MANAGING RISK IN NONPROFIT ORGANIZATIONS

A Comprehensive Guide

Melanie L. Herman
George L. Head
Peggy M. Jackson
Toni E. Fogarty

Managing Risk in Nonprofit Organizations

A Comprehensive Guide

Melanie L. Herman
George L. Head, PhD
Peggy M. Jackson, PhD, CPCU
Toni E. Fogarty, PhD

WILEY
John Wiley & Sons, Inc.

Managing Risk in Nonprofit Organizations

A Comprehensive Guide

Melanie L. Herman
George L. Head, PhD
Peggy M. Jackson, PhD, CPCU
Toni E. Fogarty, PhD

WILEY

John Wiley & Sons, Inc.

This book is printed on acid-free paper. ♾

Published by John Wiley & Sons, Inc., Hoboken, New Jersey
Published simultaneously in Canada

For general information on our other products and services, or technical support, please contact our Customer Care Department within the United States at 800-762-2974, outside the United States at 317-572-3993 or fax 317-572-4002.

Wiley also publishes its books in a variety of electronic formats. Some content that appears in print may not be available in electronic books.

For more information about Wiley products, visit our web site at www.wiley.com.

Library of Congress Cataloging-in-Publication Data:

Managing risk in nonprofit organizations : a comprehensive guide / Melanie L. Herman . . . [et al.].
p. cm.
ISBN 0-471-23674-8 (CLOTH)
1. Risk management. 2. Nonprofit organizations—United States. I. Herman, Melanie L.
HD61.M265 2003
658.15'5—dc21

2003006624

Printed in the United States of America

10 9 8 7 6 5 4 3 2 1

About the Authors

Melanie L. Herman

Melanie L. Herman is the executive director of the Nonprofit Risk Management Center, a management assistance organization that provides informational resources, technical assistance, and training to an estimated 20,000 nonprofits annually. Melanie's entire career has been spent in the nonprofit sector, where she has held increasingly responsible management positions at four organizations. Before her appointment as CEO of the Center in 1996, Melanie served on the senior management team at the National Legal Aid and Defender Association, where she directed the association's development, membership, and communications activities. In addition, Melanie served as in-house counsel to the association's CEO and board. She also managed the creation of and subsequently ran a subsidiary company established to market and broker lawyers' professional liability insurance for the legal aid and defender community. Melanie is a graduate of American University, where she earned a BA in Urban Affairs, and of George Mason University, where she earned a JD. Melanie has published numerous articles on risk management topics and gives many presentations each year on topics related to nonprofit risk management, liability, and insurance. Melanie is the author of *Ready in Defense: A Liability, Litigation and Legal Guide for Nonprofits* (2003), and *Full Speed Ahead: Managing Technology Risk in the Nonprofit World* (2001). She is the coauthor of the following books: *Enlightened Risk Taking: A Guide to Strategic Risk Management for Nonprofits* (2002); *Enlightened Risk Taking: The Workbook* (2002); *Coverage, Claims & Consequences: An Insurance Handbook for Nonprofits* (2002); *Vital Signs: Anticipating, Preventing and Surviving a Crisis in a Nonprofit* (2001); *No Surprises: Harmonizing Risk & Reward in Volunteer Management* (2001); *Taking* *the High Road: A Guide to Effective and Legal Employment Practices for Nonprofits* (1999); *No Strings Attached: Managing the Risk of Fundraising and Collaboration* (1999); *Leaving Nothing to Chance: Achieving Board Accountability Through Risk Management* (1998); *D&O: What You Need to Know* (1998); *More Than a Matter of Trust: Managing the Risks of Mentoring* (1998); *The Best Defense: 10 Steps to Surviving a Lawsuit* (1998); *Mission Accomplished: A Practical Guide to Risk Management for Nonprofits*—2nd Edition (1999); *Mission Accomplished: The Workbook* (1997); and *Managing Special Event Risks: 10 Steps to Safety* (1997).

George L. Head, PhD

George L. Head, PhD, holder of several professional designations in insurance, safety, and risk management, has been a risk management educator since he graduated in 1967 with a doctorate in economics from the Wharton School of the University of Pennsylvania and joined the American Institute for Chartered Property Casualty Underwriters in suburban Philadelphia. Throughout his career, Dr. Head developed and maintained the texts, curriculum, and examinations for the Institute's professional designation programs in risk management and safety, earning career recognition awards from the Risk and Insurance Society, the Public Risk Management Association, the American Society of Safety Engineers, and the International Insurance Society, while contributing regularly to their publications and to the general risk management, insurance, and safety trade press. After retiring in 2000 to become a Director Emeritus of the American Institute, Dr. Head continues to write, consult, and serve as a special advisor with the Nonprofit Risk Management Center in Washington, DC.

