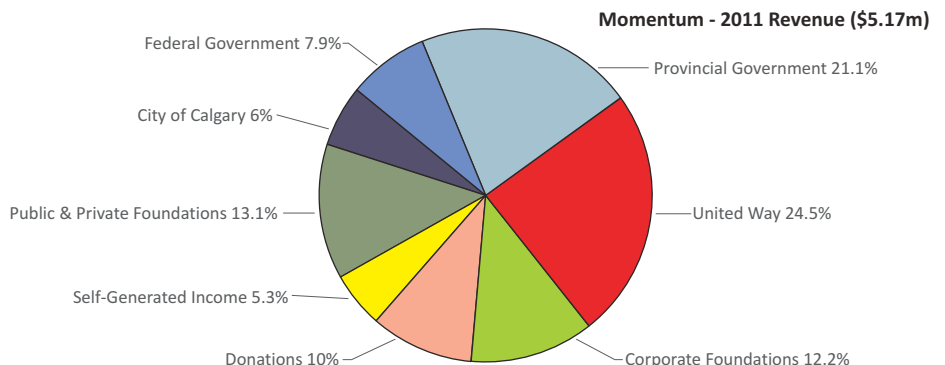
Momentum's revenue has diversified dramatically in the past 20 years. We have arrived at a good mix of government, non-government, and community sources, meaning individual donors who receive a charitable donation receipt for their contribution.

The decision to build this donor base has been an important one in Momentum's history. It took a lot of soul-searching to specify our market and our case to the community. We decided to build a donations program based on major gifts from people to whom we can present an economic case for Momentum. In times like these, one way to differentiate our work – and that of other CED organizations – is the economic case.

We talk about the results. We describe where people end up after they've been through one or several of our programs. (See photo, above.) As their incomes rise, their dependence on social services and on the nonprofit sector falls, while the taxes they pay increase. As a result, there is less dependency and a greater contribution to the community as a whole, in non-monetary ways as well as taxes. That's what we sell to donors.

Then we build and maintain a strong relationship with donors over time. That's more than simply sending out e-mails. We talk to them whenever the opportunity presents itself.

We've built that program slowly but steadily over the years. Once we made less than 2% of our revenues from donations. Today it's closer to 10%. Most of that money is undesignated. (See pie chart, below.) When talking to donors, we say that as attractive as a specific project might be to them (microlending, for example), we really need their donation to strengthen the organization as a whole. ■



What's the biggest financial challenge we in this sector have to face? To generate undesignated revenue. This has to be our constant preoccupation – and it's a problem that the private sector simply doesn't have.

So the outcomes-based contracts that strike so many nonprofits as an onerous burden are in fact an opportunity. In Momentum's case, when the Province of Alberta first introduced fee-for-service contracts, we were worried. The government opened contracts to competitive tendering and several private sector firms also responded to the Requests for Proposal (RFPs). Surely, we thought, we would be underbid. Unlike the others, we had no access to equity capital to cover our risk. What did we find? Price was a key aspect of the selection criteria, but not the only one. Ultimately, in that new scheme of contracting, our reputation for delivering results (and our ability to track results, of course) won out.

Résumé : Gestion financière des organisations de D  C

Contrairement    une entreprise priv  e, une organisation sans but lucratif (OSBL) engage habituellement des d  penses apr  s avoir obtenu des revenus. Sans ce revenu, m  me les meilleures id  es ne peuvent avancer. De plus, la majorit   du revenu doit   tre utilis   comme stipul   dans les clauses d'un contrat. Quel est donc le plus gros d  fi financier auquel font face les OSBL? G  n  rer des revenus non d  sign  s qui peuvent   tre affect  s strat  giquement, sans devoir commencer par convaincre un bailleur de fonds.

Pour accomplir ceci, prenez quatre dispositions : 1)   valuez bien les co  ts, 2) accumulez des surplus, 3) cr  ez des r  serves, et 4) reconnaissez comment essentiel la bonne gestion financi  re est pour votre organisation.

Lorsque vous   valuez les co  ts, ajoutez 15 % de frais pour couvrir les co  ts de fonctionnement des employ  s. *Ne jamais* payer les employ  s moins que des salaires professionnels. Ciblez les bailleurs de fonds qui ont    c  ur la croissance du secteur sans but lucratif. Pour accumuler des surplus, comp  titionnez pour des contrats bas  s sur des revenus. Incluez dans vos estimations un « frais de risque ». Il r  compense l'OSBL si des *r  sultats* sp  cifiques sont atteints en plus du *rendement*. Pour cr  er des r  serves, d  pensez moins que pr  vu au budget. N  gociez ensuite avec les bailleurs de fonds pour reporter les revenus non d  pens  s    la prochaine ann  e fiscale. Sugg  rez diff  rentes fa  ons de le d  penser. Lorsque vous cr  ez des r  serves, assurez-vous de sp  cifier les raisons pour lesquelles elles doivent servir.

Finalement, d  pensez du temps, des efforts et des fonds sur la gestion financi  re. Embauchez des gestionnaires financiers qualifi  s et payez-les bien. Examinez les implications financi  res de vos d  cisions. Rendez la gestion financi  re une t  che quotidienne pour les employ  s-cadres, les membres du conseil et les gestionnaires de programmes.

