**Fiducient Advisors, Nonprofit Investment Stewards Podcast**
*Episode 18, May 5, 2021*

## How Nonprofit Leaders Can Overcome Today's Challenges – with Dennis Morrone

[00:00:00] Welcome to Non-profit Investment Stewards with Bob DiMeo and Devon Francis from Fiducient Advisors. Bob and Devon are passionate about helping nonprofit organizations prosper. Whether you oversee endowment, foundation or retirement plan investments, this podcast exists to help stewards improve performance, reduce costs and discover strategies that enable your charitable organization to prosper and advance its mission.

[00:00:27] Now on to the show. Hello, and welcome back to the Nonprofit Investment Stewards podcast. I'm Bob DiMeo. As always, joined by co-host, Devon Francis. Today's episode is relevant to a wide array of nonprofits and charitable organizations. We have a terrific guest to help us navigate challenges I know our listeners are contending with. Things like how nonprofits should think about liquidity and debt, the governance of your nonprofit.

[00:00:57] How your board and even your investment committees [00:01:00] might need to change and a lot more. But before we jump to that and our expert guest, Devon, good to be with you. How are things? Excellent. Couldn't be better. I am very excited to hear from our guest today. We have Dennis Morrone who leads Grant Thornton's Not-for-Profit & Higher Ed Practice.

[00:01:15] Dennis is a CPA. He has extensive experience in finance transformation and organizational transformation. He has also authored a great amount of content for nonprofits, including a recent article that's titled "Focus on 5 Areas for Post-Pandemic Recovery."

[00:01:36] That piece in particular has very timely insights for schools, cultural institutions, religious organizations, and really many other types of nonprofits. So, we're very eager to glean some insights from him. Dennis, welcome to the show. Good morning. And I'm happy to be here. Dennis, so good to have you on the show.

[00:01:55] And before we jump to specifics, perhaps you can share a bit about how you landed [00:02:00] in this world of serving nonprofits and perhaps even touch on the types of clients you work with. Sure, happy to. So, my dedication and service to this industry really has its moorings back to my days in college. I was involved in a number of not-for-profit organizations on campus that served the Greater Philadelphia area.

[00:02:22] I was involved in mentoring kids in afterschool program in Center City for the entirety of my four years. And I also served as a buddy for a program to assist disabled adults. And so, focusing my professional career on serving the organizations that serve others really just feels right and aligns with my personal values and goals.

[00:02:47] And in terms of the types of organizations and institutions I serve, I work with the full spectrum of not-for-profit organizations, including institutions of higher education, foundations, museum and cultural [00:03:00] organizations, environmentally focused organizations, religious organizations of all denominations and social service organizations as well.

[00:03:09] Oh, so that's quite an array. Obviously, you advise many nonprofits. So as we sit here in spring of 2021, how would you describe the current landscape and the tone for the nonprofit community? Well, what a year it has been really. And I think it's been said certainly by others, but it has been unprecedented, but certainly not without some form of analogy.

[00:03:32] I don't think there's one answer that fits all given the broadness of the not-for-profit sector. I think the effects have been demonstratively different amongst the different sub sectors, but yet, equally as pronounced. And to start, I would focus on those organizations, social service organizations that serve desperate populations in need.

[00:03:54] We've learned that not for profits of this type have been incredibly valuable and provide all [00:04:00] kinds of support services. They've been called on like never before. To fill the gaps, uh, provided or, or present as a result of the insufficient nature of federal, state, and local funding and programs. But I think it's fair to say that the demand significantly exceeds the supply.

[00:04:20] So that has caused a considerable amount of strain while programmatically, I believe these organizations are really thriving in terms of actually delivering on their mission. It's been hard. And I think if I had to categorize the tone, I would say it's somewhat fatigued. And then as I think about some of the other sub sectors, for example, museums and cultural institutions, they were shuttered for such a protracted period of time.

