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# Nonprofit organization

Presented by BHCEF, a 501(c)3 California  
corporation

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# Economic and demographic environment in 2023 and beyond

## • Demographic challenges

- Second digital revolution and the many left behind
  - In the 80s, the first digital revolution introduced computers into people's lives. They were mainly used for practical applications, and they were so limited technologically that data-heavy applications and graphics were not attractive. Non-digital games were more attractive and cost-effective.
  - 2 decades later, when telecommunication improved (*bandwidth*) and heavy data storage became cheap and easily accessible, social networks rapidly became part of people's lives. In parallel, graphism and digitization made highly realistic and attractive games available. The impact of the second digital revolution on human behavior transformed social habits (*agoraphobia for many teens*) and helped create new addictions (*gambling and porn*). That in turn lead to boredom, a well-known source of chemical substance addictions.
- COVID-19 pandemic aftermath: trauma, depression, anxiety
  - Service-oriented societies were hit hard by the pandemic: businesses had to close, people had to isolate, which led to a general social disconnect, and consequently, a substantial increase in social media use
  - Forced social transformation led to more isolation, depression, and anxiety
  - Unfortunately, while these conditions quickly became a reality for many, they also last for many, indirectly creating an unforeseen increased and constant need for mental health treatment
- Synthetic drugs (*e.g., Fentanyl*)
  - Illicit drug manufacturing evolved in parallel with telecommunication and computer technologies. Once natural products (*e.g., marijuana, cocaine*), illicit drugs have become chemical compounds that are cheaper to produce and can be designed to create specific effects (*e.g., crack vs. fentanyl*).
  - Illicit drug manufacturers and dealers' actions are no longer uncoordinated short-term fixes but rather well-planned business models where supply and demand are constantly evolving to meet the market trend (*e.g., increased demand for fentanyl due to an increased sense of powerlessness among the younger population*).

# Economic and demographic environment in 2023 and beyond

## • Financial challenges

### ◦ Few with many options and many with few options

- Before the ACA, there were virtually 2 options:
  - Option 1: one can afford \$50K for rehabilitation + another \$25K to \$50K afterwards, and quality of care is outstanding (market rules dictate the care).
  - Option 2: AA or a similar group
- After 2010, the ACA mandated that SUD treatment and mental health must be covered by health insurances (*who are in turn financed by the US Government*). The direct consequence of the ACA was a dramatic expansion of services for a greater number of clients
- Unfortunately, when demand for treatment surged, overall quality of care diminished (*mostly after discharge from active treatment*)
- Today, insurance premiums for quality care have increased dramatically, treatment portability has decreased, and length of treatment has been shortened, altogether limiting treatment options for insured clients

### ◦ Broad insurance-based healthcare financing is financially unsustainable

- Without the support of the US government, affordable healthcare insurance premiums will not cover SUD treatment costs. Example: Low cost - *without relapse* - SUD treatment cost for the first year of treatment amounts to \$25 K. Annual premiums collected for an adult (*age ranging from 26 YO to 40 YO*) range from \$3,600 to \$10,800. Management costs range from 15% and 25%, leaving \$2,700 to \$9,180 for all treatments. In other words, SUD related treatment shortfall ranges from \$15,820 to \$22,300 per individual per year

### ◦ New therapies, new technologies, new regulations dramatically increase operating costs

- Recently, M.A.T. gained popularity with healthcare insurances because the process shortens inpatient treatment duration and is a way to cut costs
- In addition, synthetic drugs (*e.g., Fentanyl*) require a more aggressive treatment thru M.A.T. for an expanded duration to succeed

### ◦ Government sponsored programs (*Medicare - Medi-Cal*)

- These programs cover - *if not most of the SUD treatments in the US* - certainly a substantial portion thereof.
- Unfortunately, funding is insufficient leading to many untreated clients, in turn leading to loss of lives

