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# CSOS AND NGOS

*WAYS OF FINANCIAL SUSTAINABILITY*



**RASHEED TI-JO RESEARCH SERIES:  
THIRD SECTOR**

*Rasheed (Transparency International-Jordan) was established at the end of 2013, as a non-for-profit civil society organization, through a group of activists working in the field of anti-corruption. Rasheed (Transparency International-Jordan) commenced work in Amman at the beginning of April 2014, and it represents the only official contact group of Transparency International in Jordan.*

*Rasheed (Transparency International-Jordan) aims to reinforce the involvement of the Jordanian citizen in anti-corruption activities, protect public, private and local governance institutions against corruption, enhance the efficiency and independence of control agencies specialized in the area of anti-corruption, strengthen the integrity of the legislative and judicial authorities, and reinforce the performance of Rasheed (Transparency International-Jordan) towards achieving its mission and vision.*

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## **Introduction**

The non-profit sector is one of the largest employers, as well as an effective mechanism for mobilizing public resources. 39.5 million people participate in the activities of NGOs. This is 4.4%, or one in twenty, in the economically active population. Of these, 22.7 million people, or 57%, work on conditions of paid employment, and 18.8 million people, or 43%, are volunteers. The high level of voluntary work in the activities of NGOs proves that these organizations are able to attract huge social potential to the implementation of socially significant activities (Liboralina, 2014, 3).

At present, all the activities of the third sector are aimed at finding and accumulating funds for solving various, and mainly, social problems, without diverting significant state resources from the country's economy. The issue of financing the third sector is a question on which its future directly depends. The material and financial situation of these organizations is largely determined by their characteristics. Poor financial support is today the most painful issue in non-profit organizations. It is the lack of money that most often becomes the main obstacle to their activities.

The financial and economic sustainability of the non-profit sector is a system whose uninterrupted operation ensures efficient search and use of resources based on strategic planning that defines the organization's goals and ways to achieve them, assesses the current activities of such organizations and their readiness to adapt to changing conditions.

Non-profit organizations produce services for the population that have two fundamental qualities: non-competitiveness and non-exclusion. Therefore, the finances of such organizations have a number of differences from the finances of enterprises and organizations in the commercial sphere.

## **Nature of the Third Sector: CSOs and NGOs**

A civil society organization (CSO) is a voluntary organized association of citizens, created to express and satisfy their interests and needs on the basis of self-government. Meanwhile, non-governmental organizations (NGO) – are organizations that pursue activities aiming at achieving social, charitable, cultural, educational, scientific and managerial goals - health protection of citizens, development of physical culture and sports, satisfaction of

spiritual and other intangible needs of citizens, protection of rights, legitimate interests of citizens and organizations, resolution of disputes and conflicts, providing legal assistance, etc.

Both CSOs and NGOs are defined as being parts of the third sector that is represented by the organizations, which are formed on the own initiative of the founders, independent from the will of the authorities or officials, and without the purpose of profit gaining for its redistribution between the members of organizations.

They take on functions that the state cannot or does not want to perform. At the same time, many people, who are guaranteed the right to social assistance (social services) by the state, turn to non-governmental organizations to help them overcome life's difficulties and support social activity. In this case, the state does not fulfil its obligations towards these people. In order to be able to overcome social risks, the social services system must respond quickly and adequately to the demand and changes in the needs of people. Due to their mobility and creativity, they are able to identify and meet the needs of various vulnerable groups of citizens while promoting the development of competitive social services.

The non-profit sector makes direct and indirect contributions to the global economy. Direct contributions are related to the fact that the non-profit sector is an area that provides employment and self-employment of the population. From the point of view of employment, the non-profit sector is in many respects similar to small business, but it additionally provides social and psychological support to its employees and volunteers, is more active in involving socially vulnerable part of the population in the economic activity (disabled people, parents of disabled children, unemployed women of older ages, etc.). Non-profit organisations buy and produce goods and services necessary for their activities, thereby stimulating aggregate demand and increasing aggregate supply. At the same time, they work in niches that, given the natural situation in a free and competitive market, would not interest the commercial sector, since they give too small profit margins.

