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Board Oversight of Financial Management


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Presentation Objectives




- What are the risks?
- What is financial risk management?
- Aspirations for financial management
- The board's role
- Tools for engaging the board
 - Helpful resources

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What are the Risks?

- Institutional Mission
 - Value versus Costs
- Program Objective
 - Resources expended per objective achieved
- Appropriate Activity
 - [media headline: "What were they thinking?"]




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- What is financial risk management?
 - “the concepts, policies, and systems that enable an organization to manage without undue exposure to significant financial losses arising from those factors.”

Source: *Financial Risk Management: A Guide for Nonprofit Executives*



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Aspirations for Financial Management

- **Ethical Conduct** - “the paid and volunteer personnel of the organization understand the difference between what is acceptable and what is not.”
- **Accountability** - This intensified interest, fueled by media reports of wrongdoing by a small number of sector leaders and the growing interest by donors (organizations and individuals alike) in assuring that their chosen charities act responsibly, puts additional pressures and responsibilities on nonprofit leadership.

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Aspirations for Financial Management

- **Transparency** – “A nonprofit that embraces transparency is open about its sources and uses of monies provided to the organization in the form of donations, contract fees, grants, membership dues and more.”

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Aspirations for Financial Management

- **Enlightened and Involved Leadership** –
 - Boards must be fully aware of the risks facing their beloved organizations.
 - Need for special emphasis on those that threaten the sustainability of the nonprofit.
 - Financial management provides an opportunity for the board to discharge its legal duty of care.

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What's Required?

1. Commitment to participating in discussions about financial risks and planning and management strategies.
2. Taking time to review materials provided by staff and request additional materials that are necessary to effective decision making, and
3. Asking questions that increase the board's understanding of the financial condition of the nonprofit and its plans for the future.

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Aspirations for Financial Management

- **Sustainability** – “Effective management of the organization’s finances is not an end unto itself. Recognizing financial risks and implementing effective financial risk management activities can play an important role in financial sustainability.”

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Seven Characteristics of Financially Healthy Nonprofits

1. The financially healthy organization has sufficient income to ensure stable programming.
2. The financially healthy nonprofit has an internal source of cash or ready access to cash in times of shortfall.
3. Financially healthy nonprofits engage in income-based, rather than budget-based spending.

Source: www.nea.gov/resources/Lessons/STEVENS.HTML
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Seven Characteristics of Financially Healthy Nonprofits

4. At the end of each year, the financially healthy organization retains a positive cash fund balance (surplus).
5. In years where a deficit does occur, the financially healthy organization has accumulated surpluses sufficient to cover the current year's deficit.
6. The financially healthy organization has established (or has plans to establish) an operating reserve to finance growth and cash shortfalls.

Source: www.nea.gov/resources/Lessons/STEVENS.HTML
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Seven Characteristics of Financially Healthy Nonprofits

7. The board and management of financially healthy nonprofits hold themselves responsible for the **financial stability** of the organization.

Source: www.nea.gov/resources/Lessons/STEVENS.HTML
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Key Lesson

- Board members exercise *overall responsibility* for the fiscal affairs of the nonprofits they serve.

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Case Study: Truth and Consequences

A highly regarded nonprofit recently profiled in the book, *Forces for Good: The Six Practices of High-Impact Nonprofits* received publicity of a different kind in the Summer of 2008 when *The New York Times* ran a story detailing the failure of the organization to account adequately for some of its federal funding. According to the story, "The finances of a national teacher-recruitment program have come under scrutiny by the federal government, reports *The New York Times*.

According to the inspector general at DOE, Teach for America did not provide adequate documentation as to how it spent federal grant money it received from 2003 to 2005. The group received about \$6-million in grants, and of that amount, auditors examined \$1.5-million. Teach for America couldn't account for \$775,000 of the figure auditors looked at."