# Is there a third rail?

- **How can nonprofits help?**

- Nonprofits' social roles have risen since 1986 (*tax code reforms and impact of government sponsored social programs, including healthcare*)
  - Since 1980, tax rates have constantly diminished while the overall population has more than doubled. In other words, available governmental financial resources have shrunk while demand for healthcare service (*all things being equal*) has substantially increased
  - To maintain a social standard of living in line with the US economy, little by little the more fortunate citizens (*individuals and corporations*) have moved some of their tax burden from taxes into charitable contributions. Such transfer is a win-win-win solution for donors (*who reduce their tax burden*), for beneficiaries (*who receive financial support they otherwise would not receive*), and the government (*that has its social "liability" lighten by charitable contributions*).
  - For donors, it is somehow reassuring to know funds will be used for a specific purpose and not diluted in the government's general budget that is known for being loosely managed and a source of substantial waste
- Fundraising to cover traditional economic models' shortfalls
  - Many nonprofit organizations are set up to receive grants and give them to a for-profit organization. While this occurs frequently, it is frequently misused. This may lead to a reclassification from nonprofit to a foundation, and in some instances grants claw back. Organizations should use caution and consult with a professional (attorney or CPA)
  - Nonprofit organizations rarely share funds between multiple recipients. Organizations that provide grants to multiple recipients are more frequent.
- Advocacy & "lobbying"
  - Nonprofit organizations with such purposes are frequent and very helpful for the public at large as well as their members (see below).
  - Lobbying nonprofit organizations are subject to additional regulations designed to enhance transparency
- Nonprofit organizations as an operating model
  - Many hospitals are organized as nonprofit organizations
  - This increases access to public funding and other nonprofit organizations as well



# How does a nonprofit work?

- **Nonprofits are subject to extensive regulations**

- Tax regulations, accounting requirements, specific reporting requirements (*e.g., California Department of Justice registration and reporting*)
  - Nonprofit organizations must comply with applicable corporate laws. In other words, except for the body of laws that covers ownership (*through shares / capital stock*), most of the body of laws that covers governance apply (*Board of directors, Officers, Directors' fiduciary duties, etc..*)
  - While nonprofit organizations' accounting is unique by nature, basic GAAP apply
  - Nonprofit organizations are subject to extensive tax regulations. Such regulations are designed to protect the rights of the Treasury Department (*the nonprofit status can be revoked by the department for non-compliance*), the public (*to protect donors and beneficiaries from unscrupulous promoters*)
- If the organization is engaged in SUD treatment activities, it is subject to ALL applicable regulations and credentialing requirements
  - In other words, a treatment center that is organized as a nonprofit organization must comply with state and federal laws covering its specific activities, namely labor laws, environment laws, HIPAA, etc.
  - Credentialing through JC and CARF may not necessarily be required. It is, however, highly recommended
- A nonprofit organization cannot benefit any of its promoters, and management cannot be “locked” through ownership
  - This core tenet of nonprofit organizations can be found in organizing documents (articles of incorporation and by-laws)
  - It is specifically stated that (1) the organization cannot be used for the benefit of one of its promoters, (2) all assets owned by the nonprofit organization must be liquidated in case of dissolution, and the proceeds used for the organization's purpose. No asset is returned to promoters
  - To maintain strict separation of church and state, rules covering conflicts of interest must be adopted by the organization to get the nonprofit status granted
- It is an organization that must have “*a social purpose*”
  - There are two social purposes: a general social purpose (*e.g., improving access to SUD treatment*), and a specific purpose (*e.g., by providing access to dieticians*)

# How does a nonprofit work?

- **There are many types of nonprofit organizations**

- Tax categories: because of the unique posture nonprofit organizations have in the economy (*they are economic agents that can be profitable, but the profit must be dedicated to a public or a charitable purpose*), the code, in great details regulates and recognizes only specific organizations:
  - Churches
  - Schools, colleges, & universities
  - Hospitals & medical research organizations
  - Supporting organizations
  - Homes for the elderly or handicapped and low-income housing
  - Successors of other organizations
  - Organizations providing scholarships, fellowships, educational loans or other educational grants to individuals and private foundations requesting advance approval of individual procedures
  - Lobbying
  - Political activities

**Membership based:** In some instances, nonprofit organizations are membership based. Membership can be based on the level of contributions, the level of specific services performance, or at the level of beneficiaries

- This type of organization is frequent for promotional purpose and for common defenses purposes
- Do not forget that the nonprofit landscape greatly varies and creativity to match a specific purpose is not prohibited. It must be carefully crafted with the help of a professional

