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Missouri Nonprofits: Building Capacity for the 21st Century

Executive Summary



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Dear Colleagues

Missouri Nonprofits: Building Capacity for the 21st Century conducted for the Nonprofit Services Center (NSC) by IFF provides a baseline from which we can begin to understand current challenges and track financial indicators and governance and management practices. Moreover, it offers insight into future operating challenges.

Our conviction is that strong organizational performance is built on a foundation of organizational financial health and sound governance and management practices. Those of us who work to increase the capacity of nonprofits should be encouraged by the stability revealed by respondents in this study. At the same time, the findings show that there is still much to do in helping nonprofits across the sector access the resources required for maximum effectiveness. Good data is the basis for focused work around increased investments in capacity-building. This study is intended as a beginning of providing just that.

This study also provides concrete Action Items specific to the roles and responsibilities of the nonprofit sector and its stakeholders in philanthropy and government to ensure the continued financial strength and increased capacity of Missouri nonprofits. Together these Action Items provide a framework for expanding the sector's collective ability to continue meeting the needs of Missourians.

NSC is committed to taking steps to improve the stability of the sector and this report gives nonprofits and their stakeholders valuable data needed to assess the strengths and weaknesses of the sector and to plan for expansion.

Deborah L. Cooper

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Executive Summary

Each day millions of Missourians rely on a broad range of community-based cultural, social and support services provided by nonprofits to enrich their lives. From meeting essential needs for food, health care and counseling to improving their lives through the arts, education and community development, nonprofits affect the most vital aspects of our lives. These organizations with diverse structures and missions comprise the nonprofit sector.

Missouri Nonprofits: Building Capacity for the 21st Century is the first statewide study to examine both the financial underpinnings of nonprofits and how they function to accomplish their missions. The survey analyzes operations and governance as well as audited financial data for FY2004, FY2005 and FY2006. Using this information, the Nonprofit Services Center and its partners in the nonprofit sector, government and philanthropy can work together to ensure Missouri nonprofits throughout the state have the resources and capacity needed to continue developing and responding to community needs.

The primary goal of the study is to collect baseline data on nonprofit finances, operations, capacity and governance in order to understand both the organizational performance and the capacity of the sector to meet the needs of Missourians. Within this context, organizational performance focuses on the full range of resources used by a nonprofit, from the staff and board of directors to facilities and information technology. Organizational performance in this original research is distinct from organizational effectiveness, which seeks to evaluate nonprofit outcomes or impact.

Missouri Nonprofits: Building Capacity for the 21st Century does not evaluate the effectiveness of the services and programs Missouri nonprofits provide. Rather it assesses how nonprofits use resources and plan for and acquire future resources. In other words, are these organizations pursuing financial health? Are they governed and managed effectively? Are they efficient in how they secure and employ resources?

Financially healthy organizations are those that: maintain programs without interruption that regularly achieve established performance measures and outcomes; meet all financial commitments; end each year with positive net assets in order to realize the organization's vision; maintain a board of directors that assumes responsibility for financial stability by establishing financial benchmarks for the organization and monitoring them regularly; and retain management that integrates program and financial planning. This study also examines accountability to the public as reflected in governance and standards adopted to protect the public interest.

A secondary goal of the report is to collect data on how nonprofit leaders perceive organizational strengths and weaknesses to understand the sector's outlook on the future. The report recognizes that these perceptions affect plans for service delivery. A final goal of the report is to provide nonprofits and their stakeholders with comparative data to assist nonprofits in responding to changes in the operating environment and to begin to develop a statewide capacity-building agenda for the sector.

The data reported in *Missouri Nonprofits: Building Capacity for the 21st Century* are based on responses from a representative sample of over 200 nonprofits that provide direct services and have incomes between \$100,000 and \$15 million. The responses of these organizations paint a picture of a relatively stable and strong voluntary sector when measured according to financial indicators and organizational capacity.

Nonprofits of all sizes, in all sectors, throughout the state rely on experienced leadership and strong financial management to address recent fluctuations in income and the growing demand for services. At the same time, however, one-fifth of the sector faces significant financial challenges. As the data demonstrate, Missouri nonprofits are well-positioned to benefit from increased general operating support and technical assistance designed to improve management, operations, governance and facilities.