Peggy M. Jackson, DPA, CPCU

Peggy M. Jackson is a founding partner of the Fogarty, Jackson & Associates Consulting Group in San Francisco. She has also held faculty positions and the position of Instructional Technology and Curriculum Advisor to Golden Gate University's CyberCampus. She received baccalaureate degrees from Connecticut College and Hawaii Pacific University, a master's degree from Central Michigan University, and a doctorate in public administration (DPA) from Golden Gate University. She also holds the professional designation of Chartered Property and Casually Underwriter (CPCU). She designed the Jackson Risk Management Model© as part of an award-winning doctoral dissertation on risk management techniques for nonprofit organizations.

Dr. Jackson has coauthored three books on risk management in nonprofit organizations: *Mission Accomplished: A Practical Guide to Risk Management for Nonprofits*, 2nd edition, and *Mission Accomplished: The Workbook*, with Leslie T. White and Melanie L. Herman of the Nonprofit Risk Management Center in Washington, DC, and *No Surprises: Harmonizing Risk & Reward in Volunteer Management*, 2nd edition, with Melanie L. Herman. Her newest book is *Risk Management for Schools*. Dr. Jackson is a member of the Golden Gate chapter of the CPCU Society.

Toni E. Fogarty, PhD

Toni E. Fogarty, PhD, is an associate professor in the Human Resources and Organization Development program at the University of San Francisco, teaching courses in organizational behavior and change, research methods, data analysis, and business fundamentals. Dr. Fogarty previously held faculty positions at San Jose State University and Golden Gate University. She is currently a general partner and CFO in the consulting firm of Fogarty, Jackson & Associates (www.fjaconsulting.com). Fogarty, Jackson & Associates provides consulting services in the areas of risk management, business continuity planning, injury and illness prevention programs, and distance education and training.

Dr. Fogarty received her doctoral degree in 1995 at the University of California, Berkeley, where she was also awarded an MPH in health policy and administration in 1990. She earned an MA in psychology at Middle Tennessee State University in 1988. Dr. Fogarty has been published in several professional and academic journals and has made a number of presentations and invited lectures at professional conferences.

Contents

Part I

Managing Risk in the Nonprofit Sector

CHAPTER 1

The Nature and Purposes of Risk Management

Every nonprofit organization takes risks as it goes about achieving the mission established by the organization's founders. Yet managers in the nonprofit world often bring a schizophrenic attitude about risk to their work. While acknowledging the inherent risks in the nonprofit's mission, from serving a vulnerable population, to using volunteers to deliver services, to relying on the kindness of strangers for donations to meet payroll and other expenses, managers often express their risk management goals as focusing on *eliminating* or *avoiding* risk. To complicate matters, chapters on risk management buried in nonprofit management texts often describe *minimizing* or *avoiding risk* as the ideal without paying any attention to the inherent and desirable risks that nonprofits must take to accomplish their missions. An organization that designs its risk management activities solely around the goal of minimizing or avoiding risk will miss out on opportunities to strengthen the organization's assets, to offer more meaningful services to individuals or a wider community, and to attract a steadily growing constituency of donors, supporters, and volunteers. Ironically, risk taking is inherently positive: A nonprofit takes risks in order to achieve positive or beneficial outcomes. Prospective volunteers may be more likely to view an organization that takes bold risks, for example, through innovative service delivery or working with a difficult or ignored client population—as a desirable place in which to volunteer. This is particularly significant as community-serving nonprofits compete for volunteers. Today's volunteer may feel a greater attraction to a nonprofit that boldly takes risks in order to address social conditions, such as poverty or homelessness.

The discipline or practice of risk management must compete for managerial attention and resources with other important concerns, from strategic planning to program evaluation to financial management and fund development. Like strategic planning, risk management in the nonprofit sector often involves groups of volunteers, in addition to paid staff, who engage in a process of examining the organization's past experiences, future prospects, and environment in order to reach decisions that will best propel the organization toward a mission-centered future. Like financial management and fund development, risk management activities cannot be accomplished at an annual retreat and then shelved until the next all-hands meeting. The risks facing a nonprofit and the strategies it chooses to address priority risks require care throughout the year. Like the increasingly popular discipline of program evaluation that seeks to determine the true effect the nonprofit has in the community and incorporates this information into program design and future services delivery, a risk management program requires periodic adjustments to ensure its effectiveness. Unworkable and ineffective strategies or those that are having unacceptable, undesired results should be substantially changed or abandoned altogether.