**Non-membership based:** This is a type of organization that benefits individuals or businesses that fit in a specific category that is defined through objective criteria

**Foundations:** Foundations are organizations that are closely tied to individuals (*the family or the individual who formed the organization for a specific purpose*). Most of the time, the tie is financial (*limited number of contributors that have a relationship with the organization and / or beneficiaries*)

- This type of organization is subject to more stringent tax covenants than organizations for charitable purpose or public benefit to ensure proper funds allocation

**Nonprofit organizations for public benefit:** This is a very common type of organization that provides certain benefits to specific categories of beneficiaries based on objective criteria

# Joining a nonprofit

## • First, check if the organization's activities match your needs and expectations

- Define your own needs and expectations
  - Funding
    - Check specialized websites
    - Work with a grant writer
    - Know that these organizations are rarely membership-based
  - Advocacy / Lobbying
    - Search among organizations that have an online presence to determine which one may match your interests
    - A hint: organizations state their purpose. Check how their activities can benefit you as well as related costs
    - Most of these organizations are membership-based
  - Services
    - Some organizations are set up to provide services and benefits to specific groups
    - Usually, these organizations are membership-based.
- Define how your organization can meet public interest
  - The services you provide MUST be of public benefit and / or of charitable nature (*proceeds used for scholarships*)!! **Scholarships financed through grants must be documented!!**

## • Pros:

- Cost savings
- Existing structure and trained staff
- Flexibility (*except for some membership-based organizations. Please carefully read by-laws*)

## • Cons:

- Benefits limited to what is offered (*even membership-based nonprofit organizations management is independent from membership*)
- Membership-based organization can sometimes be too rigid and disappoint members

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# Creating your own nonprofit

## • Fundamental issues directing your course of action

### ◦ Scalability:

- Can the beneficiary entity afford the nonprofit entity's setup and operating costs?
- Are the expected benefits drawn from the nonprofit activity in scale with the beneficiary entity's overall business level?
- Below is a tool to determine if the considered nonprofit matches your SUD treatment business

#### • Step 1: Optimum turnover determination:

- Assuming SUD Provider (ABC) is a 12 beds residential treatment facility providing 3.1., 3.2. & 3.5. ASAM rated services
- Throughout the years, ABC occupancy rate is m%
- In network average daily rate is \$ x n%
- X or Annual expected revenue =  $365 \times 12 \times \$ n\% \times m\%$
- Y = Reduction in revenue for co-pays / deductibles and other collateral charges
- Z = Adjusted optimum turnover expected annual revenue = X - Y (example : \$2.4 MM)

#### • Step 2: Estimated nonprofit organization operating costs:

- Accounting: \$ aaa
- Management: \$ bbb
- Fundraising costs: \$ ccc
- Additional operating costs: \$ ddd
- Total operating costs or TOC =  $aaa + bbb + ccc + ddd$  (example: \$ 120 K)

#### • Step 3: Operating parameters:

- FR = sum of all fundraising activities (*without deductions*) (example: \$ 360 K)
- TOC up to 15% of FR are considered normal. Above that ratio, the organization may be requalified as a foundation (example TOC = 33.333% of FR: too high)
- FR up to 15% of Z is acceptable. Above that ratio, the organization may be requalified as an operating nonprofit organization (*falling in tax categories listed on page 11*) (example FR = \$ 360 K : \$ 2.4 MM = 15%: acceptable)
- **Above ratios are average ratios. It is highly recommended to consult with a professional to determine specific applicable ratios!!**

# Creating your own nonprofit

- **Fundamental issues directing your course of action**

- **Affordability:**

- It is impossible to predict how much will have to be spent to raise sufficient funds for a scholarship program. One grant can cover many scholarships like many grants are needed to cover a program's shortfall.
- To be efficient, nonprofits require resources. Out of experience, we learned that a minimum "investment" of \$120K in the nonprofit is not out of the norm (see below for budgets)
- Ideal example: If we refer to the scalability parameters, this means that nonprofit generated revenue should ideally reach \$800,000 with an ideal turnover of \$5.33 MM
- Many nonprofit organizations do not meet these criteria, and often miss revenue leading to a quasi abandonment!! To generate revenue, a nonprofit must actively seek donations and adequately fund distributions.