Indirect contributions are due to the fact that the non-profit sector brings elements of competition into the social sphere. By creating competition for state and municipal structures, they increase the efficiency of the functioning of the system of providing social services in general. Improving efficiency means that in order to perform the same amount of social functions, fewer resources will be withdrawn from the economy (that is, it will be possible to reduce the tax burden), which means that more resources can be invested in ensuring future growth. The activities of non-profit organizations help to improve the level of education and health of the nation, which, according to modern research, increases the efficiency of the economy and ensures higher rates of economic growth. By improving the social climate, these

organizations contribute to ensuring social and political stability, which are necessary conditions for economic development.

In a democratic society, the state does not interfere with the activities of such organizations, although it regulates them according to the current legislation. The main principles of public associations are the combination of personal and common interests, self-government, equality of all members, legality and transparency (Tomlinson, AidWatch Canada, 2013).

The constitutions of democratic states guarantee the freedom to create public associations, whose activities must be based on democratic principles and meet the requirements of openness and transparency. In most countries in the world, civil society enjoys the rights to fulfil its goals and objectives as enshrined in the statutes:

- To participate in the formation of state power and administration;
- To implement a legislative initiative;
- To participate in decision-making of government authorities;
- To represent and protect the interests of its members (participants) in state and public institutions.

Civil society organizations perform a number of functions:

- **Opposition function.** Its role is to prevent excessive centralization of power, to promote the progressive development of civil society. To achieve this, CSOs have taken various measures: alternative programs, public opinion appeals, control, etc.
- **Protective function.** It aims to protect the interests, needs of members of the organization through the requirements and statements to the government as well as legislative initiative. Radical methods of pressure on administrative bodies and protection of people's interests are strikes, demonstrations, protests, ultimatums and picketing.
- **Educational function.** It is aimed at forming moral, political, managerial, legal culture, creative approach and professionalism among citizens.
- **Personnel function.** It consists of training of qualified personnel for state and public bodies, institutions and organizations.
- **Political function.** It is not aiming to fight for power, but to exert pressure on it to realize the interests of its participants.

There are many different types of CSOs in each country. These are professional unions, women's, youth, veterans, children's organizations, scientific, technical, cultural and

educational, physical and sports and other voluntary associations of citizens, creative unions, associations, foundations, associations, etc. They may have different names: organization, association, union, society, club, circle, council, foundation, association, etc., but their common characteristics are voluntary association, the presence of a certain organizational structure and activity on the basis of self-government. Another feature of a non-profit organization in many countries is its not-for-profit nature – it should not carry on business for profit, otherwise it should be registered with an authorized public authority as an entrepreneurial entity.

