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THE CHRONICLE OF PHILANTHROPY
MANAGING

From the issue dated April 5, 2007

Getting a Head Start

Fiscal sponsorship helps fledgling charitable programs fly

By Eman Quotah

Chris Baty never planned to start a nonprofit organization. It sneaked up on him. In 1999, buzzed on caffeine in a San Francisco-area coffee shop, he and a group of his friends dared one another to write novels in 30 days. That first year, 21 people accepted the challenge.

The following year, 140 would-be novelists participated in National Novel Writing Month, or NaNoWriMo, which is now held in November. In 2001, as a handful of bloggers spread the word about the event, participation shot up to 5,000. Mr. Baty hand-processed the registrations and recalls the experience as "sort of a nervous-breakdown year."

To host NaNoWriMo in 2002, he knew he needed to raise money to automate registration, upgrade to a more expensive Web-hosting service, and hire staff members. But potential supporters wouldn't give money to an arts organization that wasn't registered as a charity with the Internal Revenue Service, because it couldn't offer donors a tax deduction.

Reluctant to go through the effort of applying to the IRS for a group whose future was unclear, Mr. Baty enlisted the help of Media Alliance, an Oakland, Calif., membership and advocacy organization for people who work in the news media.

The group agreed to serve as National Novel Writing Month's fiscal sponsor, a relationship in which one tax-exempt organization receives donated funds on behalf of a group that is involved in charitable activities but has not received charity status from the IRS. The arrangement allowed donations to NaNoWriMo to be considered tax-deductible.

Traditionally, arts, advocacy, and environmental groups, along with community foundations, have offered fiscal sponsorship as a way to test and develop new projects, to support one-time activities such as building a neighborhood park or making a movie, or to start an innovative project that fits the sponsor's mission.

The practice helps nonprofit novices like Mr. Baty ease into the nonprofit world without all the red tape involved in creating a free-standing charity.

User Agreement
Help

"If two people are sitting at a kitchen table who want to solve a problem, why do they always have to form a nonprofit?" says Tom Reis, a program director at the W.K. Kellogg Foundation, in Battle Creek, Mich. "They don't want to get bogged down in structure and other stuff. All they want to do is their project."

Lack of Skills and Time

Forming a nonprofit organization can take months or years and thousands of dollars in start-up costs and legal fees. Often first-time nonprofit leaders just don't have the time, money, or knowledge to start an independent charity.

That was the case for Reach Out and Read Colorado, a network of literacy programs offered in pediatricians' offices.

Founded three years ago by a pediatrician and a retired children's librarian who wanted to link all the Reach Out and Read programs in Colorado, the group at first had no paid staff members, no money, and no expertise in fund raising or nonprofit management, says Megan Wilson, the coalition's executive director.

So the group turned to the Colorado Nonprofit Development Center, a Denver fiscal sponsor.

In return for 9 percent of Reach Out and Read Colorado's revenue, the center received donations on the literacy group's behalf, advised the founders on how to hire their first paid staff member, provided employee benefits, and taught the group how to raise money.

"It's an essential function in a charitable community to be able to provide forms of incubation and support for organizations that don't have resources to become 501(c)(3)'s," says Gregory Colvin, author of *Fiscal Sponsorship: 6 Ways to Do It Right.*

"Applying for nonprofit status is increasingly complex," he says. "If you want to try out programmatic areas for a few years, to see if people will support it, it's better to go with an existing organization than to start a new one. Once they try their wings under fiscal sponsorship, they have more likelihood of succeeding once they're incubated."

Fiscal sponsorship can also benefit projects that don't require longevity.

The Seattle Parks Foundation, an organization that builds parks and green spaces in its home city, sponsors local volunteer-run groups, helping them to start operating a lot faster than they otherwise might have on their own, says Woody Wheeler, Seattle Parks' program director.

"We have knowledge of how to build a park, how to raise money, and we do this all the time," he adds.