[00:04:48] And they saw a complete reduction or loss of their revenues. And even after they opened up and did they had reduced levels of attendance to comply with relevant [00:05:00] restrictions, the level of attendance that they generated was not sufficient to really cover the cost structures that these institutions had in place.

[00:05:09] And so it didn't even result in any kind of meaningful margin for these organizations. When I think about colleges and universities, where I spend a lot of time, they really struggle with, most institutions maybe struggled to adapt to the new modality of going all virtual. Some institutions made the jump much easier to deliver their instructional content and pedagogy, but others struggled.

[00:05:33] And for institutions of higher education, I think those that went full virtual, which was the preponderance of institutions, the loss of their revenues associated with ancillary activities like residence halls and dining services, which tend to be the more profitable revenue streams for institutions really had a significant negative impact on these institutions' operating budgets for the period.

[00:06:00] [00:06:00] One other sub-sector I'd like to highlight is the foundation sub-sector and, frankly, I'm quite proud of this sub-sector because foundations, private foundations in general, stepped up in a variety of ways, perhaps even unexpected to help grantees, in particularly not-for-profit organizations, to provide the funding to propel their mission forward.

[00:06:22] They greatly aided those organizations that were struggling from a revenue or contribution-based perspective to provide the resources to keep up with that demand that I mentioned earlier. When I think about the federal relief programs that have taken effect, they've helped.

[00:06:39] No, no question about that, but it's not been enough. And I think in summary, when I think about the tone of the sector, it's at least from my perspective, maybe a cautious optimism.

There's signals certainly that we're all seeing that continue to emerge at the, that of a positive nature, including certainly the efficacy and [00:07:00] availability of vaccines.

[00:07:01] And improving economy kind of bolstered and buoyed by the equities market, as well as the expansion of the federal programs and other types of aid that's out there. I want to believe that the future is brighter and tomorrow will be better really then today and what we're seeing. Well, that's great insight.

[00:07:21] And I also echo your thoughts on the foundations. I spoke last week to a group of CFOs and such from a consortium of foundations in Illinois, and it really is impressive. Just what's been going on in that space and sort of a step up to the call. So, I was reading in a recent article of yours, Dennis. You touch on governance and you recommend that nonprofits should flex and evolve their structures.

[00:07:45] What do you mean by that? Great question. Yes. I'm spending a lot of time talking to boards about their, their overall governance structures and policies. And I believe that the construct of boards and even good [00:08:00] governance needs to morph and evolve to keep pace with the changing environment in which the organizations operate.

[00:08:06] So for example, Right. About a decade ago, it was not uncommon to find not-for-profit organizations that didn't have an audit committee, for example. And even those that did have an audit committee, it wasn't necessarily staffed with individuals that had a depth of financial, internal control and risk acuity, but more recently, as organizations have developed and professionalized their board governance processes.

[00:08:31] We're seeing them focus certainly more on the composition of their board with an intentional focus on attracting and retaining diverse individuals. And they're doing this of course, to broaden the perspective, to inform strategy, to aid in decision-making. Um, and also to make sure that their boards are certainly a reflection of the constituents that are served by their mission.

[00:08:57] And I think that's absolutely the right [00:09:00] choice and, uh, continued energies in that regard are going to be important. Beyond just the composition, I think of the, the board, certainly there's some different policies and procedures. Maybe I'll speak about it in a moment, but what I'm also encouraging boards to do are two other things of significance.

[00:09:17] The first is to be introspective in terms of thinking about what are going to be the skillsets of the future board members of the organization. And again, as the operating environment continues to change and new risks emerge, what's going to be needed? I think there's going to be requirements for perhaps those organizations that have a capital-intensive nature to have real estate background.

[00:09:42] For health care to make sure that we're safeguarding our constituents, our people, um, focus on strategy and maybe it's part of today's discussion. I'll get a little bit more time to talk about strategy, investment management, which I know is top of mind of many institutions and [00:10:00] of the, over the past year, I have not been at one board or audit committee meeting where the concept and concern around cybersecurity has not been raised.

