What is Risk?

- "Uncertainty is therefore transformed into risk when it becomes an object of management, regardless of the extent of information about probability."
  - Michael Power, Organized Uncertainty: Designing a World of Risk Management

What is risk management?

- "...a discipline for dealing with uncertainty."
- Can we really "manage risk?"
- "I suspect the best we can do is manage ourselves and our organizations using risk measures as imperfect guides." - H. Felix Kloman
To Plan for Today is Human

• There are many motivations to focus planning on the short term. These motivations include:
  ▪ The “crisis management cycle”
  ▪ The speed with which “things” change
  ▪ Past experience with forecasting and strategic planning

Optimism Bias

David Ropeik:
  ▪ “colors our views of how things will turn out further down the road”
  ▪ “without the ability to see whether the future will actually be ours, the statistics suggest that we need clearer lenses”

Poll Question

• In your view, which of the following is the most compelling benefit of long-term planning?
  1. It provides a structure and the discipline to think about tomorrow, today
  2. It may help us forecast events that could derail our mission
  3. It inspires confidence in stakeholders
Budgeting Recap

- A shared, strategic vision of the future is the starting point for sound budgeting.
  - Challenges, opportunities, strengths and weaknesses

Budgeting Recap

- Getting on the same page is essential:
  - The nonprofit’s financial goals (e.g., building a reserve fund, increasing funds in an endowment, operating key programs on a break even basis, etc.)

Budgeting and Forecasting Go Hand in Hand

- Forecasting is essential to effective and accurate budgeting
- Reviewing budget outcomes is part of forecasting
Ensure Accurate Forecasting

• Helpful forecasts consider:
   Historical results
   Anticipated changes in the organization’s environment, activities and strategies

Financial Planning Basics

• An external scan (for opportunities and threats) is essential to effective long-term financial planning:
   Are there TRENDS with which we should be more familiar?
   What trends have we observed? What trends SHOULD WE be tracking?
   Have we examined goals and results, and goals VERSUS results on a multi-year basis?
   Is GROWTH a goal? What are the most compelling opportunities for growth?
   What THREATS to growth and other goals can we envision?

Long-Term Goals

• Financial independence
  “Begging for Change,” by Robert Egger
Long-Term Goals

- **Sustainability**
  "A sustainable future will mean different things for different organizations, but at its heart, it means planning for the long-term. This could mean managing or reducing debt, building a cash reserve, changing your mix of income sources, or improving your infrastructure…"
  - Source: www.nonprofitsassistancefund.org

Long-Term Goals

- **Cash Reserves** – Kate Barr, Nonprofits Assistance Fund, www.nonprofitsassistancefund.org
  - "The "right" target for reserves needs to be customized for each nonprofit based on their operating structure, cash flow, and ability to generate surpluses in the operating budget."
  - "Building reserves requires an intentional budget strategy and follow through to generate surplus funds. Whatever the target amount, reserves are most useful if there is clear agreement about their purpose and use codified in a written policy."

Forecasting Missteps

- Failing to forecast
- Fear of forecasting
- Sole proprietor forecasting
  - Who should be involved?!
**Resources**

- Nonprofits Assistance Fund has developed [Nonprofit operating reserves policy guidelines and examples](#).
- If you are interested in a deeper dive on the issues, considerations, and structure for reserves, you’ll love the [Nonprofit Operating Reserves Initiative Workgroup White Paper](#). They answer the “how much” question with a useful chart that sorts through the “it depends” factors.

**Operating Reserves**

- “…that portion of “available unrestricted net assets” that an organization’s board maintains and/or has formally designated, or “reserved” for use in emergencies to sustain financial operations in the unanticipated event of significant unbudgeted increases in operating expenses and/or losses in operating revenues. The adequacy of operating reserves beyond the minimum is variable and depends on factors such as the reliability of operating revenues, impact of economic conditions among others.”

Source: [www.nonprofitsassistancefund.org](http://www.nonprofitsassistancefund.org)
Investment Policy

- Suited to your circumstances
- Arguably needed in every nonprofit
- “Unrestricted working capital” -
  - Essential to financial integrity, if not viability
- A plan to develop a reserve – over several fiscal periods… is key

www.nonprofitrisk.org

Investment Policies

- **Designation of authority** to make investment decisions
  - Possibilities include: finance committee, full board, or investment committee
- Provisions governing the management of operating versus endowment funds

www.nonprofitrisk.org

Investment Policies

- Goals for the rate of return and preservation of spending power of each type (operating and endowment) of investment.
  - Investment goals differ…

www.nonprofitrisk.org
Investment Policies

• Provision concerning liquidity (availability) of funds.
  ▪ Operating fund: more liquid, available for short term use
  ▪ Types of accounts in which each type of funds is held (e.g., checking, savings, brokerage, etc.)

Investment Policies

• The diversity of investment types for each type of funds, e.g., stocks, real estate, etc.
• Guidelines for the maximum percentage that could be invested in any particular type of investment… to ensure adequate diversification

Investment Policies

• How portfolio manager is selected… reporting requirements to be followed to ensure that leadership of nonprofit is kept apprised of the status of investments.
• Warning: delegation danger
Investment Policies
• Frequency with which the investment policies will be reviewed and adjusted to address changed circumstances.

Investment Policies
• Prohibited investments – either by type of investment, rating of investment, or reflecting a particular social philosophy (e.g., no investment in tobacco and alcohol company stocks)

“Cash is Cash...Sometimes”
• “Beyond verifying an accurate number, though, it’s important to have a solid grasp of all the strings and restrictions that might hinder your ability to use that cash when you need it. Some restrictions are external, such as temporarily restricted grants. Other strings on cash result from internal decisions related to investment decisions, reserve policies, or overly-complex designations and conditions.”
• Kate Barr, Nonprofits Assistance Fund
RESOURCE

• Nonprofits Assistance Fund has created a quick cash analysis resource to help nonprofits easily distinguish cash that’s liquid and available from other types of restricted, designated, or hard-to-access funds. You can download the Cash and Investment Analysis worksheet at www.nonprofitsassistancefund.org

What is Financial Health?

• Financial resources are directed to mission fulfillment
• Income is available to support key programs / sources of income are stable
• Nonprofit is flexible – able/willing to try new things and adapt to change
• There is appropriate investment in facilities, technology and staff
• The nonprofit has sufficient cash to pay its bills
• The nonprofit is a good steward of all funds
• Every board member is knowledgeable about the above!

Source: www.nonprofitsassistancefund.org

Recap

• Failing to forecast puts your nonprofit at great risk
• Effective forecasting should be an inclusive process
  • Involve the board!
• Question assumptions!
• Look far and wide
Recap...

• Remember that updating your investment policy(ies) is key to good financial health
• Prudent financial risk management requires that decisions about managing cash are not ad hoc but made with care and in the context of policies that suit the circumstances of the nonprofit

My Reading List...

• How Risky Is It, Really? Why Our Fears Don’t Always Match the Facts, by David Ropeik
• Why We Make Mistakes: How We Look Without Seeing, Forget Things in Seconds, and Are All Pretty Sure We Are Way Above Average, by Joseph T. Hallinan
• Stumbling on Happiness, by Daniel Gilbert
• Struck by Lightning: the curious world of probabilities, by Jeffrey S. Rosenthal

New from the Center
Thank you!

• Melanie Lockwood Herman
  • Melanie@nonprofitrisk.org
  • www.nonprofitrisk.org

Next Month’s Webinar

• Shred or Retain? A Closer Look at Records Destruction/Retention Policies
• June 2, 2010 – 2:00 pm Eastern