Why Manage Risk in a Nonprofit?

With myriad pressures coming to bear on the CEO of a nonprofit and its beleaguered and overworked staff, and with its governing board pressed continually to focus on policy versus day-to-day management issues, why devote any precious resources to risk management?

There are a number of reasons why risk management deserves the attention of the governing board of a nonprofit, as well as that of its senior, midlevel, and junior level staff and volunteers. These reasons include protecting tangible and intangible assets the nonprofit requires to operate and freeing up resources for community-serving activities. We discuss some of the general reasons below.

Asset Stewardship

A nonprofit that has integrated risk management practices into its operations is in the strongest possible position to prevent the unnecessary erosion of core assets, such as property, income, and good will, or the departure of or harm to its human resource assets, the human face of the nonprofit. For example, a nonprofit that pays scant attention to the protection of its blank check stock and accounts payable procedure may find that it is the victim of embezzlement by a determined employee or volunteer. Funds that would have been able to support educational programs for a vulnerable population are lost to the organization. A nonprofit that suffers a similar theft but has purchased crime coverage may find itself in a similar position when it learns that its failure to seek criminal charges against the employee voids coverage under the policy. The nonprofit's decision in this case stems from its fear that criminal prosecution of a popular and community-minded volunteer treasurer would bring disastrous negative publicity to the nonprofit and ruin its chances of meeting the goal of an ongoing fundraising campaign.

Achieving Public Accountability

The call for greater accountability in for-profit and nonprofit organizations has never been greater. With new legislation adopted in response to the corporate scandals of the early twenty-first century, experts predicting unprecedented regulation of nonprofits in the years ahead believe that it is not a question of if such regulation and scrutiny will occur, but when and how. Nonprofit leaders have learned in recent years that the issue of accountability is inextricably woven into every aspect of an organization's success. Questions about the use of a nonprofit's charitable assets make it more difficult to recruit volunteers, including board members; retain generous institutional and individual donors; and attract competent staff. It is therefore imperative that every nonprofit give thoughtful consideration to how it is achieving accountability to key stakeholders and remaining faithful to the organization's mission.

Attracting Stakeholders

A nonprofit organization cannot operate successfully without the sustained support and participation of a wide array of stakeholders. Institutional supporters and individual donors provide the funds the nonprofit needs to pay operating expenses and deliver services. Paid and volunteer staff perform the work of the organization, from providing direct service to clients to public advocacy to fundraising and administrative activities. Members of the community in which the nonprofit operates benefit from its services and provide the support for the organization that enables it to compete for financial resources and clients. When an organization is viewed as careless or uncaring, support from its stakeholder network is certain to wane. A nonprofit that seeks to fortify the support of stakeholders must take the management of risk—both upside and downside risk—seriously.

Freeing Up Resources for Mission

When a nonprofit faces an accidental or intentional loss, it must devote resources to replace the lost or damaged equipment or pay the victims of harm resulting from its operations. In most instances, the cost of repairing damaged equipment or compensating a victim exceeds the cost of preventive measures. For example, when a faulty sprinkler head is triggered in a nonprofit's administrative offices, the accumulated water causes irreparable damage to a dozen CPUs sitting on the floor—a loss in excess of $25,000. By comparison, the cost of plastic stands elevating the CPUs off the floor would have been around $250. Because the organization did not purchase the stands, it must reallocate $25,000 in operating revenue to replace the equipment. Even if the organization is adequately insured for this loss, the cost is still significant. The nonprofit must devote numerous person-hours to calculating the value of the loss, meeting with the insurance company's adjuster, ordering new equipment, configuring the new equipment with custom software, and replacing lost data from back-up tapes.

Staying True to Mission

No nonprofit operates for the express purpose of causing harm to persons or property. When a nonprofit's operations and activities result in harm, the outcome is antithetical to the mission of the organization. By directing the attention of key personnel away from core service delivery or program activities, the harm that results is also likely to slow down the nonprofit's pursuit of its mission. A nonprofit that endeavors to stay true to its mission is well served by a risk management program that helps managers predict and evaluate future events and take actions in accordance with these predictions and informed expectations.

Key Starting Points: Risk, Uncertainty, and Loss

What Is Risk?