Environmental Factors Affecting Missouri Nonprofits

To provide some context, this section reviews several recent trends that have affected nonprofits, particularly in the area of funding. Missouri nonprofits,

like all nonprofits, are affected by national economic and political trends. Inherent in any discussion of nonprofit funding is the exceptional challenge of providing services to those that cannot pay for them.¹ Nonprofits rely on a variety of income sources, including private philanthropy, individual givers and some earned income to support their activities. While the role of government has changed, it still represents an important part of operating budgets for many nonprofits.

The decades preceding the years covered in this study were characterized by significant economic and socio-political environmental changes with direct and indirect implications for nonprofit organizations. These changes had additional repercussions at the state and local level with implications for nonprofit leaders in Missouri. First, shifts in government funding for human services that began in the 1980s persisted into the 1990s.² This resulted in the redefinition of the role of the public sector and the emergence of market-based approaches to government that culminated with the dismantling of traditional welfare programs.

As a result of welfare reform through the Personal Responsibility and Work Opportunity Act in 1996, nonprofit human service and health care organizations serving low-income populations faced new requirements governing access to services and program participation. Government also reduced its involvement in the arts and community and economic development during this period. As the decade ended, the economy surged in response to the emergence of the technology sector and the belief in its future potential to drive

the U.S. economy. Nonprofits, as the beneficiaries of the charitable expressions of individual financial well-being, participated in the economic expansion and perceived new opportunities for growth that had not existed previously. As the millennium approached, nonprofits were focused on building capacity.

The initial optimism with which the nonprofit sector approached the 21st Century was curbed by the onset of the economic downturn as the technology bubble burst and terrorists attacked the U.S. in the fall of 2001. These national events were soon followed by both corporate and nonprofit accounting scandals. The Sarbanes-Oxley Act was passed in 2002 to strengthen governance and deter fraud in the corporate sector. Though not specifically intended to increase the accountability of the nonprofit sector, the legislation aimed at the corporate sector resulted in greater scrutiny of the nonprofit sector and informed the sector's response to calls for greater transparency.³ No federal nonprofit-specific legislation similar to Sarbanes-Oxley Act has been passed to date, but some states have extended the Act's provisions to nonprofits through regulation. In addition, several provisions of the Sarbanes-Oxley Act have been promoted by nonprofit professional associations as guidelines, including adopting written conflict of interest, document retention and whistleblower protection policies and establishing independent audit committees.⁴

In October of 2004, the Independent Sector convened the Panel on the Nonprofit Sector in response to a request from the U.S. Senate Finance Committee. The independent panel of national leaders was charged with developing an action plan to ensure the accountability of charitable organizations through improved governance and ethical conduct. The Panel's final report included 120 recommendations for nonprofits, the U.S. Congress and the Internal Revenue Service (IRS). The report concluded that nonprofits would have to actively demonstrate that they upheld the highest standards of accountability in order to maintain the public's trust in the future.⁵ The online availability of IRS Form 990 Return of Organization Exempt from Income Tax increased the relative transparency of nonprofit financial data in the 1990s and also increased accountability. The Panel recommended that Form 990 be revised to improve accuracy and provide more complete and timely information.⁶

After a public comment period, the IRS released a redesigned Form 990 in December 2007 with the goals of enhancing transparency, promoting tax compliance and minimizing the burden on the filing organization.⁷ In addition, by 2007, when this survey was conducted in Missouri, nonprofits had adapted programs and operations in response to the shifts of the previous decade.

Nonprofits were also benefiting from a more stable economic environment that posed the more customary challenges of raising resources to meet persistent and emerging community needs.

Environmental Factors Specific to Missouri

State policies affect nonprofits through two primary mechanisms: the determination of the types of services the state will fund and the increase or reduction in state funding of those services. As a result of the national economic downturn, federal program reductions and state tax cuts, Missouri entered a five-year fiscal crisis that began in FY2001. It resulted in budget shortfalls totaling \$2.4 billion that were addressed by making core reductions and one-time withholdings of state programs.⁸

Under Governor Matt Blunt, efforts were made in 2005 to reduce the state's financial obligation by narrowing adult eligibility for Missouri's Medicaid program. Recommendations were made to reform the program and while this survey was being conducted, the state passed The Missouri Health Improvement Act of 2007. The Act created MO HealthNet which reduced the coverage of optional services to many adults, excluding pregnant women and the blind, but continued coverage of children up to 300 percent of the Federal Poverty Level (FPL) with premiums beginning at 150 percent of FPL.⁹ These changes will inevitably affect nonprofits providing health care services to Missouri

families. As contractors or providers of government-mandated services, nonprofits are adversely affected by significant changes in program eligibility. However, responding Missouri nonprofits rarely reduce program services and Health Care nonprofits were just as likely as all other sectors to report service expansion in the next three years. Given their missions and expansion plans, nonprofits will likely continue to provide health care to adults, but will have to find new ways to pay for these services.