[00:10:08] So I think as boards think about the composition of their board compliment going forward, making sure that they have individuals that really going to bring the skill sets to help the management team is going to be critical. The other item that I wanted to bring up was the size of the board. And we're seeing organizations certainly look at the size of their board and saying, is this an opportunity to pair it down a little bit, to make sure that we can really use our board in the most effective way?

[00:10:39] And, perhaps a smaller board may be more nimble, more responsive to the nascent risks and operating challenges and strategy changes that the organization is going to be adopting going forward. In terms of boards and their committees. I'd also like to say that boards have been called on perhaps like never before, [00:11:00] during this period of pandemic.

[00:11:01] And you know, the days of maybe just meeting once or twice a year or committees meeting even quarterly, certainly changed over the past year. And we've seen committees, particularly audit, finance, investment, and other ad hoc committees meet more regularly, sometimes twice a month or more often as needed to be responsive to new, the challenges that were raised and to really get the board's perspective and approval on different operating activities that the organization was taking advantage of.

[00:11:31] That's great. Those are some really important points and you know, it's so, board composition is such a complicated thing because board recruitment can be really difficult, but you're so right, Dennis, when you say that, um, organizations really need to be intentional about recruiting board members with the right skills and the skills that are going to help the organization in the future.

[00:11:53] So thank you for those comments. That's, that's really insightful. So, let's talk risk management in these [00:12:00] times and you referred to it a bit. Um, but is there anything more that investment committee members or, or board members more broadly should be thinking about as it pertains to risk? Absolutely. So, uh, certainly when I think about risk within the context of a not-for-profit organization, I think it's fair to say that this sector as a whole has perhaps lagged behind its commercial counterparts in maybe putting together a more varied, wholesome risk register.

[00:12:27] But I think the first process, or the first step in any well-defined enterprise risk management process is to begin to get the management team and all of the, the owners of risks throughout the organization and functional areas aligned in terms of identifying, inventorying, uh, mapping and aligning, and also thinking about how we define risk across an organization.

[00:12:51] Who owns the enterprise risk management of an organization? And to my comment earlier, when I [00:13:00] mentioned audit committees, right? So, audit committees previously were focused solely on just financial reporting, perhaps a little bit of internal controls and tax reporting.

[00:13:09] But what we're really seeing as the emerging practice is audit committees, kind of about their titles and their charge and charters to really focus on audit, risk and compliance and to really embrace and own the enterprise risk management process. And risks can be defined across, of course, a broad spectrum of areas, including financial and operational, strategic, personnel, information technology, reputational, compliance, legal and insurance, and of course, investment.

[00:13:43] And so I think those organizations, need to really be intentional about creating a very comprehensive list of those risks. Now, risk isn't necessarily a bad thing. Risk, it just, it needs to be managed and it needs to be understood. [00:14:00] Um, but certainly we're not risk adverse as a, as a not-for-profit sector.

[00:14:04] We just want to make sure that we have the right controls and discipline around that activities. To focus on the investment committee for, for a second here. Um, of course we, we recognize that there's really two competing sets of priorities here, certainly preservation of capital, um, and optimizing returns within relevant, comfortable risk parameters that, uh, the institution and the investment committee establishes. What we saw in 2007 and 2008 during the period of the great recession.

[00:14:37] Um, where organizations with large portfolios did not have sufficient liquidity to provide for their obligations as they became due. And so, during that time period, it was very interesting where organizations began to significantly post that period or during that period increase their cash, cash [00:15:00] equivalents and short-term investments, to insulate and protect them against the, um, inability to provide for their obligations as they became due.

[00:15:08] Now, what that then required was a change in mindset. Where organizations revisited their IPS statements and began to make sure that their portfolios were invested in instruments that provided for enough liquidity, should it be needed. And the reason why I bring that up is because during the early period of this pandemic, during the March and April of 2020, we certainly saw organizations deal with the strains on liquidity, um, as being one of their chief concerns at that point.

