



Published on National Council of Nonprofits (<https://www.councilofnonprofits.org>)

Original URL: <https://www.councilofnonprofits.org/running-nonprofit/administration-and-financial-management/misunderstanding-overhead>

(Mis)Understanding Overhead

Your nonprofit's mission matters. And it costs something to deliver it! Enlightened donors and grantmakers recognize that administrative costs (called "indirect costs" when government dollars are involved) are essential in order for charitable nonprofits to be financially sustainable, but for too long, "overhead" has gotten a bad rap and been inappropriately used as a measure of a nonprofit's effectiveness. The assumption that overhead is "bad" reflects a mis-appreciation of the reality of what it costs to deliver a nonprofit's mission.

Views of Overhead are Changing

The belief that overhead is negative is changing. Indeed, more people are realizing that costs may have nothing to do with how effective a nonprofit is. In fact, overhead that is too low can be of more concern. Instead, the focus is shifting toward a nonprofit's *impact and effectiveness*. It is our hope that everyone who invests in a charitable nonprofit's mission – its staff and board, as well as individual donors, businesses, private foundations, and government – become aware that operating a charity is not free. *It costs something to deliver a nonprofit's mission.*

What is "overhead?"

Overhead is generally defined as a combination of “management,” “general,” and “fundraising” expenses. Based on [the Form 990](#), a nonprofit has three categories of costs: Program, Management and General, and Fundraising. **Management and General plus Fundraising make up overhead costs.**

Program Costs: The costs incurred in connection with *a specific program or activity* of the organization. These are the costs often referred to as direct costs. Some nonprofits have only one program, others many.

Fundraising Costs: Costs that involve *seeking, soliciting, or securing* charitable contributions. *Examples:* the portion of a staff member’s salary allocated to development, the fees paid to a fundraising consulting firm, and the fees paid to register the charitable nonprofit for solicitation purposes.

Management and General Costs: All the other costs that are needed to operate the organization and are shared across programs.

Practice Pointers

- Note that for those nonprofits that file the IRS Form 990, they will have to report “management and general” separately from “fundraising” expenses. (See [Instructions to the Form 990](#) at page 42.) The practical effect of this is that any charitable nonprofit that files the IRS Form 990 (as opposed to the 990-EZ or 990-N) is required to report its fundraising expenses annually to the IRS.
- The IRS and FASB (Financial Accounting Standards Board) classify functional expenses in ways that are not always consistent with each other. Every nonprofit needs to use judgment and may need professional assistance, such as from a CPA, to sort out the appropriate allocations of costs. [Overhead Costs Definitions](#) can help. (Propel Nonprofits)
- More and more nonprofits, joined by enlightened grantmakers, are comfortable with the reality that costs – whether referred to as “overhead,” “management and general,” “administrative,” or “indirect costs” – are essential to advancing their missions. But in order to maintain the public’s trust, it’s important to be transparent about your nonprofit’s finances and also the outcomes of your nonprofit’s activities.
- The talented people that work for charitable nonprofits are worth investing in! If the people who are employed by nonprofits don’t have the respect and the

resources needed to get their work done, the organization will struggle to advance its mission. Fund the People is an nonprofit with the mission of helping grantmakers and charitable nonprofits understand the importance of investing in a nonprofit's talent. [Fund the People toolkits](#) help nonprofits and grantmakers understand and make the case for investing in the nonprofit workforce.

- Unrestricted, multi-year funding is being [promoted by leaders like Darren Walker of the Ford Foundation](#) and is one of the six practices embodied by the [Trust-Based Philanthropy](#) approach. It's one solution to "[the nonprofit starvation cycle](#)."

Related Insights & Analysis

- Learn about the significance of federal rules for nonprofits that contract with governments to provide services: [OMB Uniform Guidance](#)
- [Investing for Impact: Indirect Costs are Essential for Success](#)

Additional Resources

- [A Board Member's Guide To Nonprofit Overhead](#) (Blue Avocado)
- [Overhead Cost Definitions](#) (Propel Nonprofits)
- [The Overhead Project](#) (It's time to change how we think about overhead) CalNonprofits
- [Why funding overhead is not the real issue: the case to cover full costs](#) (Nonprofit Quarterly)

Resources for Donors, Grantmakers, and Government

- [Changing the Conversation About Overhead](#) (NTEN Change)
- [Ending the Nonprofit Starvation Cycle](#), a report and related articles by foundation leaders (The Bridgespan Group)
- [If we want our funding to change the world...](#) (Video by Forefront)
- [Tackling Overhead Together: Grantmakers and nonprofits must come to a mutual understanding of the true costs of change](#) (Stanford Social Innovation Review)

- [Unrestricted Core Support: Strengthening the Capacity of Our Nonprofit Sector](#)
(Weingart Foundation)

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