Si vous prenez ces quatre dispositions    long terme, votre organisation sera performante et ind  pendante sans diminuer sa motivation ou sa passion. ■

Another way to build surpluses is to self-generate revenue. Social enterprise is one of the most well-known. But there are simpler ways. For years we have charged fees for internal services that funders have accepted as project fees. For example, we own our own photocopier. We charge market rates for whatever photo-copies a program requires.

Interest is another way to self-generate revenue. As our reserves have grown, interest income has become more substantial. While interest rates have dropped and our interest income has also decreased, every little bit helps. Experienced finance people on the Board and Finance Committee have helped to ensure that we get the best rates available on our investments.

build a reserve fund we call the Sustainability Fund. This fund was to have an amount in it equal to a quarter (25%) of our annual budgeted operating expenses and was developed from organizational surpluses. It took us probably five or six years to get there. Ever since, we've increased the target by the same amount as the budget has increased.

The purpose of the Sustainability Fund is to support projects whose external funding is finished, but which merit continuation. We have established two other Board-restricted reserve funds, each with its own purpose. The Capital Fund is to replace equipment or make renovations to space. This ensures that during tougher times, when cash is tight, we are not

Too often in our sector we treat money as a taboo subject. This will never do when we have such passionate people working for us. What we want are organizations with passion, performance, and independence. Financial management is the best way I know to make that happen.

3. Build Reserves

Having budgeted high, spend low. So at the end of the fiscal year, chances are you will have cash left over. The opportunity then presents itself to negotiate with the funder to defer those revenues into the next fiscal year. If you don't have that discussion, the money either has to go back to the funder or you keep it on the books and cannot use it. Do whatever you can to keep the money. To have that discussion and win a deferral at the very least helps you with cash flow. At the very best (that is, if you have already achieved all the project outcomes), you may be in a position to suggest to the funder a different way to use the money. Some funders will allow a percentage of unspent project funds to go towards building organizational reserves.

The trick with building reserves is to be purposeful. Commit your organization to specific amounts of money to be used for specific purposes. In 2001 we set a target to

stuck with old, outdated equipment or inadequate office space to attract professional staff. The third is a Strategic Fund. It helps us invest in innovation and new ideas, before funding is secured.

4. Organizational Culture

If you haven't already guessed, you might say I am a champion of strong financial management in the nonprofit sector. A big part of that task is to keep money in the back of my mind at all times. I constantly watch the numbers. I know what things cost. I sift every idea through a financial filter. So an idea whose impact might total a hundred thousand dollars is a different issue than one that might cost five thousand. It's not that one is more or less important than the other. But they do differ – significantly – in their financial implications. As a leader, my focus goes to the hundred thousand dollar issue, not to the five thousand dollar one.

I also make a point of knowing what I can do, and what I need help with. Years ago that got me thinking about Momentum's need to have the best people possible in charge of finances. That would spare me sleepless nights every month end making sure that the income statement was correct. So we hire them, pay them well, and give them a high profile in the organization. I ask business people to sit on the Board and on the Finance Committee.

Another thing we do is share leadership and access to information in our financial management. For example, we have a very transparent budgeting process. Program managers help create the budget for the coming year. They are expected to track their own budgets. They know what has been spent. They can meet that responsibility only if accurate and timely information is available. They are included in the decision-making process and get their say in how extra revenues get shifted around.

A third and salient point here is that Momentum transfers money between itself and its participants. Traditional social service organizations generally don't cut cheques for participants. But we have to have an accounting system that can track, for example, the matching dollars paid to Individual Development Account holders as well as track the repayment of microloans. It's critical for us to have accurate and up-to-date information on the loan portfolio, so we know when to follow

up with a participant who has missed a payment. It's a quasi-banking function that requires quite a sophisticated accounting system. That also colours who we have working here. We have probably as many people that have an MBA background as we do people with a social work background, and the other fields in between.

Passion, Independence, & Performance

In summary, if you follow these four steps consistently for many years this is where you will get to:

- You will have solid – yes, complex – accounting systems that give you the numbers you need to make good decisions during the year.
- You'll have a Balance Sheet that shows a solid base of unrestricted new assets.
- You'll have reserves on hand that reduce your risks, let you explore new approaches and ideas, and enable you to plan for the future.
- Every member of your senior and middle staff will understand financial management as an important part of his or her job description.

Too often in our sector we treat money as a taboo subject. Too often, we're content to interpret "nonprofit" to mean "living hand-to-mouth." This will never do when we have such

passionate people working for us. Rarely is there a shortage of ideas for great things to do. We can't do more than what we actually have money for. We shouldn't constantly confine ourselves to what funders consider worthwhile. We mustn't undervalue our staff in order to make projects fit the money available.

What we want are organizations with passion, performance, and independence. Financial management is the best way I know to make that happen. ⁱ⁴

WALTER HOSSLI has been Executive Director of **Momentum** since it was founded in 1991. Momentum works with people whose incomes fall below the poverty line and partners with them to ensure they can participate fully in the community and economic opportunities. Contact Momentum at 403-272-9323 and URL www.momentum.org

ⁱ⁴ is an ejournal about Inspiring, Innovating, Inciting, and Inventing ways of life and work that permit humanity and the planet to thrive in this century of unprecedented challenges. ⁱ⁴ is a publication of the Canadian Centre for Community Renewal.



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