[00:15:42] And they were taking advantage of drawing down, available credit under their lines of, lines of credit and doing everything they could to bolster their cash reserve positions. Now in 2009, as the economy began to regain its momentum, [00:16:00] we saw organizations revert back to the historical behaviors of putting excess cash balances back to work.

[00:16:07] And so, this 2020 experience in the March, April and May period kind of takes us back to the future. And so, I think institutions, as they move forward, should think more about ensuring that they always maintain a sufficient level of liquidity within their portfolio. The, that takes me back to risk management here as well.

[00:16:32] And so, there's an alignment certainly in thinking about investment committees and finance committees, and there is, there should be overlap perhaps amongst those committees so that the finance committee, which really articulates and defines operating, operational spending and the investment committee, which certainly plays a role in ensuring that adequate resources will become available to provide for that budget.

[00:16:58] Um, there, there needs to be a [00:17:00] certainly an alignment and thinking and philosophy amongst those two committees. The last item that I'd mention around risk and investment committees is, um, you know, really ensuring that for IPS statements, that for those organizations, that they're mindful of socially responsible investing and to the extent that they want to dedicate and focus their portfolio on those positions that align with their philosophy and mission.

[00:17:28] Certainly we see a lot of that across the not-for-profit space. Dennis, as we talk about, uh, some of the budget and the finance side of things, we actually in working with our clients, use an exercise called the three levers and everyone likes to jump to, Hey, what's an interesting investment, or even the asset allocation, but we sort of call a time out on that process and we say, let's first get the three levers.

[00:17:54] What are the inflows? What are the outflows? And what is the required return in order for the [00:18:00] institution or organization to achieve their mission? And then you sort of back into how portfolios and such could be constructed. We'll drill down on investments in a moment, but before we do that, any other overarching considerations or advice you would offer concerning budgeting and forecasting, and even how that ties into managing the investments?

[00:18:21] Well, yeah, that's a great question. And you know, certainly, what I would say about budgeting in general is that, you know, there continues to be a focus on the annual budgeting process. No question about it. That will always be of paramount importance for organizations. But what we are beginning to see is, uh, is, is financial leaders focus more on scenario planning.

[00:18:44] And so what I mean by scenario planning is that, now, what sort of assumptions do we want to bake in to our models on a go-forward basis? For example, if we need to close for a protracted period of time, if we continue to see a reduction in our revenues, [00:19:00] if they don't rebound in a post COVID world and, and if the investment portfolio doesn't perform within alignment with our expectations. Also, what if we need to make additional cost reductions to continue to sustain our organization?

[00:19:15] And so it's that sort of thinking and focus around the scenario planning. We're seeing organizations develop multiple iterations of their budget. They are creating assumption banks, and they're toggling with those assumptions quite regularly and providing those types of analyses to their boards and their finance committees and investment committees in particular, so that they have more information available to them as they make decisions around the future financial performance.

[00:19:44] We need to make sure that as institutions, organizations, we have very flexible tools and models in place to adjust to these scenarios, but perhaps contemplated and yet unknown. Um, I also like to say that, you know, COVID has been an [00:20:00] accelerator in, in two particular ways. Okay. The first, for those organizations that were certainly experiencing pronounced financial strains in a pre-COVID world.

[00:20:10] COVID certainly exacerbated those financial strains and it caused organizations to make some really hard decisions about their overall performance and their future. The other item I would say, and kind of goes part and parcel with that first comment is it provided license like never before. And so, for organizations that may have been reluctant or reticent to say, we need to make an adjustment here to a program, we need to stop this program or do additional costs.