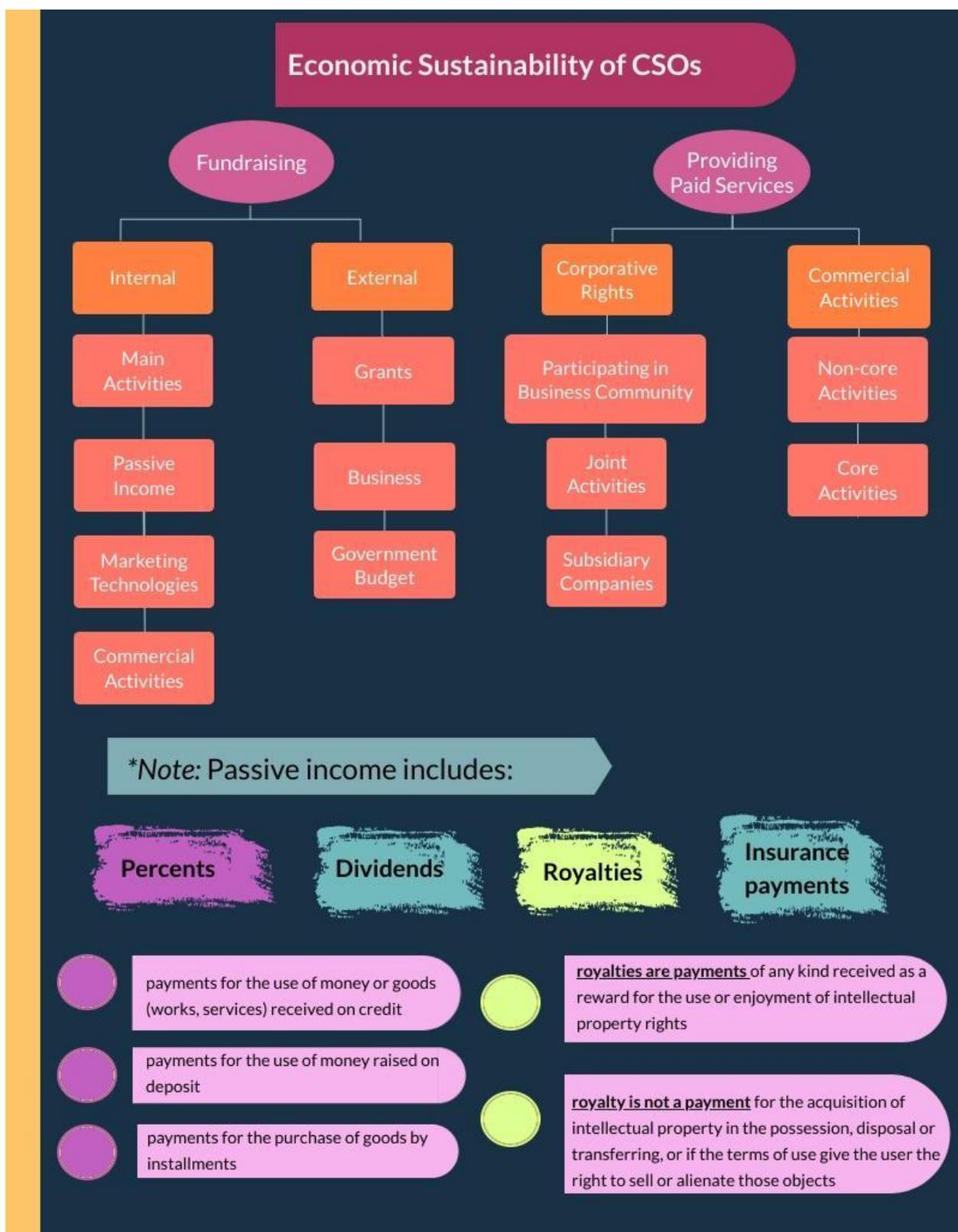
### **But if they do not seek for profit, how do they sustain themselves financially?**

Effective functioning of a non-profit organization is impossible without the existence of sustainable sources of money and other property that can be found both domestically and abroad.

There are different ways to fund public sector activities: grants, membership fees, sponsorship, community funding, creating a social business, and more. But roughly funding sources can be divided into three groups:

- Own funds (including membership dues, founders' contributions, entrepreneurial income, income from storing funds in bank accounts, etc.);
- Raised funds (including donations received both domestically and from abroad);
- State funding and support (combining direct and indirect government subsidies, including government procurement of goods and services from CSOs through a government procurement mechanism).

The given below infographic will provide more detailed information on the economic sustainability of CSOs in a schematic way:



It also should be mentioned that main activities include, but are not limited by, publishing, educational and consulting services, meanwhile marketing technologies and commercial activities consist of sample distribution, coupons, contests, special events, prizes, points, etc. and creation of separate units respectively.

Internal sources of funding are the least used to attract funds to nonprofit organizations. And this is despite the fact that the organization can decide independently when, how, in what form the funds from these sources should come. Internal sources of income such as passive income are in most cases tax-free for most types of non-profit organizations.

As for the raised funds, the funds of international donors can be both private resources of a certain person (e.g. George Soros Fund) and taxpayers of other countries (e.g. USAID – USA, SIDA – Sweden, DRC – Denmark), or contributions of other countries (UN, OSCE, OECD).