Mr. Wheeler helped one project raise $1-million in a year — providing both practical advice and cheerleading.

"What we did was sort of like counseling: 'You can do it!'" he says. "We'd go over plans, provide encouragement and support, and cheer [them] up when something didn't go through. It can be almost crushing if they don't get a certain gift, and they don't realize that there's hope beyond that."

Potential Risks

Despite success stories, some observers warn against the potential pitfalls of fiscal sponsorship for both sponsors and projects.

As a fiscal sponsor, "you have to supervise the grant and don't just let yourself be seen as a conduit or a pass-through," says Mr. Colvin. "Otherwise, the IRS could treat you as being just the intermediary, and you never had true ownership of the funds. The worst word for it is 'money laundering.'"

Furthermore, he notes, "if you were not exercising supervision and control over the money and that resulted in money being used for political lobbying" — or other noncharitable activities — "you could lose your 501(c)(3) status as a public charity recognized by the IRS. And it might mean donors are not able to get a tax deduction and the project is without funds."

To avoid such possibilities, he recommends that sponsors require project leaders to sign grant agreements and that sponsors not release a grant if a project is not meeting charitable requirements.

Another danger is projects going into debt, say Ellen Friedman, executive director of the Tides Center, a fiscal sponsor in San Francisco. "When you're working with entrepreneurs, it's not unusual for ambitions to be bigger than reality," she says.

She has seen a few examples of inflated ambitions over the years, including a project whose expected support never arrived. "The grant didn't come in, and we had to lay off staff," Ms. Friedman says.

When another Tides project dissolved because of lack of financing, she sold office furniture to recover the cost of the project. But she says bad debts from fiscal-sponsorship arrangements account for less than 1 percent of Tides' budget because of its close relationship with its projects.

Time to Grow

Although Mr. Baty's group didn't seek the kind of training, counseling, or fund-raising help that leaders of other fledgling charities seek from fiscal sponsors (NaNoWriMo gets by mostly on donations from individuals), he says having a fiscal sponsor for six years gave his group time to mature.

Participation in the annual writing event swelled to an all-time high of 80,000 people last fall. Mr. Baty and his fellow organizers also expanded beyond their original mission, adding writing events stateside and raising money to build and stock elementary-school libraries in Southeast Asia. By last year, Mr. Baty says, NaNoWriMo had one full-time and three part-time staff members, eight contractors, and an annual budget of $189,000.

All that growth and activity, he says, led to an inevitable conclusion: "We were either going to become our own 501(c)(3) nonprofit and expand the scope of it, or we were going to have to end it."

So, last September, the organization officially became a tax-exempt nonprofit organization, called the Office of Letters and Light, with headquarters in Oakland, Calif.

"I think we're gaining a lot," Mr. Baty says, such as having the advice of a board of directors and, for himself, being considered a peer to executive directors of other charities. Plus, he says, "people believe in you because you're taking it seriously."

This past January, Reach Out and Read Colorado also spun out on its own, after three years as a project of the Colorado Nonprofit Development Center.

"We simply reached a level of maturity that we didn't need the technical assistance that CNDC offered," Ms. Wilson says. The literacy coalition wanted to recruit its own board to aid in fund raising and crafting a strategic plan. But until it declared its independence, it had to answer to the Colorado Nonprofit Development Center's trustees.

"It was difficult for us to ask people to join our board and get them to serve in the way we needed them when they were really on an advisory commission, not a governing board," she says.

One service Ms. Wilson's former fiscal sponsor still provides is financial management for her group, whose annual budget is $300,500.

"We're still the same-size organization," she says. "I don't have the time to take on those responsibilities myself and still run the organization the way I need to, and they have the experience. They have accountants on staff. It's more affordable than hiring a bookkeeper."

For the Long Haul

But declaring independence from a fiscal sponsor isn't a logical progression for every group involved in such an arrangement. For many sponsored projects, not having to deal with administrative issues on their own may be a long-term strategy rather than a way to get started.