In FY2004, the state legislature cut appropriations to the Missouri Arts Council (MAC), a state agency, to zero. MAC was authorized to withdraw principal from the Missouri Cultural Trust. However, arts organizations' requests for additional funding were not granted and organizations had to

use reserves or raise additional funds to cover budgeted increases in expenses or expanded programs and services. The appropriation was restored in the following year. From FY2006 to FY2007 the appropriation was increased by over 300 percent and MAC planned to stop using principal withdrawals from the state's arts trust.¹⁰ A small group of arts organizations were better insulated from the appropriation cuts, having benefited from a MAC capital program started in 2000 that matches endowment contributions.

The report provides detailed information on the impact of the environment on responding Missouri nonprofits' finances and operations from 2004 through 2006, as well as the sector's response, including future plans. The Respondent Profile and Key Findings report the trends for the sector overall from a

representative sample of Missouri nonprofits,¹¹ but efforts to respond must necessarily recognize and address the diversity of the sector and the variety of challenges nonprofits face.

The publication of *Missouri Nonprofits: Building Capacity for the 21st Century* provides an important opportunity not only for each nonprofit to assess its organizational and financial strengths and weaknesses, but for government and private funders to consider how they can support practices that promote effective management and financial stability. The Key Findings and the Action Items that accompany them highlight how knowledge gained from this research will assist the nonprofit sector in preparing to respond to increased need in Missouri's communities and pursue the communities' many compelling visions for Missouri's future.

Respondent Distribution by Size, Sector and Geography (N = 210)

Size	Number of Respondents	Percent of Respondents
<\$250K	55	26.2%
\$250K-\$499K	38	18.1
\$500K-\$999K	40	19.0
\$1M-\$4.9M	59	28.1
\$5M-\$15M	18	8.6
Sector	Number of Respondents	Percent of Respondents
Arts, Culture & Humanities	24	11.4%
Health Care	23	11.0
Public & Societal Benefit	25	11.9
Human Service	102	48.6
Education	36	17.1
Geography	Number of Respondents	Percent of Respondents
Large Urban Areas	111	52.9%
Urban Areas & Small Cities	33	15.7
Towns & Rural Areas	66	31.4

Respondent Profile

Basic Respondent Characteristics

Median Organization Age	24 years
Median Tenure of Current Executive Director	7 years
Median Full-Time Paid Staff	6
Organizations Using Volunteers	79.1%

Perceptions of Financial Health

Financially healthy and not presently vulnerable	40.4%
Have been financially healthy, but feel vulnerable in future	38.0%
Have chronic financial problems, but expect to survive	21.6%

Financial Indicators

Median Income in FY2006	\$662,839
Change in Median Income FY2004–FY2006	8.4%
Percent of Income Confirmed	37.5%
Percent of Income from Government Contracts and Grants	31.3%
Percent with Cash Reserve Fund	75.0%
Percent with Cash Flow Problems in Any Year	50.2%
Percent with Deficits All Three Years	7.2%

Financial Practices

We attempt to diversify revenue sources.	90.4%
We maintain financial benchmarks, established by the board, to assess our organization's financial health.	75.9%
We distinguish between capital and operating funds in our annual budget.	73.9%
We document the cost of cash flow borrowing. <i>Includes only organizations with cash flow problems.</i>	57.1%

Operations and Capacities

Our organization has changed as a result of the capacity improvements we have made.	76.3%
We have acquired information technology, but do not use it fully in our programs and operations.	28.8%
We have an in-house bookkeeper or accountant on staff.	66.3%
We have an in-house development director or fundraiser on staff.	46.1%
We have the right board to bring us through the challenges of the future.	68.2%
In the next three years, we will expand services in certain key areas.	61.5%

Accountability

Boards with Finance Committees	71.4%
Boards with Audit Committees	38.1%
Organizations with a formal whistleblower protection policy	72.1%
Organizations with a written policy regarding the retention and destruction of documents	59.8%
Organizations require board members to sign a conflict of interest statement annually	44.2%
Organizations with diverse boards, i.e. with at least one non-white member	58.3%

Key Finding #1

Responding nonprofits are adept at managing the constant challenges posed by uncertain and restricted income, but are challenged to grow their programs without additional resources to do so.