When asked to identify words that come to mind when they hear the term *risk*, nonprofit managers often suggest terms such as *hazard*, *harm*, and *danger*. There is a bias toward viewing risk in its pejorative sense. The traditional discipline of risk management has heightened this bias by focusing principally on losses resulting from accidents. Yet it is necessary to think about risk in its broadest sense in order to effectively manage risk in a nonprofit. Focusing only on the negative dimension of risk imposes unacceptable limits on the ability of the nonprofit to consider a wide range of possibilities in fulfilling its destiny.

To better reflect the positive and negative dimensions of risk in the nonprofit sector, we offer the following definition of risk:

> Risk is a measure of the possibility that the future may be surprisingly different from what we expect.*

A risk, therefore, is something for which there is a greater than zero but less than 100 percent chance of its happening.

What Is Uncertainty?

Every nonprofit operates with continuing uncertainty—a lack of knowledge about something. A youth-serving nonprofit may not know whether any of its clients for a summer camping program have a propensity to violence. A nonprofit advocacy group does not know whether one of its recent hires will be able to program the organization's systems, a skill listed on her resume. A mentoring program does not know whether the adult-child pairing it has just identified will be the right match for the child.

Uncertainty is an important concept in the field of nonprofit risk management. Managers must be prepared to make decisions in an environment of uncertainty while working to reduce the degree of uncertainty associated with a particular decision. For example, the youth-serving nonprofit

***Enlightened Risk Taking: A Guide to Strategic Risk Management for Nonprofits*, by the Nonprofit Risk Management Center.

cannot eliminate the uncertainty that exists about the personalities and likely behaviors of its summer campers, but it can design a screening process that requires a recommendation from one adult who knows the camper. The nonprofit advocacy group can reduce uncertainty by conducting in-person interviews with prospective employees, checking at least three professional references, and providing thoughtful, careful supervision of new employees once they have joined the nonprofit's staff. A mentoring program can reduce some of the uncertainty it faces by closely monitoring the adult-child pairs, seeking feedback from both adult and child on how the relationship is progressing, and prohibiting certain activities it considers too risky during the first six months of the match.

What Is Loss?

A loss is damage to or destruction of an asset a nonprofit uses to achieve its mission. Nonprofit assets typically fall into one of four broad categories: people, property, income, and reputation. A loss could be damage or destruction to facilities, equipment, supplies. A loss also could be an injury to or the death of a participant, staff member, volunteer, or member of the general public. A loss can also be the erosion of a nonprofit's reputation, perhaps following public allegations of wrongdoing, such as misuse of donor funds or client neglect. A nonprofit also sustains a loss when a large foundation announces a change in its grant-making priorities and the intent to discontinue its historical support for the nonprofit's operations.

Losses in the nonprofit sector can be gradual or sudden. When a funder announces that it will slowly reduce the amount of funding it provides to a nonprofit over a two-year period, the organization has some time to cope with the gradual loss of core funding. When the nonprofit's executive director arrives at the headquarters office one morning to discover that all the organization's computers have been stolen, she must act in the face of a sudden, unexpected loss. Losses may stem from accidents or intentional acts. When the contractor refinishing the woodwork at the nonprofit's residential treatment facility tosses a rag soaked in benzene into a cardboard box and the resulting fire causes substantial damage to the facility, the nonprofit has suffered an accidental property loss. When a part-time bookkeeper embezzles $10,000 by writing and cashing a series of checks payable to cash, the nonprofit suffers a loss stemming from an intentional act even though the loss was a surprise to the nonprofit management.

The magnitude of a loss depends on a number of factors, including:

- *Whether the organization has anticipated the possibility of the loss occurring and taken steps to mitigate the loss.* For example, in anticipation of a possible fire at its headquarters building, an organization may install smoke detectors, a fire alarm, and a sprinkler system (some may be required by local building codes, whereas others may be installed as pure mitigation measures). Although a malfunctioning sprinkler could also cause loss under different circumstances, when it works as intended it can greatly reduce the amount of damage from a fire. Another category of mitigation is work the nonprofit does in advance of a loss to prepare its response. For example, to prepare for allegations of wrongdoing or client maltreatment, a nonprofit prepares a template press kit containing background information on the nonprofit and a statement expressing concerns for people who suffer harm when participating in the nonprofit's programs. When a group of children is injured in a bus accident while returning from an outing sponsored by the nonprofit, the media materials are finalized and delivered to the media within two hours of the accident. The story on the evening news includes the nonprofit's statement of concern, which serves to bolster the nonprofit's reputation as a caring community organization. A similar organization whose executive director is vacationing in the Caribbean when the accident occurs and therefore is unavailable for comment is the subject of critical editorial coverage and faces a dramatic drop in enrollments for the upcoming program year.
- *Whether the organization has financed the risk of loss through insurance or has other financial resources available to pay for damages related to the loss.* Insurance neither alters the chance of a loss occurring in the first place nor allows the nonprofit to escape a loss without incurring a financial or other loss. When an insured loss occurs, the nonprofit's personnel must spend time meeting with insurance company personnel, such as loss adjusters and claims counsel. Time is often devoted to purchasing replacement equipment. Other time may be required for counseling or additional training, when, for example, the loss has been a client injury