- Because affordability is such an issue, many providers use resources from the benefiting business. Below are basic principles that management needs to implement to avoid issues with tax authorities when audited.

- **Operational relationships between the nonprofit organization and the beneficiary organization:** Here are four major principles embodied in federal and state statutes and regulations that cover nonprofit organizations.

- 1. Outside of the nonprofit's general and special purposes, none of the nonprofit's activities can benefit promoting individuals or for-profit organizations
- 2. All transactions between the nonprofit and any entity – and even a fortiori the sole / major beneficiary entity -- must be an arms' length transaction
- 3. The requirement for arms length transactions does not prohibit transactions between the nonprofit and a for-profit entity (*even if this entity receives grants from the nonprofit organization*)
- 4. To ensure that such transactions do not unduly profit individuals and / or organizations, nonprofit organizations must develop specific procedures covering disclosures and conflicts of interests (*The nonprofit governing body is held to high standards of implementation and enforcement by IRS and state tax authorities*)

# Creating your own nonprofit

## • Fundamental issues directing your course of action

- Operational relationships between the nonprofit and the beneficiary organization: Practically, resource sharing is treated as follows:
  - **ABC** desires to organize a nonprofit that would benefit ABC. However, setup and operating costs are disproportionately high for ABC. To save money, ABC is willing and able to provide (i) an office space, (ii) office equipment, (iii) utilities, and (iv) useful support.
  - To validly proceed, the following processes must take place:
    - - The nonprofit organization (**DEF**) management must establish clear and comprehensive conflict of interest rules and abide by them.
    - - ABC must establish the value for items (i) to (iv) provided to DEF based on fair market value
    - - DEF board of directors to make a special resolution to be memorialized in DEF minutes of the board to accept the terms of the proposed transaction. Board members who have a conflict of interest (*as defined above*), shall abstain to vote on the proposed resolution
    - - ABC's compensation cannot be paid to the detriment of other creditors. Should funds raised be insufficient to cover all debts, non-related parties shall be paid first, and if that class of creditors cannot be covered entirely, apportionment within the class is permitted, related parties remaining out of the general creditors class
- Financial relationships between the nonprofit and the beneficiary organization
  - When it comes to financial relationships between a beneficiary entity and a nonprofit, the standards guaranteeing total independence are higher than operational relationships, namely:
    - It is a prerequisite for the nonprofit organization to have its controlling body (*Board of Directors*) and officers (*president, vice presidents, secretary, treasurer*) completely independent from family members control and / or beneficiary entity.
    - It is a prerequisite for the nonprofit organization to have its own complete set of books and records
    - It is a prerequisite for the nonprofit organization to have its own bank accounts and credit cards
    - It is a prerequisite for the nonprofit organization to maintain its own payroll
    - Out of caution, nonprofit organizations record all financial movements in compliance with GAAP
    - Strict adherence to the nonprofit organization by-laws is mandatory
    - All financial movements between nonprofit organizations and insiders must be disclosed and treated in a manner consistent with the organization's purpose and founding documents (*articles of incorporation and by-laws*)

# Creating your own nonprofit

- **Fundamental issues directing your course of action**

- An in-depth cost/benefits analysis must take place before creating a nonprofit

- How much does it cost to set up a nonprofit?

- The fees: The fees to set up a nonprofit vary from state to state. In addition to the fees to be paid to the state where the nonprofit will be registered, the fee to file the accreditation form with the IRS is \$600.00
- The work: To setup a nonprofit organization, the following documents must be prepared by professionals (Attorneys, CPA'S, enrolled agents) and / or officers with sufficient knowledge to prepare and file required documents: Articles of incorporation (cost vary State from State), Statement of information, By-Laws, Form 1023, Form SS4, Conflict of interest policy, Organizational meeting of the Board of directors, Financial projections (P&L, cash flow, BS minimum 3 years), Clear objectives definition with funds disbursements policies, Employee related documents (if the nonprofit entity hires employees)(This list does not include any state required filing)
- To perform the work described above, prices range depending on the preparer's rates and qualification. Experience has shown that prices range from \$5,000.00 to \$15,000.00.