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Suggested follow-up:

- Could this (or something similar—different funding source or scope) happen to your nonprofit?
- How could it happen?
- What practical steps can you take today to reduce the risk?

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The Board's Role

- The board of directors is the ultimate caretaker of the organization's community-serving or member-serving mission.
- The absence of financial security and protection of financial assets makes mission fulfillment impossible.
- The board has ultimate responsibility for the fiscal health of the nonprofit it serves.

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Legal Duty

- Every nonprofit board has specific legal duties of care, loyalty, and obedience. The *duty of care* asks a director to be reasonably informed, participate in decisions, and to act in good faith and with the care of an ordinarily prudent person in similar circumstances.
- Ways to assess a board member's commitment include asking if the person participates actively in decisions, attends meetings, uses independent judgment, and seeks reliable information to make informed decisions.

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Why is it difficult to engage the board?

- Board members are recruited for their demonstrated commitment to the mission of the nonprofit.
- Few bring practical experience examining the financial statements of a nonprofit organization.
- Some board members feel reluctant to ask questions about the financial circumstances of the organization.
- In some cases board members believe that asking questions about the reliability of revenue projections or use of funds may cause offense.

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Tools for Engaging the Board

- Board Manual
 - Or password-protected board web page
- Board orientation or briefing
- Finance related training
- Board self-assessment

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Tools for Engaging the Board

- Cultivate a “culture of candor” –
 - An accountable board meets in an environment characterized by a culture of candor. Each board member must feel comfortable raising difficult issues for discussion (e.g. “Will this new program truly further our mission, or are we pursuing this opportunity due to the associated revenue?” or “Is the figure proposed for client fees realistic given our history of declining demand for services?”).

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Tools for Engaging the Board

- Breathe life into the nonprofit’s financial statements
 - “Nothing can be more dreadful or tiresome to a board member who attempts to provide appropriate fiscal oversight of an organization than to receive financial documents and statements that are stale or static, that include only debits and credits, and that do not bring those materials to life through a link to the organization’s greater purpose, mission, and strategic directions.” – Paul Parsons, *Raising the Board’s Financial IQ*

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Tools for Engaging the Board

- Encourage/invite the board to ask tough questions, such as:
 1. Do the current revenue streams for the organization best serve its interests? (for example, a nonprofit board may reflect that reliance on large government grants necessitates focus on a narrow component of the organization's broad mission due to the restrictions that accompany the acceptance of such funding)

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Tough Questions, *continued*

2. Has the organization effectively evaluated the risks associated with its key funding strategies and developed associated strategies to guard against the loss of a single source or to replace a primary funding source?
3. Do the nonprofit's expenditures reflect the core aspects of the organization's mission? (versus a spending pattern that suggests overemphasis on one aspect of the mission)

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Tough Questions, *continued*

4. Has the nonprofit wisely invested its unrestricted net assets to ensure protection of and growth of these assets?
5. Does the professional staff with finance responsibilities demonstrate a high degree of competence on finance matters?
6. Is the staff encouraged to reach outside the organization for technical help on finance matters?

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Financial Know-How: Equip Your Board to Lead

- Training and resource materials combine to offer a powerful antidote to ignorance and lack of confidence in providing fiscal oversight. Consider:
 - Purchasing copies of a how-to-read financial statements guide* for each member of your board;

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Equip Your Board, *continued*

- Scheduling a two-hour training program on nonprofit financial statements as part of the board's agenda—perhaps the first meeting of your fiscal year.
- Reaching out to a local CPA whose practice focuses on nonprofits to deliver a briefing to the board and to serve as a resource should members have questions during the year.

*An example of a guide that may be suitable for nonprofit boards is Andrew Lang's booklet titled, *How to Read Nonprofit Financial Statements*. The booklet is available from www.asaecenter.org or www.amazon.com

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Suggested Board Orientation

- **Part 1 - Understanding Nonprofit Financial Statements (30 minutes)**

Start off with an introduction to nonprofit financial statements. Be aware that the degree of familiarity and comfort with this topic is likely to vary! The goal is to get the entire board in sync with the manner in which financial information will be transmitted to the board, and enable individual board members to feel comfortable asking questions about the nonprofit's results.

