

Introduction

Imagine you are given a check to buy any one thing you want. What would you buy and why?

Would you buy something fun and luxurious, or would you save it for a rainy day? Would you buy something that provided income regularly? Or would you buy something that could grow over time to increase your wealth for the future?

How you answer this depends upon your personal motivation. Now, however, what if this check does not belong to you? What if it was given to you by a donor and you become a *steward* of this money?

This is the challenge facing professionals and trustees in the philanthropic industry every time a donor check is received. Whether the check is for immediate or long-term use, such individuals must decide what to do with it. Because the money must fulfill the qualified intent of the donor, the leaders of the organization must comply with fiduciary standards to ensure proper financial oversight. These are known as the 7 Standards of Care and have formally evolved over time under the presumption that if the financial management *process* is followed properly, the best possible outcome will result: the wishes of the donor, and the nonprofit mission, will be fulfilled with the utmost care and professional-

ism. These stewardship processes apply to both private foundations and public charities with endowed assets.

Due to the tax-exempt status afforded charitable and civic nonprofits, a unique collection of financial strategies is available to incentivize taxpayers to provide financial support, both for short-term and long-term revenue needs. These approaches range from simple tax deductions on donations to sophisticated legal structures providing donors with both tax advantages and lifetime income. Collectively these have become known as *planned giving* strategies, the goal of which is to convert wealth into cash flow for current use or long-term endowment needs.

Much nonprofit and charitable literature is rightfully devoted to managing mission fulfillment, the expenditure side of the equation. But the revenue side, what to do with checks and how to harvest large ones, receives too little attention.

This book provides a new description to promote attention to the monetary function of foundations and endowments, otherwise known as *Agencies of Cash Flow*. Cash flow will be the core of our discussion. Nonprofits convert wealth to cash flow using their tax-favored status; investment portfolios are managed to provide long-term cash flow to fund programs; pricing of wealth (businesses, bonds, real property, etc.) is predicated upon cash flow. Foundations and endowments are transaction agencies bringing together two parties, patron and nonprofit, to manage cash flow to fulfill a charitable or civic purpose.

A focus on cash flow has practical benefits. It is familiar, easy to understand, and provides a conceptual basis for this subject matter, which can be technical and rule bound. Those

with little or no experience in finance may find the exploration of endowment management intimidating and confusing, but the skills necessary are in fact straightforward and can be learned with familiar language and concepts.

An emphasis on cash flow streamlines the planning, management, measurement, and communication of ongoing fundraising and portfolio management. The math is simple, workable, and within our everyday experience.

Finally, cash flow is the central thread that connects the three functional components of a foundation and endowment: Money In Motion (fundraising), 7 Standards of Care (governance), and Modern Portfolio Theory (investment).

The intention of this book is to educate volunteer trustees, nonprofit professionals, and students of nonprofit studies on the rationale and practice of *wealth management* and how to apply these practices *specifically* to philanthropic fundraising, portfolio management, and fiduciary governance. In the private sector, wealth management professionals (financial advisors) provide investment management, lending, estate planning, and tax planning via a holistic consultative process to solve financial needs, and many of the academic and financial technical skills required of philanthropic professionals are the same.

I share this with you as someone who for 28 years practiced wealth management within a major financial institution, served a dozen years as a member of the board of trustees for a public university foundation, and taught as an adjunct professor in finance and nonprofit studies. Presented here is a tutorial on how to gather and manage wealth as a nonprofit professional, and how to fulfill your stewardship responsibilities as a volunteer trustee on a nonprofit board.

Most of the information put forth in this book is applicable to philanthropic enterprises small and large—from the start-up to the behemoth. The dynamics of financial markets and rules of financial stewardship discussed here do not distinguish between the two.

Note to Readers

The information presented in this book is solely for educational purposes and should not be considered investment, tax, or legal advice. Before making any financial commitment regarding the issues discussed here, first consult the appropriate investment professional, tax adviser, estate planning, or nonprofit attorney. Further, each nonprofit organization must check its own state laws to learn the nonprofit corporate code or UPMIFA rules adopted by that state.

Who should read this book

- Trustees of nonprofit boards
- Nonprofit professionals
- Leaders of colleges, cultural organizations, and nonprofit hospitals
- Donors creating a private foundation or public endowment
- Grant-receiving nonprofits investigating the diversification of their revenue stream
- Students of nonprofit studies and public policy

How this book is organized

This book, divided into four chapters, is built around these themes, all from the point of view of philanthropy:

- What is wealth?
- How do you invest it?
- How do you govern it?
- How do you raise it?

Chapter one begins by examining the two primary legal structures of **AGENCIES OF CASH FLOW: Foundations and Endowments**. We will examine their monetary function, self-managed assets to distribute long-term revenue, and how they receive special tax treatment.

The next chapter, **INVESTMENT MANAGEMENT – The Three Asset Classes**, defines financial markets and explores the profound importance of inflation and interest rates. This leads to the study of stocks and bonds and how to blend them expertly, using Modern Portfolio Theory, for long-term revenue.

Nonprofit boards are responsible for managing fiduciary compliance, the subject of chapter three, **GOVERNANCE – 7 Standards of Care**. We will study the contrast of accountability between the commercial and nonprofit sectors, and the management process referred to as the 7 Standards of Care. Requirements for an Investment Policy Statement (IPS) are provided.

We conclude with chapter four, **PLANNED GIVING – Money In Motion**; how to raise long-term assets utilizing

an organization's nonprofit, tax-exempt status. Planned giving strategies, as discussed in this chapter, require a comfortable familiarity with taxes donors face and a general understanding of the estate process. Money In Motion is introduced as a practical management tool to focus attention on assets that are in transition, assets transferring at death, and liquidity-generating business transactions.

These four chapters are a comprehensive survey of Agencies of Cash Flow, but each chapter is also written as a stand-alone narrative if you prefer to read it individually.