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nancial Oversight: Expanding the Board's Role in the Pursuit of Sustainability

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SUSTAINABILITY: BEYOND FINANCIAL OVERSIGHT

Most of the time, whenever anyone talks about boards and finances in the same sentence they make a point about accountability.

They warn us that our Form 990s were now on GuideStar, so we'd better make sure that our Boards are reading them. They tell us to have an audit committee and a "Conflict of Interest" policy. They tell us that we should study Sarbanes-Oxley and apply whatever we can to our own Boards. They make reference to a handful of nonprofit fraud cases, suggesting that this is what awaits us if our Boards do not get very serious about oversight and accountability.

Now, as nonprofit organizations continue to weather the severe, and in many cases permanent, shifts in their operating environments, those accountability concerns seem downright quaint.

The truth is that one of the roles that most decently functioning Boards play quite well is providing financial oversight. Compared to other Board functions, financial oversight is relatively clear:

- there is a dedicated officer role, the Treasurer;
- nearly all Boards have a Finance Committee; and
- there are tangible products such as an annual budget to approve, financial statements to distribute, and an auditor to select.

The problem is none of those tangible products in and of themselves has anything to do with nonprofit sustainability. And it is sustainability that is keeping executive directors up at night, not financial oversight. In ***Nonprofit Sustainability: Making Strategic Decisions for Financial Viability***, sustainability is defined as being both programmatic and financial:[1]

Sustainability encompasses both

1. **financial sustainability: the ability to generate resources to meet the needs of the present without compromising the future &**
2. **programmatic sustainability: the ability to develop, mature, and cycle out programs to be responsive to constituencies over time.**

In other words, Board Finance Committees can look at annual budgets, financial statements, and audits forever, but if some group of Board members is not **considering those financial results in light of the organization's programming mix and its results**, then their efforts are very unlikely to contribute to sustainability.

Boards, not unlike many staff, are artificially siloed into:

- groups that consider financial results,
- groups that consider programmatic results, and
- groups that consider fundraising results.

For community foundations, program results, in large part, drive financial results:

- the number and dollar value of the **funds we manage** yields a particular allocation reimbursement
- the number and dollar value of the **grants and scholarships we process** result in a particular fund balance
- the popularity and audience of our **workshops** and gatherings yield a particular dollar revenue.

And just as critically, the number and generosity of people who respond to our **direct mail campaign** and to our **special event invitations** determine how much subsidy we raise for programs that don't cover their own costs.

Put another way, if the Board Finance Committee doesn't like the financial results it is seeing as it provides oversight, what is it going to do about it? It has to look to the programs and the fundraising activities of the organization to yield different financial results; that's the only way to make the financial statements say anything better.

So while financial oversight is absolutely critical, it is hardly sufficient. **Boards of Directors charged as stewards of an organization have to be fundamentally knowledgeable about and actively engaged in the business models of the organizations they govern.**

Community Foundation business models are typically the antithesis of siloed; they are instead a very interdependent mix of programs, asset development, and fundraising activities that work together to achieve a set of impacts and financial results. How engaged are most Boards in that interdependence? And if they are *not* engaged, how can they meaningfully assist with the dogged pursuit of sustainability in which so many of their executives find themselves?

The complex challenges require that we **shift our mental model** from **Boards being primarily about financial oversight and accountability**, to **Boards being concerned in an ongoing way with the financial sustainability of their organizations.**

When pivoting a Board of Directors from a strictly oversight orientation to a sustainability orientation, there are a number of things to consider.

For instance, a Board with a sustainability orientation requires Board members who are financially literate. By this we mean that everyone has, or is actively developing, an understanding of the financial statements they receive. They have the fluency, for instance, to ask how a core program is performing both financially and programmatically. If only two or three people on the Board can read the financial data, the Board is unlikely to have **holistic conversations that take both mission impact and financial return into account.** With a sustainability orientation, financial statements become a useful tool in the ongoing discussion of where the organization should go next rather than merely reports that the Treasurer assures everyone has reviewed on their behalf.

Practically, this means that Board Members and Executives need to team up in creating a Board culture that expects and supports financial literacy from all members. During the recruitment and orientation of new Board members, **thorough and transparent discussion of the organization's business model and its current financial challenges and opportunities should be central**.

A Board with a strong sustainability orientation will most likely pass on the potential recruit who uses stale language such as, "I am not a numbers person. I leave that stuff to the treasurer." The response should be, "Our Board is focused holistically on the sustainability of this organization, so everyone engages with our financial results. We will train you and support your development as a financial leader, but you have to be committed to our stance on this point to be successful on this Board." In addition to this kind of strategic recruitment and orientation, Board members and Executives should prioritize financial training opportunities and consider mentoring among Board members to support members who are in active development of their financial literacy. Once a year, all Board members should receive a one-hour refresher on how to read and interpret the organization's particular set of monthly financial statements.

To signal and reinforce this sustainability stance, Board Chairs and Executives should consider renaming or extending their Finance Committees and adding nontraditional members—people who are financially literate but who have program or fundraising as their primary orientations, for instance. **A Board Committee called "Finance and Sustainability" that is composed of both finance experts and programmatic experts actively engaging with the business model's concerns will support the pivot to a "beyond oversight" Board.**

When a diverse group of members is reviewing and discussing the numbers, not only can it go beyond merely reporting to the full Board how close to its budget the organization is or is not**, it can also frame for the Board the questions of "why?" and "what might we do about it?"** With this approach, the Treasurer role evolves from that of a CPA, who is among the only people able and willing to review financials, to a full leadership role that **supports the full Board's meaningful focus on the complex questions and difficult decision making of the sustainability pursuit.**

Another key shift required for a sustainability orientation is the **normalizing of profit. Profit, like program impact, is fundamental to sustainability**. A Board of Directors that is uncomfortable budgeting for surplus and unwilling to face the brutal facts about the prospects for profitability of core activities is not operating with a sustainability orientation. It is important not to conflate profitability with earned income, however. Many nonprofits achieve profitability—that is, consistent annual surpluses—through a mix of earned and donated income. A special event can be just as profitable as a fee-based service to the community. The key is for Boards to be looking for profit wherever it can be generated in the model, and to be ensuring that, as a set, the organization's activities yield more than they consume.