Related survey findings that support this conclusion are:

- Responding Missouri nonprofits are stable, have cash reserves and increased their overall financial management between FY2004 and FY2006.
- Seventy-five percent of respondents report that they maintain a cash reserve and 79 percent of cash reserve funds are equivalent to two or more months of operating expenses.
- Over the last three years, two-thirds of responding nonprofits increased their organization's overall financial management capacity.
- Seventy-six percent of respondent report that they use financial benchmarks to assess financial health and 70 percent have a finance committee of the board.

- Respondent median net assets grew by a substantial 23 percent from FY2004 to FY2006.
- One-third of responding Missouri nonprofits report that the growing demand for services without the resources to support program growth is their most significant ongoing problem.

Implications for the Future and Action Items

Organizations' future financial strategies should focus on expanding unrestricted funding and leveraging the sector's resources.

Action Items

- 1 Missouri nonprofits should meet with key funders to demonstrate how increases in general operating support can be used to improve operations and, therefore, outcomes.
- 2 Nonprofits should consider establishing an endowment or increasing the value of an existing one through a capital campaign.
- 3 Nonprofit executive directors and staff, together with their boards of directors, should identify and explore strategic opportunities for organizational development and growth that will address the increased demand for services.
- 4 Nonprofits struggling with chronic financial problems, including regular operating deficits and cash flow problems, should engage in the financial practices on which their peers rely, such as increasing overall financial management, maintaining financial benchmarks established by the board and strategic planning.

Key Finding #2

Responding Missouri nonprofits recognized the strength of their financial position at the time of the survey and are optimistic about their ability to maintain or build on this capacity. At the same time, some organizations are challenged by the limitations posed by the uncertainty of their future income.

Related survey findings that support this conclusion are:

- Forty percent of respondents report that the organization is financially healthy and not presently vulnerable and 38 percent are financially healthy, but feel vulnerable in the future. Moreover, these are organizations that typically do not post deficits.
- Responding nonprofits are led by experienced executive directors, who have been in their current positions for a median of seven years and report capacity increases since 2004.
- On average, responding nonprofits report that approximately 37.5 percent of income is certain, 39.6 percent is expected and 22.8 percent is uncertain or not yet identified at the beginning of each year.

- Seventy-eight percent of human service nonprofits report that the current level of government funding does not cover the actual cost of providing services.
- It is easier for financially healthy nonprofits to build the right board of directors—40.5 percent of respondents perceiving their organization to be financially healthy say it is “not at all difficult” to find qualified board members as compared to 19.4 percent of those that are not financially healthy.

Implications for the Future and Action Items

While most responding Missouri nonprofits perceived their organizations to be financially healthy in 2007, more than half are concerned about their ability to maintain or achieve financial health in the future.

Action Items

- 1 Missouri nonprofits concerned about their ability to meet the organization’s goals should assess what capacity-building is needed to achieve financial health and improve operations to respond to future challenges.
- 2 Nonprofits should increase the likelihood of future success by planning and budgeting for technical and other assistance needed to meet the organization’s future goals.
- 3 Nonprofit leaders should engage their boards of directors in the strategic issues related to achieving a high level of organizational performance and financial health.

Key Finding #3

During the past three years, over three-quarters of responding Missouri nonprofits changed as a result of capacity-building according to responding nonprofit leaders, especially in the areas of information technology, strategic planning and fundraising.

Related survey findings that support this conclusion are:

- Most responding nonprofits pay for capacity-building by including it in the operating budget or raising special funds.
- Outside consultants are an important source of capacity-building.
- In the past three years, 72 percent of responding nonprofits increased their organization's information technology capacity, 65 percent of respondents increased fundraising capacity and strategic planning and 60 percent increased program evaluation.
- Fifty-seven percent of financially healthy Missouri nonprofits reported having sufficient access to capacity-building assistance as compared to 39 percent of those with chronic financial problems, an 18 percent difference.