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Part 1

- To make this segment more productive, consider:
 - Providing a list of questions that board members should ask to evaluate the nonprofit's fiscal health
 - Obtaining copies of a resource document on nonprofit financial statements, such as *Understanding Nonprofit Financial Statements* from BoardSource (www.boardsource.org), or *How to Read Nonprofit Financial Statements* from ASAE (www.asaecenter.org)
 - Including magazine or journal articles on the basics of nonprofit budgeting

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Suggested Board Orientation

- **Part 2 - Overview of [Name of Nonprofit]'s Finances and Budget (30 minutes)**
 - Present a brief overview and analysis of the nonprofit's Statement of Financial Position, Statement of Activities, and Statement of Cash Flows for the most recently available accounting period.
 - Copies of these documents should be provided as part of the orientation materials.

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Suggested Board Orientation

- **Part 3 - Additional Finance Resources (30 minutes)**
 - Call the board's attention to the resources on the next slide, all of which provide a picture of the nonprofit's fiscal health and financial management strategies.

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- Audited financial statements for the year just ended
- Narrative highlights of the past fiscal year
- Consolidated schedules of audited statements - five years
- Approved operating budget for the current year
- Financial policies and procedures
- Investment policies and procedures

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How?

- PROVIDE: "a trends analysis report that is taken directly from audited financial statements and presents, in narrative form, each of the major line items over a five-year period so that board members gain an historical perspective on the association's finances and financial health."
- "When a narrative explanation is given for each line in your audited financial statement, a board member gains a fundamental understanding of these documents. Equally important, there is "nowhere to hide" when presenting an organization's financial statements in this narrative format - by explaining each line item, whether it's positive or negative."

To read the full article, visit:
www.asaecenter.org/PublicationsResources/articleDetail.cfm?ItemNumber=13419

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Advice from: Frank L. Kurre, National Managing Partner,
Not-for-profit Industry Practice, Grant Thornton

Strategies for managing the "too-much" versus "too little" tug of war...

- Perform a brainstorming session with the board to determine the types of information members are interested in receiving.
- Develop a dashboard of key financial and operational metrics that provides information on the most relevant indicators.
- Identify key metrics to assess the organization's performance against its mission statement and strategic plan.

Source: NPT Weekly Update, Jan. 5, 2009

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Advice from: Frank L. Kurre, National Managing Partner,
Not-for-profit Industry Practice, Grant Thornton

- Inform the board on budget versus actual revenues and expenses, as well as budget versus actual capital expenditures and debt payments.
- Provide the board with adequate financial information to support decisions such as adding or expanding programs, acquiring property and equipment and making significant investments.
- Provide monitoring information so that the board can provide adequate oversight. Monitoring information is typically provided in, among other areas, liquidity, financial condition, reserves, revenue and expense activity, compliance with donor restrictions and status of significant investments.
- Provide the board with information on programs and activities to ensure that members have adequate knowledge of the current state of the organization and the expected future state.

Source: NPT Weekly Update, Jan. 5, 2009

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Questions?
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Next Month's Webinar

- **February 4 / 2 p.m.**
Risk Management, Culture and Mission: Engaging Stakeholders to Protect Your Nonprofit
Managing risk in the nonprofit world takes a "village" of stakeholders. Yet it is sometimes difficult to engage stakeholders in a discussion of risk issues, when their passion for the nonprofit is focused on its mission and programs. Attend this webinar to learn how to demonstrate and connect risk management to mission accomplishment, how to engage your stakeholders, and how to bring about culture change that will propel your risk management goals and agenda forward.
- <http://nonprofitrisk.org/training/webinars/reg1.html>

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