## **Fundraising Types: Detailed Review**

### Grants

Grant conditions under which the activities of government, business or public institutions are supported are open: anyone can read the terms on which the donor provides the grant, for instance, on their websites. However, obtaining funds from an international investor is a complex process that requires the organization to meet certain criteria, like for example, transparency, openness, managerial and financial capacity. Each grant requires very detailed programmatic and financial reporting, either monthly or quarterly, according to the conditions of the individual donor.

In addition, the implementation of the grant implies a deep understanding of the context and issues facing the non-profit organization, qualifications and knowledge, and a high level of responsibility. The grant can be also considered as a social investment. The international funds, through providing grants, do not aim to receive money in future, but the development of society, democratic values, experience of certain social changes in order to raise the standard of living of the people in the country, solve humanitarian problems, etc. (Poole, 2014).

Such grants can be received by actively seeking them and preparing applications for them.

### Membership Fees

The statute of a public association may provide for payment by members of membership fees (introductory or membership fees), and the amount and frequency of payment of these membership dues shall be determined by the decision of the highest management of the organization. The funds can be accepted from the members at the cash desk of the organization,

or transferred directly to the current account. Membership fees are usually not subject to income tax and, accordingly, are not included in the entity's income.

### Donations

Donations from individuals and legal entities are one of the most common sources of income for the third sector. In foreign practice (Europe, USA), most non-profit organizations live solely on donations.

One of the most important points for the third sector institutions is the following: donation of property to legal entities may be conditioned by the donor using the property for a specific purpose (i.e. to be target-oriented). The donor organization must keep a separate record of all transactions for the use of the donated property. This is important as that is the condition, which excludes targeted donations from the base for the calculation of income tax (and, accordingly, the tax applicable when applying the simplified tax system).

The use of the donated property, not in accordance with donor`s designation, entitles him or his heirs assignees to request the cancellation of the donation. Thus, just as any citizen transferring property to the organization or financial resources has the right to demand their return if the organization used it for other purposes, so the organization may demand a refund (for instance, received for the implementation of a specific project, but used for other activities not included in it). Difficulties with improper use can be avoided only by the competent formulation of payment documents and the maintenance of constant separate accounting in the organization.

### Subsidies and Allowances

The subsidy differs from the grant, primarily in that it is budgetary funds. For non-profit sector organizations, there is no fundamental difference in whether it participates in a grant or a subsidy competition. This difference is more important for the budget managers themselves: all documents, regulations, etc. must be approved by order of the government authorities and meet certain standards and requirements (which slows down and complicates their preparation).

The subsidy can be provided both for reimbursement of expenses of the organization (for payment of premises, performance of work or services), and for the implementation of specific programs and projects in a certain area. However, subsidies are strictly targeted, and they are subjected to be reported about with documents confirming the intended use, and

separate accounting is needed. The fundamental difference between allowances and other forms of inter-budget transfers is the absence of a targeted focus.

### Procurement of Services by the State

Public procurement is the state's acquisition of goods and services produced or provided by non-state suppliers, including CSOs and NGOs. In most countries, there is a single legislative mechanism for all potential participants in public procurement, including commercial structures and third sector: all entities that have the appropriate competence and meet certain criteria can participate in the competition for receiving a state order for the provision of services. Non-profit bodies most often participate in tenders for the purchase of social services, and in a number of countries, general procurement mechanisms for services provide for the specifics of procurement in the social sphere and have certain preferences for NGOs and CSOs. For instance, in Germany, it is NGOs that primarily - by default - provide social services to the population, and in Kazakhstan, the social order mechanism provides for tenders for the purchase of social services in which only third sector institutions can participate (Berman, Brooks, 2016).