Many leaders have had to face the reality that they can no longer subsidize core activities that do not cover their own costs. The fact that an activity is core to an organization's mission and very needed by its constituency does not necessarily mean that the organization can afford to keep it in its business model. So many Boards and Executives lament not having faced those realities sooner. We attribute this reticence to act on unsustainable deficits in part to Boards and Executives not deeply engaging in why and how their organizations were incurring deficits. **That is, they didn't deeply understand which activities in their business models were losing money, and how much; instead, they talked in macro terms about the organization's overall "not hitting budget."**

Part of pursuing sustainability is determining the desired profitability of every core activity—programmatic and fundraising. While most organizations elect to subsidize a handful of money-losers—allow the profits from an annual event to offset the losses in the training program, for instance—the Board should be very clear on these decisions and ensure that those subsidy decisions do not result in deficits for the organization overall.

The nature of financial plans and reports shifts with a sustainability orientation. Ironically, the classic tools of annual budget, monthly financial statements, and an audit can actually keep a Board focused on oversight rather than business model sustainability. When Boards focus too much on annual budget variance, for example, they are often not sufficiently engaging in projection.

Rather than focusing all of their analytical energy on how close the organization is to numbers it predicted six or eight months ago, members of the Finance and Sustainability Committee want to be anticipating the next several quarters' results, too.

We spend too much time providing oversight on things that already happened, and not enough time considering the financial road ahead. For-profits engage in rolling projection, and we believe that nonprofits should do this as well.

Rolling projection moves the Board of Directors away from the silly obsession with "hitting the year-end budget" and toward the capacity to make earlier and better decisions given the economic forces happening in real time. Fiscal years are artificial time frames. All major decisions will have economic impact far beyond the current fiscal year. Put another way, it is just as important to have a good July as it is to have a good June. When Boards focus only on predicting the coming twelve months (annual budget), monitoring variance from that increasingly outdated prediction (monthly financial statements with budget variance), and reviewing the past year's statements (audit), they risk not actually engaging in the pressing and emerging business issues facing their organizations right now. Again, financial oversight is critical but insufficient for sustainability.

A Board that is focused on sustainability will be working a handful of key business-model issues all the time. In this economic climate, very few organizations do not have to rethink some aspect of their business models. The Finance and Sustainability Committee members partner with staff leadership to articulate those issues and find meaningful ways for the full Board to understand them and, where possible, contribute to their resolution.

For instance, the Committee may come to the realization that the organization needs to refine, close or transfer a program because, while valued by the community, it has lost money for five years in a row, and its funding is unlikely to grow. A committee member can partner with the staff leadership to craft a presentation to the full Board, laying out the data and framing the key questions for Board decision making:

- What refinements would improve the program's profitability?
- Are we prepared to end this program, and if so, by what date?
- Are there elements of this program that we can transfer to a collaborator or competitor?
- Are there financial implications of refining or reducing or closing this program that we need to understand (for example, laying off staff, alienating a key donor, or losing the program's modest contribution to defraying overhead costs)?

Board members can be engaged in reaching out to other community organizations about the potential for program partnerships and/or transfers; another Board member can join the staff leadership in explaining the shifts to donors and those served; and so on. In this fashion, the full Board is actively engaged in decision making and execution on a business-model issue essential to the organization's sustainability.

For too long, too much of our Boards' finance focus has been on reviewing the past. This meant decision making was too slow in the face of mounting losses. Modest reserves were depleted, and organizations were left exceedingly vulnerable during a time of great community need.

The lesson is that Boards must engage not only in financial oversight but also in the pursuit of sustainability. To do this well, Boards have to be composed of financially literate members who engage in real-time analysis and focus on answering the complex business-model questions their organizations face today.

NOTES

1. Jeanne Bell, Jan Masaoka, and Steve Zimmerman, *Nonprofit Sustainability: Making Strategic Decisions for Financial Viability*. San Francisco: Jossey-Bass, 2010.

https://nonprofitquarterly.org/2011/04/26/beyond-financial-oversight-expanding-the-Boards-role-in-the-pursuit-of-sustainability/

Is Our Board Sustainability-Focused?

To pivot from an oversight orientation to a sustainability orientation, consider these discussion questions at a Board meeting:

1. How financially literate are we as a group? If we have knowledge gaps, how will we work together to close them, and by when?

2. Is our Finance Committee & Board engaging in the key business-model questions facing our organization, or focused primarily on monitoring budget variance and preparing for the audit?

3. What major sustainability decisions are before us as an organization, and how will we structure our Board and committee meeting agendas to ensure we make those decisions effectively?

4. Overall, how healthy is our organization financially? Is it healthier today than it was three years ago? Why or why not? When our Board terms end, where do we want to leave the organization financially?

5. How strong is our partnership with staff leadership around issues of sustainability? Are we sharing information and ideas across staff and Board in a way that truly leverages our individual and collective strengths and networks as Board members in the sustainability pursuit?