[00:20:37] For the first time, we really did have all the, all the license we needed to make the changes that we know were necessary and, and back to budgeting, we're seeing organizations kind of move away from maybe rolling forward past budgets with some incremental growth rate when we're looking more at zero-based budgeting. And everything is on the table in terms of developing budgets going forward.

[00:21:00] [00:21:00] But, as we now move perhaps to, with hopes of moving out of COVID in, in the coming months, we are seeing organizations start to think about adding back to budget. And so, this period of austerity can only last for so long. And as we position ourselves or organizations for success, you know, what can we add back to the budget?

[00:21:23] Whether it'll be something we've done previously or new types of investments, as we begin to morph and evolve our mission and thinking going forward. I think it's really hard to talk about budget and forecasting without thinking about strategy and also thinking about investments and, um, one or one, you know, some organizations have spent so much time just trying to right the ship that they haven't been focused enough on strategy.

[00:21:49] And I've been encouraging financial leadership of the organizations that certainly I work with to say, listen, you've done all you can perhaps operationally at this juncture. [00:22:00] I think you need to turn your focus to thinking about strategy. And now is the time to kind of reconstitute strategic plans going forward and involve your investment committee and all of the committees at the board to help inform and shape those strategies going forward.

[00:22:18] Yeah, I think you're spot on Dennis when you say that it's really important for organizations to be flexible and to adapt to the changing environment when it, you know, as it pertains to budgeting and forecasting. That's the name of the game is adaptability in the current environment. So, I think that's really insightful.

[00:22:36] So you talked a bit earlier about governance and the concept of nonprofit organizations having to flex and evolve their structures. Um, can you give any insight as to the makeup of investment committees? So do you have any recommendations on structure, purpose, approach, or perhaps you have an example or a story that you can [00:23:00] share that conveys some best practices.

[00:23:03] Sure. It's, it's a, it's a great question. And you know, I'd probably start by saying, we want to make sure that there's overlap, but yet not majority of representation across the committees, particularly audit, finance and investment. You know, for some organizations even, as you know, only a few years back, we'd see that organizations would have the same members on audit, finance, investment, or enough of an overlap where it was, it was hardly independent of in terms of their, their thought process.

[00:23:32] So I think overlap is of, of importance, but certainly shouldn't be this, shouldn't be a majority representation. The reason why I say that is because the investment committee certainly, you know, executes on the IPS, a statement in terms of philosophy, in terms of planning, in terms of evaluation of performance and making sure that those investments certainly generate the sufficient levels of return that are contemplated within the budgeting process that is really overseen by the finance [00:24:00] committee.

[00:24:00] And then ultimately, we want the audit committee as the oversight committee to really be responsible for serving as that check and oversee the performance of certain, of the other committees of the board in that regard. I've certainly highlighted the importance of the nexus between finance and investment, I think throughout my comments this morning, but what I haven't really talked a lot about is endowment spending.

[00:24:24] And, what we've seen, certainly from the signals that I see in the marketplace is that institutions have had effective endowment draws around 4.5%, but that doesn't fully contemplate the supplemental draws that many institutions were required to take from their endowment funds, uh, to provide for the shortfalls due to the loss of revenues and their inability to quickly scale their operations and cost structures.

[00:24:53] Um, and some just, it wasn't even that they couldn't quickly do it enough. It was that they just had an inability to do any more [00:25:00] cost reductions. So, when I think about the structure and the composition of, of investment committee members, of course, we want to make sure that our committee members are certainly very conversant and familiar and experienced as it relates to investment managers, but, um, investment management activities.

[00:25:17] But we also think that they want to have a broader perspective to make sure that they have an understanding of strategy. And that they're closely connected with the leadership of the organization in terms of directionally what's going to be needed from an investment portfolio to support the strategy on a go-forward basis.

[00:25:37] The other comment I would mention just as it relates to investment committees and overall financial performance is, you know, lines of credit. And I'd mentioned this, that in the early days of COVID organizations worked quickly to draw down on their lines of credit. But what we've learned now is that, you know, some institutions had their credit facilities canceled, um, and, um, unexpectedly, and that money, [00:26:00] that those credit facilities weren't available to them to help support and, uh, to augment their cash flows at a time of great need.