### Regulatory Support and Vouchers

Regulatory financial support of the non-profit sector has some similarities with the system of state competitive procurement of services: this is a monetary reimbursement paid to the non-profit body for the provision of social services, and the amount of funding is based on the actual amount of services provided. The system consists in the fact that individuals have the right to choose a service provider – in particular, they may prefer to receive the services of a CSO or NGO, which then requests monetary compensation from the state. As a rule, a precondition for the use of such a financial mechanism is either a state agreement with an organization, or permission received by an organization for such type of activity. Thus, such system is available in Hungary and Croatia: third sector entities can create social service institutions on the basis of a contract with the relevant ministry; and financing, which the organization has the right to receive for services rendered, cannot be higher than received by a state institution working in the same field of activity, and its amount is defined in the annual law on the state budget (Telyukina, 2000). The use of vouchers reflects trends in the modernization and use of market mechanisms for the provision of public services to the public. With particular success, vouchers are used in the Scandinavian countries. The system is based on the municipalities issuing vouchers to all citizens for the services they are required to provide, and citizens themselves choose whom to receive these services from. The use of

vouchers issued by municipalities removes the theoretical question of whose services are better, strengthening the role of citizens and giving them responsibility for choosing a service provider

### Agreements and Government Contracts

Another source of funds for the non-profit sector may be budget funds received through bidding and quotation procedures. This source is allocated separately from activities for the sale of goods and services for one reason – funds received from budgets of various levels in case of their targeted spending are not subject to income tax (and therefore are not taxed when using the simplified taxation system) (Berman, Brooks, 2006).

### Entrepreneurial Activity

In some cases, entrepreneurial activity itself may be a project or program of a non-profit organization (for instance, the creation of enterprises and jobs for the disabled or socially vulnerable categories of the population), however, the rule on the use of income remains unchanged.

When conducting entrepreneurial or commercial activity, CSOs and NGOs are required to comply with all the norms and regulations related to it (including the payment of all taxes, licensing requirements, etc.).

In order for the organization to be able to conduct entrepreneurial activity, a corresponding section should be included in its Charter. It is necessary not only to indicate the fact of this in it, but also to list specific types of entrepreneurial activity

Some countries do not allow third sector organizations to conduct entrepreneurial activities. So, in such states (for business purposes), these organizations are allowed to create subsidiary commercial companies: a subsidiary commercial company carries out entrepreneurial activities, the profits from which are transferred to the owner of the company, i.e. CSO or NGO, and they direct these funds to achieve the goals of its creation.

### Sponsors and Business Financial Support

Sponsorship and philanthropy are popular sources of funding that nowadays, however, it requires a large database of contacts in various fields (entrepreneurship, printing, construction, logistics, etc.) and a good reputation. For some, the key point is the opportunity to benefit from such financing (barter, company advertising, image profit), meanwhile for

others it is important to be involved in the noble cause of promoting the development of culture, to fulfill their duty to society, and to show patriotism. However, despite their motivation, they still provide support to the third sector, if not financial resources, then intellectual or human.

Fundraising of the non-profit sector can be also classified according "to who funds". And, thus, such classification may include (Pinter, 2011):

- Individuals: such financial, time or human support is essential for grass-roots institutions. Individuals are also both sources of funding various funds and foundations, and direct contributors. They also include volunteers as an assisting source in time and skills;
- Diasporas: an elusive funding source, which provides financial aid for both basic needs and building civil society that usually includes, but not limits, sponsoring health care, education and infrastructure development;
- Online Platforms: the development of information and communications technologies provides the ground for creation websites for facilitating donations, and thus, charities, donors and institutional funders are more informed and effective in fundraising. Moreover, such online services provide the opportunity to attract international and foreign donors. Usually, such services are free of charge to the donation party, meanwhile the operational cost is supported by the corporate and private funds. For instance, *thehungersitecom* – for each click on the site advertisers donate one cup of staple food to poverty programs around the world;
- State: it is the main source of grants and contracts, and the only "institution" that can provide with the favorable taxation system for the third sector bodies: although, most non-profit organizations are receiving the legal status in any jurisdiction they are registered, but, CSOs office allocation is being influenced by the tax regimes;
- Multilateral agencies: instead of acting alone, some of the leading agencies, like the World Bank, are looking forward to engaging in the collaboration with the third sector organizations, even if such partnership involves culture clashes. Their grants are mostly aimed at technical assistance and advisory services as well as scholarship programs and project preparation;
- Regional bodies: regional support is mainly based on the issues of concern and strategic aims of the funder: for instance, the European Union is concerned with its mission of European integration and, thus, it aims at funding various multinational education and research programs and projects. However, sometimes funders go beyond their strategic aims and provide support in the areas other than those of their activities: for example, OPEC funds some educational programs, however, this is not the sphere of its main activity;

