



Accountability

Building Value Together

Building Value Together is an Independent Sector initiative designed to examine and make recommendations about ways that foundations and nonprofit organizations can work together to improve their practices to achieve successful outcomes. Paul Brest, president and CEO of the Hewlett Foundation, and Hilary Pennington, IS board member and vice-chair of Jobs for the Future, are the co-chairs of the Building Value Together Steering Committee.

Guidelines for the Funding of Nonprofit Organizations

Introduction

Concerned about the health and vitality of the nonprofit sector and about the state of foundation-nonprofit relationships, the Independent Sector Board of Directors has unanimously endorsed a statement calling on funders and nonprofit organizations to adopt a reciprocal commitment to working together constructively, to enhanced performance and to effectiveness.

The statement:

- Calls on funders to opt for general operating support over project support when feasible and when the goals of the two organizations are “substantially aligned.”
- Encourages funders, when providing project support, to pay “the fair proportion of administrative and fundraising costs necessary to manage and sustain whatever is required by the organization to run that particular project.”
- Calls on nonprofit organizations to engage in “top-notch performance... in strategic planning, financial management, evaluation, development, and ultimate impact.”

The statement was drafted by Paul Brest, president and CEO of the William and Flora Hewlett Foundation, along with a working group of foundations and nonprofit organizations in the fall of 2003. The full text of the statement is below.

IS's endorsement of the statement is part of the *Building Value Together* initiative that is designed to promote practices by both foundations and nonprofit organizations that lead to enhanced results. A preference for general operating support, where the organizational missions of the foundation and the nonprofit organization are strongly aligned, and a willingness to pay appropriate overhead costs when funding projects will lead, in IS's view, to enhanced results for both parties.

Statement on Guidelines for the Funding of Nonprofit Organizations

Funders can often achieve their strategic goals through core support for organizations whose goals are substantially aligned with their own. Where appropriate and feasible, funders should prefer multi-year, reliable core support to project support.

Definitions

Core support, or general operating support, is funding directed to an organization's operations as a whole rather than to particular projects (*project support*). If an organization has separate programs, departments, or divisions (for example, schools within a university), support for a particular program, or *program support*, is tantamount to core support. Core support may be used not only for the delivery of services or other activities directly in pursuit of the organization's mission, but also for administrative and fundraising expenses (overhead).

Comments

- Reliable, predictable, and flexible support is the lifeblood of nonprofit organizations. It provides the working capital that every organization needs to carry out its mission and respond to new challenges and opportunities. Core support is essential for the individual organization's sustainability and for a vibrant, and pluralist “independent sector.”

- The value of reliable core support to high-performing organizations should not prevent a funder from supporting new organizations entering the field. Indeed, it is often in the funder's and the field's interests for established organizations to compete for funding with newer ones.
- Funders should be responsive to the capitalization needs of organizations, and to the forms of funding necessary to sustain them. Funders should not assume that an organization will become self-sustaining or that others will fund it after they have ceased supporting it. An “exit strategy” with respect to organizations pursuing social change tends to make the most sense when the social objective has been achieved, when other funders or government agencies are prepared to carry on the work, when the organization is performing poorly or the anticipated social return on investment is low or declining. Where possible, a funder planning to exit a high-performing organization should assist the organization in obtaining funding following its exit.
- A funder can often achieve its strategic goals by providing core support to nonprofit organizations. A funder can evaluate an organization much as the organization evaluates its own success, and can evaluate the organization's contribution to the funder's strategy.
- A funder interested in particular activities or programs of a multi-program organization can generally achieve its aims through general support for the organization as a whole or the program, coupled with expectations and evaluation focused on those activities or programs.
- In return for long-term, multi-year support, funders can appropriately expect top-notch performance from nonprofit organizations in strategic planning, financial management, evaluation, development, and ultimate impact.
- Rigid requirements for proposal and reporting formats may subject an organization to responding to inconsistent demands by multiple funders. Therefore, a funder should take into account the size of its grant vis-à-vis those of other funders when considering what demands to place on a grantee, and should consider collaborating with others on common due diligence, evaluation, and reporting processes, with one funder taking the lead.