[00:26:03] The last comment I would say there is that when also tends to fall under the purview of the investment committee is debt. And certainly, what I like to say is that, um, those organizations that have debt, it's because they can, and those that don't, it's because they can't.

[00:26:23] And we're seeing certainly a lot of activity within the debt markets right now, organizations looking to make sure that they've designed their portfolios to drive down the cost of issuance and borrowings and to make sure that they have sufficient debt available to them, should they need it for additional capital expansion.

[00:26:42] They're also picking amongst tax exempt and taxable issuances and private placements. And, um, certainly the market has been very favorable to organizations that have focused on their portfolio in recent weeks and months. And as you've provided so many [00:27:00] useful insights here, and as we sort of work towards a wrap here, you know, here we are, spring has sprung and folks are beginning and have the vaccine.

[00:27:10] And baseball is being played on TV. I mean, there, there's a lot of optimism out there. But as you think about leaders at nonprofit organizations, the financial officers and otherwise, any final point that you'd like to make or reemphasize for individuals that, you know, thankfully are feeling optimistic, more optimistic than think about a year ago, but anything you'd like to say, Hey, be mindful of this.

[00:27:39] Yeah, well, um, you know, what I've been consistently saying lately is today's well-prepared leaders are developing new growth strategies before the, you know, the prior success runs out. And, I think now is the time to really be focused as I had mentioned earlier on strategy. And to think about your [00:28:00] organization.

[00:28:00] Do we need to really refine and focus our mission based on what we've come to learn? And do we really see some core competencies as an organization that maybe we've under-invested in, in the past? Um, or are there some new nascent areas that we as an organization feel we have the channels of delivery.

[00:28:20] We have the resources. We have the expertise and capacity to deliver and max and to optimize. Um, those are the things that I'm encouraging organizations to ask the tough questions to themselves around strategy. I cannot emphasize the importance of enterprise risk management as I discussed earlier.

[00:28:37] And no risk register as far as I've seen, um, included what would happen to our organization if we suffered a global pandemic. And so clearly everything is on the table when it comes to risk and trying to align and map those risks to process owners and controls, I think is really important. Thanks, Dennis. That's helpful. So, before we wrap up, can you share with us [00:29:00] one thing that you enjoy doing outside of your professional and volunteer activities?

[00:29:04] We always like to learn a little bit more about our guests on a personal level. Oh, well, thank you for the question. You know, I don't think there's any one thing I would like to say that I'm very busy. I have many interests outside of work. Of course, I'm very close with my family. I'm into personal fitness.

[00:29:22] I am an aspiring pilot and I also do Taekwondo. And so, when the wheels of commerce start spinning again at a normal RPM, I'm looking forward to getting out on the road and doing some traveling and enjoying staying away from my computer. So, thank you. Excellent. You're quite the Renaissance, man. So, it's been so great to have you on the show.

[00:29:46] We, we really appreciate your time and your insight. If listeners want to learn more about Grant Thornton Services, or if they want to contact you, how should they do that? Well, I'm, I would be delighted to speak with anybody who [00:30:00] wants to talk more about any of the items that I've raised saying as part of today's podcast, they can certainly call me or they can email me.

[00:30:08] Either one of those two options would work best and happy to provide that information. Well, Dennis, thank you so much. We'll include some of that in the show notes, and also thanks to our listeners. Like many of you, Devon and I serve on nonprofit boards and we know how challenging it can be to oversee investments.

[00:30:24] That's why we created a guide called six tips to managing endowment and foundation investments. You can download this 20-page piece using the link from the show notes or at our website, fiducientadvisors.com. So, to all you good stewards, thanks for investing your time to help nonprofits prosper. We'll connect with you soon on the next episode.

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