- **Private and corporate foundations:** these asset-holding institutions are mostly conserved with the philanthropic or charity activities. It should be mentioned, that they vary in their organizational structure and, thus, are divided in grant-making, which provide grants to both other institutions and provide services themselves, and operating foundations, which are being more in carrying out activities;
- **Religious organizations:** these institutions raise their funds through donations and then act as implementing agents for other funding bodies. Number of nationally based religions have their own congregations around the globe, like Russian Orthodox Church or Federation of Islamic Religious Groups, and they facilitate the fund flow across the world for different causes that are raised and supported by the religious institutions;
- **Trade unions:** the significant number of funds is generated from the membership fees, which are based on the number of such members. International collaboration is also carried out on the industry level through International Trade Secretariats, and in this case the funds are collected from the membership fees, however, they also get grants from public institutions and private foundations.

NGOs and CSOs can use an unlimited number of sources for financing at the same time, however, the main condition for financing remains the same – separate accounting of funds and property received from the funding sources.

### **Jordanian Context**

Within the past two decades, Jordan has witnessed a rise in the number of emerging non-profit organizations of different denominations. According to Article 16(2) of the Constitution of Jordan, citizens have the right to “*establish societies, unions and political parties provided their objective is lawful, their methods peaceful, and their by-laws not in violation of the provisions of the Constitution*” (CHKJ, 1952). In addition, Article 22 of the International Covenant on Civil and Political Rights, which Jordan has signed in 1972 and ratified in 1975, guarantees this right. However, there are also a number of restrictions limiting such freedoms as freedom to peaceful assembly and association as well as freedom of expression.

Moreover, it should be mentioned that in Jordan there are different legislations regulating the activities of NGOs and CSOs. Thus, while the Law of Societies (No. 51 of 2008) as amended by Law No. 22 of 2009, is the primary legal framework governing civil society in Jordan, non-profit organizations fall under the Regulation No. 73 of 2010 on Not-For-Profit Companies, which was issued pursuant to Article 7(5) of the Companies Law No. 22 of 1997 and

its amendments. Under these legislations the third sector faces a number of restrictions and limitations. For instance, it excludes details on process of licensing such organizations (so Ministry of Social Development can change the process of licensing at any moment without the need to refer to the Cabinet of Ministers or Parliamentary for their approval), the issuing of license can be denied without stating the reason, it also empowers ministerial interference, deprives of the opportunity to open branches and allows government to intervene in the NGOs` management and activities in order to monitor their internal affairs. In case the Cabinet of Ministers issues refusal for the donation of funding, then the organization is obliged to refrain from receiving it.

Thus, according to the Article 16 of the Law of Societies (No. 51 of 2008), government is a supervising body over CSOs activities and the Boards of these organizations are obliged to provide state authorities (Ministry of Social development and the relevant ministry) with the annual work plan, report that includes information on the activities of the organization and sources of revenue and expenditure, as well as an annual budget that is audited by the chartered accountant (elected by the General Assembly). In case if the budget is less than 2000 JOD such organization can be exempted from the audit, but its accounts will be reviewed by the Relevant Ministry.

Article 17 of the same Law is regulating all the donations and funding from both national and foreign donors. Thus, the organization is obliged to provide the government with the information regarding the name of the donating entity, the amount and purpose of the donation as well as any specific conditions related to this (if applicable).

Meanwhile, under Article 3 of the Regulation No.73 on Not-For-Profit Companies, organizations that do not seek for profit must be registered with the controlling body providing all the registration information with (Companies national ID), including all amendments and changes.