- Thirty percent of respondents have up-to-date information technology that is fully integrated and guided by a technology plan. However, an equal number, 29 percent, report that they do not fully use the technology they have acquired.
- Responding Missouri nonprofits located in Urban Areas & Small Cities and Towns & Rural Areas have limited fundraising capacity. They are much less likely to have in-house development staff, 37.5 and 35.9 percent, respectively, compared to over 55 percent of respondents located in Large Urban Areas.

Implications for the Future and Action Items

The study findings suggest that Missouri nonprofits are poised to benefit from additional investments in capacity-building because of the sector's considerable capacity and its recent history of sound financial management.

Action Items

- 1 Recognizing nonprofits' reliance on operating budgets and special fundraising to build capacity, funders should encourage these efforts by providing general operating support.
- 2 Additional capacity is needed in the following areas:
 - Information technology staff as well as training of existing staff on how to maximize use of information technology
 - Board training with a focus on fundraising
 - Strategic facility planning
- 3 Nonprofits outside of the Large Urban Areas and those with annual revenue of \$250,000 up to \$1 million are challenged financially and operationally and would benefit from technical assistance to develop strategic plans and core organizational capacity.

Key Finding #4

Responding Missouri nonprofits are governed by engaged boards that most executive directors describe as the right board to bring them through the challenges of the future. Their boards are more diverse than nonprofits nationally and have adopted national accountability standards.

Related survey findings that support his conclusion are:

- Ninety-one percent of boards are actively involved in policy-setting and decision-making and 78 percent take responsibility for the organization's fiscal stability. However, fewer than half of responding Missouri nonprofits report that board training has increased in the past three years.
- Twenty-eight percent of responding nonprofits report that a majority of board members are actively involved in fundraising; however, it increases to 44 percent when the organization has a development director.
- Sixty-eight percent of responding Missouri nonprofits have the right board for the future, but Arts and Education nonprofits are less likely to have the right board.

- Approximately 58 percent of Missouri boards report having a diverse membership compared to 49 percent nationally. On diverse boards, an average of 21 percent of board members are non-white.
- Seventy-two percent of organizations have a formal whistleblower protection policy, 60 percent have a written policy regarding the retention and destruction of documents and 44 percent of organizations require the board to sign a conflict of interest policy.

Implications for the Future and Action Items

Missouri nonprofits have taken steps to improve governance, but future growth and improved organizational performance will require investments in board training. Executive directors can benefit from greater board involvement in the development and implementation of long-term strategies for financial health.

Action Items

- 1 Nonprofit boards are generally engaged in policy-setting and decision-making, but should expand their fiscal oversight and fundraising activities.
- 2 Funders and government should support the development of governance capacity through board training.
- 3 Development professionals or dedicated staff can play an important role in facilitating board participation needed to advance the organization's mission.

Key Finding #5

The majority of responding Missouri nonprofits plan to expand programs in the future and recognize the need for continued diversification of revenue and increased fundraising.

Related survey findings that support this conclusion are:

- Twice as many responding executive directors, 61.5 percent, report plans to expand services in the future as report that programs will remain unchanged or be reduced, 27 percent.
- Eighteen percent of respondents are conducting capital campaigns. When this figure is extrapolated to the universe of nonprofits statewide, it means that over 380 nonprofits may be currently engaged in or starting a capital campaign.
- Among respondents, the majority of nonprofit revenue comes from non-governmental sources.

- Individual support through donations and memberships, earned income and foundation and corporate grants make up over 50 percent of nonprofit income on average.
- Unmet fundraising goals and the timing of fundraising campaigns contribute to current cash flow problems for responding Missouri nonprofits.

Implications for the Future and Action Items

Given diverse domains, structures and histories, nonprofits need to develop multiple sources of income, particularly if they are heavily dependent on one source. Nonprofits and their development staff will need to pursue a variety of strategies to increase income certainty and raise the resources needed to achieve the organization's vision.

Action Items

- 1 The nonprofit sector can advocate for increased commitment and funding, especially general operating support, from the people, government and philanthropists of Missouri because they have demonstrated good stewardship of resources and vision for the future.
- 2 Nonprofits should build on nonprofit financial management capacity in order to identify strategic opportunities for resource development.
- 3 Missouri nonprofits that are not able to meet fundraising and capital campaign goals will need additional capacity-building to achieve financial health.

