Heads Up: Why Fortified Fiscal Oversight is Key to Financial Well Being

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During the past 15 years, I've been honored to serve as a volunteer board member for several organizations. My first board role was for a community-based organization in the small village where I live. I had long admired the nonprofit's historic preservation and conservation mission, and when the invitation to consider board service came, I jumped at the opportunity to serve.

During my first year of service, a disconcerting moment led me to volunteer to assume the role of treasurer. During a board meeting, the incumbent treasurer announced that although he had "a handful of spreadsheets and reports" prepared, he was certain no one on the board wanted to hear him read those documents. He laughed and asked if someone wanted to 'move' acceptance of the financial statements (presumably the papers he was shuffling nervously). Before I could close my gaping jaw, a motion was offered, seconded, and adopted. To this day, I regret not raising my hand to vote "no" or abstain.

Fiscal Oversight is Broken: Here's Why

While my experience was the most egregious example of financial leadership I've ever witnessed, my work as a consultant to numerous nonprofit leadership teams over the years has led me to believe that effective, appropriate financial oversight is both essential and hard to do. Why is it so hard to create an operative oversight function that supports the financial health of a nonprofit? Three culprits come to mind:

1. **Board Members Don't Join to Focus on Financial Health.** The NRMC team has worked with thousands of board members who support and oversee a vast array of charitable missions. During our one-on-one conversations with these dedicated leaders—including Audit and Finance Committee Chairs—we have yet to hear *anyone* say that they were drawn to the nonprofit because they wanted to receive financial reports or serve on the finance committee. The mission and purpose of an organization are what inspire board members to serve. And interestingly, even savvy finance professionals tell us they never expected to be drawn into financial oversight when they agreed to serve. Joining the board was a chance to do something *other than* finance!
2. **Fiscal Oversight Skills and Techniques are Taught, Not Brought.** Nonprofit board members who seem comfortable and skilled at fiscal oversight are likely to have learned their skills serving on *another* No one emerges from the womb, or college, knowing what questions to ask to probe the weaknesses on a Statement of Financial Position (the Balance Sheet) or wildly unrealistic aspirations on a revenue forecast. Serving on a board is a chance to learn and hone the skills necessary to do the job. It's all on-the-job training!

3. **Effective Fiscal Oversight is an Awkward Dance.** If you have two left feet, or you've been told you lack rhythm, fiscal oversight will be familiar territory. Oversight requires asking questions that seem to poke at what you're being told by the finance and executive staff at the organization. Strong staff members will take those questions in stride and appreciate your care and concern about the organization's financial health. Weak leaders will take offense, brush off your questions or create a diversion ("Did I mention we're a finalist for a big grant?"). The most competent staff teams recognize that they can't deliver financial management *and* financial oversight because there is an inherent conflict of interest in wearing both hats. Your accountant can't also serve as your auditor. A chef can't participate in a cooking competition where she's also a judge.

Fix It Before It's Too Late

The ultimate risk of poor financial oversight is a significant downside surprise that the board 'didn't see coming.' When frustrated, sometimes angry board members call NRMC to share tales of financial woe, they most often lay blame at the desk of the CEO. Our training and experience tell us that inadequate oversight was a corresponding if not crucial culprit in many instances.

Unfortunate, mission-crippling financial results can happen to the best-run organizations and under the watch of the most ethical managers. However, many surprises are due instead to a failure to 'mind the store.' As is true with other impending disasters, forewarning can mean the difference between survival and obliteration.

Consider adopting—or adapting—these five strategies to infuse and buttress fiscal oversight in your organization.

1. Develop and Share Relevant Oversight Questions.

When the board receives a packet of materials in advance of a committee or board meeting, conscientious board members are likely to review those materials and try to identify questions they should ask (if no one examines the packet, you've got an entirely different problem!). As a brand-new board member, I remember making notes in the margins of the board packets I received at the 11th Asking questions is a standard component of oversight. But knowing what kinds of questions to ask is a skill that develops with experience. A common occurrence is for board members to ask questions about changes in financial results from one period to the next.

I recall a frustrated CEO who was asked by a board member to explain why office supplies expense was up by 25% in the past quarter. She responded (a bit impertinently), "Do you mean the increase of $100? Is that what you're asking about?" Instead of crossing your fingers and hoping board members come up with brilliant oversight questions, add suggested questions to your board meeting agenda, or include them at the end of the Finance Committee Report. For example:

- Do the financial results for the past quarter give you confidence that our financial health is improving?
- Which specific financial result gives you the most concern?
- From your perspective, are we on track to meet our financial goals?
- In your view, is spending aligned with our strategic priorities for this year? If not, where are we off?
- Does our current level of financial reserves give you confidence that we could successfully weather a downturn in one revenue category? Multiple revenue categories?

2. Establish Ambitious Goals Related to Financial Health.

As shared by the panel members in "Examining Fiscal Risk for Mission-Minded Success," inadequate financial reserves represent a significant risk—and a weakness—for many nonprofits. Effective fiscal oversight includes adopting financial goals that provide a buffer against unexpected or unavoidable downturns or financial losses, as well as benchmarks against which to measure progress. While the list of financial goals suitable for your organization may be different from those suited to another nonprofit, there are a handful of goal types that should be considered, at a minimum. These include:

- ***Financial Reserves.*** Whether you call your reserve a 'rainy-day' fund, 'financial reserve,' or something else, most organizations define their target by the days of cash required for core operations. This is sometimes referred to as "number of days of cash on hand." A healthy reserve or rainy-day fund is typically in the range of 6-12 months of cash to cover basic operating expenses, from payroll to rent, utilities, insurance, customary contracted services, and more. Calculate "daily cash required" by taking your total costs for the year, subtracting depreciation and other non-cash expenses, and divide by 365.If your nonprofit has incurred debt for special projects or to keep the doors open, the board should appreciate and understand the purpose of that debt and the strategies for ensuring prompt repayment and keeping debt expense within reason. A goal related to debt may be in order if borrowing is a customary strategy for making ends meet (e.g., “Pay off the line of credit in 18 months.”).