Article 7 regulates the financial resources of such organizations stating that any kind of revenue must be used only for the achieving statutory aims and targets, and in no case these organizations can directly or indirectly distribute any of the revenues. In addition, Article 9, within 3 months from the beginning of the new fiscal year they are obliged to provide the government regulatory body (Companies Controller Department and the relevant Ministry) with the annual report on the performed activities along with the list of financing sources accompanied by its budget certified by the authorized signatories of the particular organization; its audit report and any other additional information that may request by the controller; organization`s business plan including list of activities that are expected to be

carried out during the year along with the detailed information on the financing sources for those projects and programs; and last but not the least – maintained correspondence with special records of facts of meetings and taken decisions as well as assessments of the carried out activities with their revenues and expenditures.

This legislation also stipulates the subject of the liquidation of the organization in Article 12, which states that Minister, upon the recommendation of the observer, may refer the company to correct the notes from the observer regarding their activities within 30 days; otherwise, the Minister may refer this organization to the competent court for its liquidation under the following cases:

- If it violates the provision of the law, or this Regulation or articles of its association;
- If it carries out activities that do not coincide with the statutory aims;
- If its activities violate the public order or moral standards.

Within Jordanian legislation the third sector is limited in ways of receiving financial support, and in fact the most common ways of funding are grants, donations, sponsors and business financial support as well as membership fees. Others like subsidies and entrepreneurial activity are restricted by the legal framework of the country, and other types of finances like allowances, procurement of services by the state as well as agreements and government contracts are often not practiced.

## **Conclusions**

Third sector can play an important role in the economic and social life of the state and can be a key factor in solving many social and economic problems. Neither the state nor business can solve such problems as unemployment or the lack of social services on their own, without involving third sector actors. But for productive activities, they need funding.

Sources of formation of the financial basis of the activities of the non-profit sector are diverse and create the opportunity to disclose and implement the statutory goals of each organization. The most advantageous position is for those CSOs and NGOs, the legal form of which allows creating target capital, and the goals of the activity are recognized as socially oriented, which allows such organizations to receive subsidies from budgets of various levels. In addition to government assistance to non-profit bodies, measures are provided that

encourage the private sector of entrepreneurs to make donations to non-profit organizations – the introduction of tax deductions for VAT and corporate profit tax.

The activities and work of NGOs and CSOs by nature are unprofitable, and mostly they depend on the munificence and benevolence of others in order to cover the costs of projects and programs through granting and donations. However, nowadays, the third sector faces the problem of insufficiency of such traditional sources of funding to follow the growing needs and increasing costs. Moreover, restrictions and limitations that are imposed on many grants and donations makes it more difficult to ensure long-term planning and improving the providing services and approaching their full potential in addition to the uncertainty of such funds within the time. As a result of the activities costs exceeding the amounts of received donations and grants, third sector institutions have to either lower the quantity of their activities and operations, reduce the quality of the performing work, or to look for other additional sources of funding in order to cover the formed differences. Usually, there are three approaches of fundraising in such case to be used: 1) to reach out new donors; 2) redesign programs in order to meet newly-emerged budget limits or to include cost recovery components (under this approach beneficiaries are to cover part of the project/program costs); 3) fundraising from carrying out commercial and entrepreneurial activities (receive income from the sale of goods, work, services produced by it, income from property of a non-profit organization, dividends on shares and other securities). Thus, a non-profit organization can independently provide itself with means for the implementation of its statutory goals, however, it should be also mentioned that, although, these are the most frequently used, but not a universally applied approaches due to the legislation restrictions and limitations of specific countries.

Providing non-profit organizations with the possibility of entrepreneurial activity is a necessity, a guarantee of the functioning of the organization and the implementation of socially useful activities even in the absence of external financing. Unfortunately, usually the legislation provides a rather fuzzy and unclear framework for the possible "self-financing" of the third sector organization, which can lead to abuse or, conversely, insufficient use of this opportunity.

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