- A website: estimated at \$2,500.00 with forms and donations module

- **Office setup:**

- Deposit: \$ 2,500.00
- Furniture and fixtures: \$ 1,250.00
- Office equipment: computer, printer: \$ 3,000.00
- Telecommunications: \$ 500.00
- Office supplies & stationery: \$ 1,000.00

# Creating your own nonprofit

## • Fundamental issues directing your course of action

- An in-depth cost/benefits analysis must take place before creating a nonprofit
  - How much does it cost to set up a nonprofit?
    - Costs depend on how extensive the work of the organization is.
    - Since nonprofit organizations are funded through fundraising programs, grants, and donations, one or more knowledgeable employees must devote 100% of their time toward developing these sources of funding.
  - A reasonable compensation for such position is \$60,000.00 per year + benefits and bonuses
  - Operating costs will include:

◦ An office space	\$ 15,000.00
◦ Utilities	\$ -
◦ Various subscriptions	\$ 1,200.00
◦ Software	\$ 150,00
◦ Telecommunications	\$ 1,200.00
◦ Website maintenance	\$ 3,000.00
◦ Marketing fund	\$ 18,000.00
◦ Accounting (including tax return)	\$ 6,000.00
◦ Fundraising agents	(TBD)
◦ Workman's comp:	\$ 2,700.00
◦ Employer's taxes on paid salaries:	\$ 6,900.00
◦ E & O insurance:	\$ 3,000.00
◦ Total minimum operating costs:	\$ 57,150.00
  - In other words, to have a truly operating nonprofit, setup costs will amount to \$21,350, and yearly costs will amount to \$117,150.
  - To reduce costs, one can “give” some operating costs to the nonprofit organization or keep such amount in an open account to be paid off under terms identical to other creditors’
  - To reduce costs, one can use third party professional fundraisers. Results vary.



# Creating your own nonprofit

## • Fundamental issues directing your course of action

- An in-depth cost/benefits analysis must take place before creating a nonprofit
  - How much money can a nonprofit raise?
    - The first year may be grim: if the nonprofit = covers its costs and setup costs, it is a good start.
    - Donors (other nonprofit organizations, governmental agencies) will always want to make sure that the funds are properly used. Based on experience, the standards used to allocate funds will be:
      - Fiscal viability (*a constant losing business is not a suitable candidate*)
      - Good governance
      - Financial transparency
      - Proportionality (*grants will be tied to what the benefiting company represents to be the usage of funds*) Example: ABC has 100 clients per year with a facility that has a maximum capacity of 120 clients, grants will usually be capped to the cost related to the additional 20 clients)
      - Proportionality rule can be overridden in specific governmental programs: these types of “grants” are usually subject to a bidding process to ensure transparency of public funds usage.
  - Do the nonprofit’s benefits outweigh its costs?
  - The answer to this question is twofold:
    - 1. Can one expect to make more than \$138,500.00 the first year of operation?
    - 2. Can the nonprofit’s promoters afford a cash drain of \$10,000.00 per month for 9 months?
- Specific HR needs
  - Operations: One full time dedicated employee with at the very least a bachelor’s degree, preferably knowledgeable in the nonprofit organization’s purpose
  - Accounting: A third party accountant / bookkeeper
  - Fund raising: See operations. Alternatively, or in supplement, hiring a professional fundraiser
  - Governance: Actual officers and directors who donate their work the first year

# Creating your own nonprofit

- **Fundamental issues directing your course of action**

- **Need For Knowledgeable Individuals**

- **Accounting:** having an accountant who is familiar with the world of nonprofit organizations is particularly useful. Indeed, the IRS works through a set of non-published rules that only knowledgeable professionals have encountered and can therefore shield their clients from some restrictive rules.
- **Operations:** having a person who knows the field that is the focus of the nonprofit and who also is trained in the nonprofit world can help dramatically to better focus efforts and resources.
- **Regulatory:** The need for counsel or knowledgeable advisors is certain from incorporation through maturity.
- **Individuals knowledgeable about fundraising:** Individuals who will cover that aspect of the nonprofit must know the field of activity, the potential donors, the right messaging, how to introduce requests for grants, the regulatory environment, as well as the best practices and best marketing processes.