- ***Administrative and Fundraising Costs.*** Many nonprofits that rely principally on donations from individuals struggle to keep total fundraising costs at a level that passes muster with charity watchdogs, the media, and the public. Thankfully, the percentage of total expenses devoted to administrative and fundraising is finally declining as the predominant indicator of ethics and efficiency.For too many years, nonprofits have been judged on the reported percentage they spend on ‘direct programs and services’ versus the true value and impact of services provided. Scant attention was paid to the fact that ineffectual nonprofits may claim to spend “90 cents” or more of each dollar raised on programs. In contrast, nonprofits that are changing lives and communities for the better may struggle with fundraising costs because their most loyal donors will only respond to appeals delivered via the costliest fundraising channel, direct mail.
- ***Change in Unrestricted Net Assets.*** As shared by Ed Mulherin in “Examining Fiscal Risk,” ending the fiscal year with a surplus is a step that must be repeated to build an adequate or healthy financial reserve. Positive, unrestricted net assets should be available for mission-advancing purposes, such as building a reserve, supporting an innovation fund, or paying off debt.
- ***Living Wage and Competitive Benefits.*** Less talked about as a financial goal—but of critical importance—is a goal related to paying a living wage to all employees of the organization. While the board should not be involved in determining pay scales, bonus amounts, or the details of benefits plans—except for compensation and benefits for the CEO—the board should have confidence that the organization’s commitment to equitable, living wages is real. Boards should not be permitted to ignore dated or otherwise inadequate compensation structures and claim that “we can’t pay people fairly because we’re a nonprofit.”

To reflect on the ambitious goals uniquely suited to your circumstances, ask:

- What mission-advancing move would we make if we had the financial resources to do so? What amount do we need?
- What unnecessary stress or strain do we face that we can attribute to having inadequate reserves? What level of reserves would eliminate or significantly reduce that stress?
- Do we have a clear and compelling compensation philosophy? Does that philosophy enable management to create pay scales and competitive benefits that support a living wage for all staff?

3. Provide Annual Financial Training for the Entire Board.

If your board is typical, a few members understand the structure and terminology of your financial statements, and many others do not. I’ve attended hundreds of finance committee and board meetings and have yet to hear anyone say, “I really don’t understand the story these financial statements are telling. What are the headlines? What do I need to know?” Most board members find it uncomfortable to admit they don’t understand the organization’s financial statements.

To ‘level’ the playing field for your board and help it ascend to the financial oversight role your mission deserves, schedule an annual workshop that explains—in layperson’s terms—the critical components of your principal financial statements (Statement of Financial Position, Statement of Activities, Statement of Cash Flows, and Statement of Functional Expenses). Invite and encourage all board members to attend. Consider making it fun by kicking off with a self-scored financial health quiz and great discussion questions sprinkled throughout the training.

4. Require All Board Members to Serve a Tour on the Finance Committee.

One of the most common mistakes made by those who determine committee assignments is to exempt some or most board members from serving on the board’s most active committee, the Finance Committee. Whether your board members serve terms lasting 3 or 4 years and whether you have term limits, sitting for at least 2 years on the Finance Committee should be required for *all board members*. The participation of non-financial leaders on this committee will lead to meaningful changes and improvements in financial presentations and the addition of much-needed, plain-language explanations of financial developments.

5. Use a Fiscal Dashboard to Tell Your Financial Story.

One of the most interesting—and challenging—tasks ever undertaken by a finance team or finance committee is constructing a fiscal dashboard that tells the nonprofit’s financial story in a concise, visual fashion. An effective dashboard draws attention to the headlines and invites a 30,000-foot view of financial health.

When building a dashboard displayed on a single page, limit the information to a maximum of 5 chunks, charts, or data sets (visualizations). Remember that a great dashboard should be understandable in five seconds, and the most crucial information should be at the top of the page. Use a simple color scheme and make sure that every word or number is readable without a magnifying glass! Many different types of information can be depicted on a fiscal dashboard. Choose the most relevant information based on your financial goals and current circumstances, such as:

- Progress towards achieving your financial reserve goal
- Current financial ratios (cash on hand, debt ratio, etc.)
- Growth in revenues/growth in expenses (%) year over year
- Change in unrestricted net assets, year over year
- Progress achieving diversification of revenue sources
- Change in reliance on a single revenue stream or principal funder, year over year
- Key financial goals for the current fiscal year or over a multi-year period

Fortified fiscal oversight is a worthy goal for all nonprofits. Your mission deserves strong financial management practices and thoughtful oversight by leaders who can step back and share insights and perspectives on financial goals and fiscal well-being. When a board develops the skills and confidence to ask tough questions about financial health, managers experience less worry that they are on the journey alone. An active Finance Committee that understands and embraces its oversight role is a priceless asset for a nonprofit mission.

Additional Reading

- "Fiscal Responsibility and Oversight: Empower Your Board to Lead," RISK eNews
- "Transparency, Not Whitewash," RISK eNews
- "Take the Fear out of Financial Statements," BoardSource

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