Barriers. If reliable core support is so important to nonprofit organizations and can often achieve a funder's goals, why is core support such a small percentage of grants and why are so many grants made for short periods or not renewed?

- Funders may not appreciate that they can often achieve their strategic goals and evaluate their achievement through core support grants.
- Funders or their program officers may not endorse, support, or even like everything a grantee does, or they may be enthusiastic in deepening, expanding, or highlighting particular activities of the grantee. The result is increased tentativeness about general support and more affinity towards project grants. (Program support may often provide a way to accommodate everyone's interests.)
- Funders or their program officers may be prone to “donor fatigue,” getting bored with regularly supporting strong organizations, and preferring to explore new ventures. They may not realize that few other sources of funding are available to the organization.
- A funder may desire more individual credit for an organization's success than is possible when it is one of a number of funders contributing core support.
- Funders may not trust grantee organizations to make good decisions about how to use core operating support.
- Because project grants, which are often favored by funders, usually have a completion date, it is not surprising that there may not be many renewals. The focus on project grants encourages grantees to continually propose new ideas to funders that possibly might fit narrow grant guidelines instead of focusing on building institutional capacity.
- Depending on an organization's overall financial situation, endowment and capital funding may be of great value to an organization in achieving its mission. Grants aimed at strengthening an organization's capacity (e.g., for strategic planning or fundraising) can also be of value—though funders should be careful to ascertain that the organization's leadership views such capacity building as a priority.

When funding specific projects, funders should presumptively pay the full, actual costs incurred by the organization, including the fair proportion of administrative and fundraising costs necessary to manage and sustain whatever is required by the organization to run that particular project.

Definitions. *Administrative expenses*, also known as *management & general expenses*, are costs associated with sustaining the operations of a nonprofit organization. *Fundraising expenses* are costs incurred in raising contributions. Administrative and fundraising expenses constitute an organization's *overhead*.

Comments

- Despite the presumption of general support, a funder's and organization's interests may sometimes only coalesce around particular projects. Funders of projects typically pay for salaries, travel, and other costs directly related to carrying out the project, but often do not pay for the additional burden the project imposes on the organization's administrative and fundraising costs.
- Overhead costs, including the costs of fundraising, are as real to an organization as the costs of activities directly associated with a project, and must come from somewhere. Thus, project support that does not pay its full proportion of overhead takes a "free ride" on other funders' support, and ultimately decreases the overall effectiveness of an organization.
- Although there are generally accepted practices for accounting for overhead costs, they are not pervasively understood in the nonprofit sector; funders as well as grantee organizations often define these costs in nonstandard or idiosyncratic ways. Where a grantee organization does not employ generally accepted practices, or where the nature of the organization, grant, or other factors do not justify detailed cost accounting, funders should base overhead on the average costs for organizations of a similar sort, based on sector and size.
- A funder may appropriately pay less than the organization's average overhead costs if some of its departments or activities have significantly higher management & general or fundraising expenses than are reasonably attributed to a project, or if the project provides non-trivial external benefits to the organization's core mission—benefits that are appropriately paid for by general support.

Barriers

- Many funders are not aware of the overhead costs incurred by organizations, or believe that they need only pay for the costs directly incurred by a project, not realizing that the organization could not function if every funder only paid only its marginal costs.
- Many funders and grantee organizations are not aware of generally accepted standards for accounting for overhead.

These guidelines were drafted by a working group established after a meeting of funders and nonprofit organizations co-sponsored by the Edna McConnell Clark Foundation, Open Society Institute, William and Flora Hewlett Foundation, Rockefeller Brothers Fund, and Surdna Foundation in New York on June 18, 2003. Paul Brest, president and CEO of the William and Flora Hewlett Foundation, was the principal drafter. The IS Board of Directors endorsed the guidelines at its meeting on January 29, 2004.