Key Finding #6

Responding Missouri nonprofits rely on a variety of facility arrangements, which affect planning for capital costs and strategic management of facilities.

Related survey findings that support this conclusion are:

- Almost three-quarters of respondents describe the quality of their facilities as either “excellent” or “good,” but only 62 percent report that the facilities meet desired space and quality needs.
- Less than one-third of responding Missouri nonprofits own all the space they use to operate their programs (30.2 percent) and 12.5 percent use only donated or free space. Twenty-five percent of respondents have a replacement reserve for facilities’ needs in their annual operating budget.
- Nearly 24 percent of responding Missouri nonprofits report that they anticipate acquiring property, undergoing new construction, or undergoing a major renovation in the coming year. Extrapolated to include all organizations in the universe, this would mean that more than 500 nonprofits anticipate a major facilities project in the coming year. Despite these projections, only 21 percent maintain a strategic facilities plan.

- Funds raised through capital campaigns will be used for purchasing and renovating a facility by 51 percent of respondents engaged in or planning on these special fundraising initiatives.
- Nearly 41 percent of responding Missouri nonprofits indicate that special fundraising (i.e. capital campaigns) will be the primary method and 28 percent indicate it will be a secondary method of paying for their facilities project.

Implications for the Future and Action Items

The condition and suitability of a nonprofit’s facilities can affect organizational performance and future expansion plans. However, most organizations undertake major facilities projects without having a strategic facilities plan and do not have a replacement reserve for unexpected expenses.

Action Items

- 1 As nonprofits prepare for expansion, facilities planning should be incorporated as part of overall strategic planning to consider the timing of facility-related projects as they relate to other organizational goals and objectives.
- 2 Nonprofits should consider creating a facilities replacement reserve to enable the organization to address issues in a timely fashion and to budget and schedule for maintenance and repairs.
- 3 Nonprofits with stable, long-term revenue should evaluate the use of mortgage debt to acquire and improve real estate and facilities if a capital campaign is not an option.

Notes

- 1 Clara Miller, "The Looking-Glass World of Nonprofit Money: Managing in For-Profits' Shadow," *The Nonprofit Quarterly* 12, no. 4 (Winter 2005): 49.
- 2 Elizabeth T. Boris, "Myths about the Nonprofit Sector," *Charting Civil Society* 4 (July 1998): 1.
- 3 Francie Ostrower, "Nonprofit Governance in the United States: Findings on Performance and Accountability from the First National Representative Study," (Washington, DC: The Urban Institute, 2007), 3.
- 4 Ibid.
- 5 Panel of the Nonprofit Sector, "Strengthening Transparency, Governance, and Accountability of Charitable Organizations: A Final Report to Congress and the Nonprofit Sector" (Washington, DC: Independent Sector, June 2005), 1.
- 6 Ruth McCambridge, "Is Accountability the Same as Regulation? Not Exactly," *The Nonprofit Quarterly* 12, no. 4 (Winter 2005): 9.
- 7 Department of the Treasury, Internal Revenue Service, *IRS Releases Final 2008 Form 990 for Tax-Exempt Organizations, Adjusts Filing Threshold to Provide Transition Relief*, December 20, 2007. www.irs.gov/newsroom/article/0,,id=176722,00.html
- 8 Amy Blouin et al., "Missouri's Budget Crisis: The Impact on Access to Health Care Cuts, Consequences and Policy Options to Restore Health," (St. Louis, MO: The Missouri Budget Project, February 2005), 1. <http://www.mobudget.org/restorehealth.pdf>
- 9 Departments of Social Services, Health and Senior Services, and Mental Health "The Transformation of Missouri Medicaid to MO HealthNet," December 7, 2006, 3. www.dss.mo.gov/mis/mcdtransform.pdf
- 10 National Assembly of State Arts Agencies, "State Arts Funding Grows in Fiscal Year 2007," Press Release, February 7, 2007, 1. www.nasaa-arts.org/nasaa/news/LA07Release.pdf
- 11 With a response rate of 19.8 percent, the report's findings are statistically significant at a 95 percent confidence level with a sampling error of plus or minus 6.4 percent.