"They might not want to devote their project staff to back-office stuff of payroll and filing taxes," Mr. Colvin says. "As administering nonprofit organizations becomes more complex, we start to see more benefit of having these financial and administrative services more centralized by someone who's good at it."

Staying with a fiscal sponsor can help a group focus on programs, says Viviana Jiménez, chief financial officer of the Ocean Foundation, a grant maker in Washington that supports ocean-related organizations and projects, serving as fiscal sponsor to three of them.

"People should stick to what they're good at," says Ms. Jiménez. "We get these wonderful people who know how to deal with sharks, but they don't know how to manage a nonprofit."

Bill Mott, director of the Ocean Project, in Providence, R.I., which works on behalf of a network of aquariums, zoos, and other conservation groups, is happy to have Ms. Jimenez's foundation take payroll and accounting off his hands, and he also likes not having to report directly to a board of directors on a quarterly basis.

Currently celebrating the 10th anniversary of his project, Mr. Mott has had a fiscal sponsor since the beginning. He has no intention of turning his project, of which he is the only full-time employee, into a separate tax-exempt organization, he says.

For similar reasons, the Children's Partnership, a child-advocacy organization headquartered in Santa Monica, Calif., has, since it opened its doors in 1993, been a project of the Tides Center.

"We wanted to be able to spend virtually all of our time and mental energy on programs," says Wendy Lazarus, the partnership's co-president. Ms. Lazarus believes her group is more effective because it doesn't have to concern itself with human resources, legal issues, and reporting to the IRS. "As long as that proves to be true and we're getting net value out of it in our work with kids, then we'll stick with it."

Still, she says her group tries to be meticulous. Although Tides does the partnership's accounting, the group double-checks its books. "We're the ones ultimately responsible," Ms. Lazarus says.

Fund-Raising Drawbacks

Both Mr. Mott and Ms. Lazarus say they face a few minor problems because they depend on fiscal sponsors.

"It takes time to explain to someone writing a check," Mr. Mott says, noting that some donors write their checks out to the Ocean Project, rather than to its fiscal sponsor, which then means he has to send the check back and ask for it to be reissued.

Other times, Mr. Mott and his fiscal sponsor have applied for the same grants, a situation that occasionally has led to confusion among foundations and other grant makers.

"I've been told by some program officers that their board doesn't understand the distinction" between a fiscal sponsor and its projects, he says.

Fiscally sponsored projects may lose some opportunities for visibility by not registering as charities. Ms. Lazarus notes that Web sites that list or rank charities, like GuideStar and Charity Navigator, don't include sponsored projects.

"Probably nobody's thought about what sort of efficient nonprofit operations are being missed," she says.

Ms. Lazarus adds that foundations generally don't question her group's decision to remain fiscally sponsored, understanding the group's desire to, as she puts it, "hunker down and focus on program."

Still, in the past, several grant makers encouraged the Children's Partnership to reassess its status. Five years ago, the group hired a consultant to analyze the costs and savings of fiscal sponsorship. The results, she says, convinced the doubters.

But, she says, that might not always be true for her group.

"At some point, a nonprofit would reach a size where it would benefit them to set up internal systems," Ms. Lazarus says. She estimates that cutoff point to be a budget of about $2-million; today, her organization runs on $1.5-million annually and maintains a staff of 13 full-time employees.

"Our management team believes that we should be reassessing this every five years or so, just to see if there are any new considerations," she says.

Mr. Mott and Ms. Lazarus call fiscal sponsorship a well-kept secret of the nonprofit world — and an approach more charitable groups should consider.

"I've been trying to convince some of my colleagues to go this route," Mr. Mott says. So far, he has had little luck.

"People feel like they want to have their own 501(c)(3,)" he says. "Some people need that control. But people don't realize they don't need that control to be an efficient nonprofit."

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