- The hypothetical we use here is ABC desires to promote DEF to receive donations. If the entirety or most of the funds raised are funneled to ABC, the status of public nonprofit corporation is likely to be changed into a foundation, which will result in tax consequences that may be substantial after few years.
- To have a nonprofit organization that operates in accordance with IRS requirements, the nonprofit organization can allocate funds based on objective criteria (*e.g., monies distributed to all applicants who qualify for grants from the nonprofit organization, including ABC*). *Hyper-concentration to the benefit of ABC will raise the same issue as funds funneled only to ABC (disqualification and reclassification as foundation)*
- In conclusion, to maintain access to SUD treatment, providers need to diversify their income stream by accessing to networks of donors (*private and public*)
- Converting a for-profit organization into a nonprofit does not make economic sense for investors and founders.
- Creating and operating a nonprofit can be costly.
- **Funneling funds from a nonprofit to only one for-profit entity may lead to disqualification of the nonprofit organization and reclassification as a private foundation, a switch that may be fiscally expensive.**
- **Only a nonprofit organization operates within the bounds of the laws can provide SUD operators with substantial resources coming from private and public donations.**

# The Perfect Solution (1)

- **Optimum transparency** (*for all interested parties*)
  - Because of the special social status granted to nonprofits, the public at large has a vested interest in nonprofits' business ethics
  - **IRS and State Secretary of States** (*or Departments of Corporations*) as well as other regulatory agencies have a vested interest in nonprofits' transparency. Current laws and regulations require some disclosures
  - **Donors**: donors want to know how the nonprofit they support manages their funds
  - **Beneficiaries**: beneficiaries want to know how grants are processed, as well as the how they can qualify for the grant
  - **Staff**: when a nonprofit provides services (e.g., hospital), staff has a vested interest in knowing how the organization is funded as well how it manages donations and grants
- **No tie to beneficiaries** (*to ensure independence from beneficiaries*)

While the tax code and regulations require a strict separation between “promoters” and the nonprofit’s management of funds through specific requirements (*e.g., conflict of interest policies*), additional mechanisms and requirements aiming at (i) identifying actual, potential and even putative conflicts of interest, (ii) setting standards covering transactions between the nonprofit and its “promoters” are fair market value based, and (iii) correcting deviances from principles contained in (i) and (ii)

- **The organization must be professionally run** (*to efficiently raise funds and objectively distribute the proceeds*). As discussed above (*budgets and HR needs*), nonprofits require extensive knowledge in the fields of:
  - **Accounting**
  - **Taxes**
  - **The field the organization intends to support** (*e.g., hospitals, schools, churches*)
  - **Fundraising techniques and applicable regulations**, including and not limited to marketing techniques, applicable rules (*e.g., limitations on text message campaigns*)

# The Perfect Solution (2)

- **Cost efficiencies**

- While, for compliance purpose, there is no specific amount or percentage that is deemed acceptable, it is very important for nonprofits to be frugal. In other words, once the “launch period” is over, costs should be under control
- When using professional fundraisers (who must be registered in some states), tax authorities are particularly sensitive to the amount of money paid regarding the amounts raised. High commission rates are often red flags for audits
- For larger nonprofit organizations, public watchdogs rank the organizations based on the ratio operating costs / funds raised. A rate of 15% is considered a good standard. For smaller organizations (that do not benefit from the economy of scale), the operating costs / funds raised of 30% is deemed acceptable

- **Quality governance**

- Since nonprofits are managed by their boards and officers (*for non-member organized organizations, there is no shareholder oversight since there is no shareholder*) good governance covering (i) corporate bodies and their members, (ii) funds management, and (iii) internal controls is key to prevent excesses
- Good governance requires quality corporate documentation covering Boards and Committees meetings, (*members' meetings minutes for member-based organizations*) as well as conflicts of interest records

- **Easily understandable and easily accessible processes covering the allocation of funds, namely:**

- Beneficiaries' eligibility criteria
- Application process
- Funds allocated for grants / operating expenditures segregation
- Grants allocation between applicants
- Grants disbursements
- Funding agreements with beneficiaries

- **Strict compliance with applicable regulations** (*Check what covers your specific industry, certain marketing techniques prohibitions, and applicable federal and state nonprofit regulations*)

# Contact

## BHCEF



[steve@BHCEF.org](mailto:steve@BHCEF.org)



424-470-7749



[www.BHCEF.org](http://www.BHCEF.org)