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Save the Children (But Pay the Bills, Too)

With Donors Balking at Overhead, Charities Make the Case For Funding Administrative Costs

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Melissa Berman recently turned down \$90 million. The president of Rockefeller Philanthropy Advisors, a nonprofit consulting firm, declined the chance to manage a potential client's \$90 million gift to support charities helping children in the developing world.

The reason: The donor specified that all of the money was to go toward the charities' programs and "not a penny was to go to operating expenses," such as accounting or other administrative functions, Ms. Berman says. "It was a very unrealistic demand."

FOLLOW THE MONEY

As more nonprofits try to persuade donors to spend money on overhead, here are some ways to judge an organization's work:

- Ask the charity which indicators it uses to monitor its own impact, then study those benchmarks.
- Check to see if the charity's progress has ever been evaluated by a third party and consider those assessments.
- Volunteer with the group to get a personal view of how, and how well, it operates.

In recent years, many donors have been critical of charities that spend money on themselves, rather than on delivering services to needy beneficiaries. Many givers have chosen to support charities that spend only a tiny fraction of their budget on overhead expenses, such as staff pay and facilities, while others have imposed restrictions on how their gifts could be spent. Such selective giving has been made easier by a host of recent charity-watchdog Web sites that evaluate how leanly and efficiently charities operate.

But now, nonprofits are trying to convince donors that spending money on overhead isn't such a bad thing. Indeed, some charities have begun seeking gifts specifically to help fund overhead expenses. Charities argue that they need to spend significant sums of money on administration and fund raising in order to grow and to attract quality staffers. Costs also are rising: New federal rules require some charities to update their governance and accounting procedures. And philanthropy advisers say finances are only one measure

worth watching; donors also must consider how effective a charity is at its purported mission.

"If a charity spends 80% of its expenses on programs it doesn't necessarily mean that it is doing a better job than one that is spending 70%," says Bennett Weiner, chief operating officer of the Better Business Bureau Wise Giving Alliance, an organization that evaluates charities based on various financial and governance standards. "Charities are more than just financial statements, and people shouldn't make donation decisions solely on financial statements."

To be sure, no one wants to fund a group that shells out most of its money to fancy offices or huge salaries. Mr. Weiner says that, in general, a charity should spend at least 65% of its total expenses on its programs, rather than on administrative or fund-raising costs. What's more, some nonprofits, such as a museum needing to secure works of art, can be expected to spend a greater share of its budget on overhead than, say, a soup kitchen. And a new nonprofit might have higher fund-raising costs as it scrambles to attract donors.

At Harlem Children's Zone, a nonprofit offering a broad range of academic, health and other services in New York, Chief Executive Geoffrey Canada says he's learned the hard way that it pays to turn away donors who only want to fund certain services and not the back-office costs needed to provide them. "The more grants I got, the further behind I got because I promised stuff that didn't have the true cost built in," he says.

The group now attracts financial support for its administrative costs by packaging them into a business plan, which it posts on its Web site. Overhead costs have been paid for in part by a \$7.5 million, five-year grant made two years ago by the Edna McConnell Clark Foundation. The group also recently landed two big gifts – a \$25 million grant from the Starr Foundation and a \$25 million matching grant from the charity's board chairman, Stanley Druckenmiller – to expand into adjacent neighborhoods.

Asking donors to foot the bill for administrative costs can be a tough sell. Some 49% of foundation chief executives said they prefer to make charitable grants that support specific programs, rather than provide general operating support, because they say it's easier to track how the money is spent, according to a new study from the Center for Effective Philanthropy. Last year, foundations were the second biggest givers to charities, after individual donors.

"The key is you don't call it overhead," says Eric Schwarz, chief executive of Citizen Schools, Boston, which places volunteer architects, lawyers and others in after-school programs in five states to teach kids academic skills. "Talk about metrics. Show that to get even better results and expand to reach more kids we need to invest in our team," he says. Citizen Schools' administrative costs rose by \$500,000 to \$2 million last year, or to 17.4% of the total budget from 17.1%, as the group increased spending for fund raising and technology, among other areas.

"If you really want these organizations to grow and make a difference, you can't starve the management group," says Dan Revers, who runs a private-equity investment firm in Boston. Mr. Revers, 44 years old, says he recently gave \$50,000 to help Citizen Schools pay general operating expenses.

Sports4Kids, in Oakland, Calif., which conducts sports programs in 114 schools, plans a costly nationwide expansion that drove up administrative costs to 14.7% of the total budget in the year ended in June from 5.6% a year earlier, mainly to build up a more experienced management team. "We have groups that will pay for balls and cones but not computers and pens," says Jill Violet, Sports4Kids' founder and executive director. The group recently landed a \$4.4 million grant from the Robert Wood Johnson Foundation to fund the expansion.

For individual donors, it can be difficult to know how a charity truly spends its money, despite all the charity-evaluation services available on the Internet. Unlike public companies, which make quarterly earnings reports, the only standard report of a nonprofit's performance is the Form 990 it turns into the Internal Revenue Service each year. (In general, faith-based groups are exempt from filing the forms.) But accountants and nonprofit officials say information on these forms is often incomplete or inconsistent, making it tough to glean accurate financial information about a charity or to compare groups with each other.

Charities' filings break down their spending into three categories: fund raising, general management expenses and program costs, which are the costs to carry out the group's charitable mission. But some nonprofits have figured out ways to shift many of their expenses into the more donor-friendly program category to make it appear that beneficiaries receive more funds than they actually do, experts say.

Savvy donors should also check out how effective a charity is at fulfilling its mission. There is no standard way to do this, but here are some tips from philanthropy advisers: Donors should ask nonprofits about their goals and strategies, and which indicators they use to monitor their own impact. Givers should see how the charity measures its results both in the short-term – monthly or quarterly – and over a period of years. It's also smart to see if the charity's progress has ever been evaluated by a third party, rather than just the charity itself. Check the charity's Web site or annual report for specific details on how it gauges its results. If the information isn't there, call the charity and ask.

If a charity doesn't answer your questions or provide IRS filings or annual reports, think twice about giving. A great way to get to know a charity: Volunteer with the group, or visit a site to get to know staffers, clients and facilities. And once you choose a charity that you trust and that has a mission you agree with, philanthropy advisers recommend allowing the charity to use the money as it sees fit, rather than imposing tight restrictions on how the gift must be spent. That gives the charity maximum flexibility to spend the funds as new needs and challenges arise.

Informed Donors

Below are several services that rate charities or help donors evaluate them. Most are free and available online. However, each uses different standards, leaving it up to donors to choose criteria important to them.

SERVICE	COMMENT
American Institute of Philanthropy charitywatch.org	Grades charities from A+ to F, based on financial criteria, such as how much the charity spends to raise \$100.
Better Business Bureau Wise Giving Alliance give.org	Issues reports on charities according to 20 financial and governance standards, including whether the charity has policies to regularly measure its effectiveness in pursuing its mission.
Charity Navigator charitynavigator.org	Rates charities on their financial health, such as how efficiently charities use their donations, using a system of zero to four stars.
GuideStar guidestar.org	A database with financial and program information for more than 1.5 million nonprofits, including IRS Form 990 filings.

Source: The organizations

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