or death. Having insurance or some other planned source of funds for compensating victims, replacing equipment, or repairing damaged property is critical to controlling the scope of the loss. An organization that is able to offer to pay for emergency room care is less likely to face a subsequent demand for money damages that include costly attorneys' fees. An organization that can quickly replace damaged equipment or rent alternative space from which it can operate will not have to substantially curtail its operations (including income-generating activities) for an extended period.

Assigning Responsibility for Risk Management

Every nonprofit must decide who in the organization will be assigned responsibility for risk management. It is important to inspire a commitment to risk management that permeates the entire structure of the organization, yet a nonprofit still needs an individual or committee to champion and coordinate its risk management activities. Nonprofits throughout the country use various approaches to integrating risk management into operations. Some of the most common approaches include:

- *Designating a single person as the nonprofit's full-time, professional risk manager.* A professional risk manager often reports to an organization's chief financial officer, although in some cases the position may report to the executive director, chief operating position, or similar upper management post (Exhibit 1.1). In very large organizations the risk manager oversees a risk management department, with direct reports specializing in critical areas such as insurance, benefits, and loss prevention. The vast majority of nonprofits do not have a full-time risk manager. In fact, of the more than 1.3 million nonprofits in the United States today, the number of people with the title of risk manager may be as few as 200.
- *Including risk management responsibilities as part of a senior manager's job description.* This approach is increasingly popular among midsize to large nonprofits that have never employed a risk manager. After a large loss or a complex insurance renewal process, an organization may decide that it needs to designate responsibility for risk management and insurance issues to a single staff member. The most likely positions to be

EXHIBIT 1.1 Sample Position Description for a Risk Manager

Job Title: **Risk Manager**

Reports to: **Chief Operating Officer/Executive Director/Director of Finance**

Risk management is the process of dealing with the uncertainty of loss in all aspects of the organization. It is an integrated system involving analysis of activities and behaviors, establishment of safety and emergency procedures, and various financial, legal, and insurance issues. Activities are evaluated based on their benefit to the organization relative to the opportunity for human loss, financial loss, or loss of reputation. The evaluation involves a great deal of interaction with the various program, property, personnel, and legal departments of the organization.

The risk manager is responsible for:

- Championing an organization-wide effort to protect the vital assets of [Name of Nonprofit] and engage key stakeholders in risk management activities.
- Developing, implementing, and monitoring loss prevention and cost containment programs for general liability and workers' compensation.
- Conducting contract reviews; developing indemnity agreements, hold-harmless agreements, and consent forms; and coordinating the purchase of insurance.
- Monitoring and evaluating the insurance program, maintaining appropriate funding levels, accurate loss forecasting, claims management, loss prevention, and cost containment programs.
- Integrating risk management throughout the organization's programs.

Essential Duties and Responsibilities

- Management—Plans, organizes, leads, and controls the activities of the risk management department.
- Program Development—Coordinates the development, implementation, and maintenance of a comprehensive risk management program for the organization.
  - Sets goals and objectives for the risk management program.
  - Identifies and analyzes perils, risks, and hazards to which the organization, its employees, clients, volunteers, families, property, and/or general public may be exposed.
  - Determines the most effective methods of handling each risk exposure.
  - Conducts an annual review (procedures to measure the effectiveness and performance) of the organization's risk management program.
- Analysis—Evaluates major loss exposures in terms of past and potential frequency and severity to establish priorities and methods for treating discovered risk exposures.
- Consultation—Advises the Chief Financial Officer on methods for avoiding and controlling risks.

(*continues*)

EXHIBIT 1.1 *(Continued)*

- Delegation—Recommends an appropriate delegation of responsibility for the organization's risk management functions.
- Integration—Establishes and maintains liaison with [Name of Nonprofit]'s administrative staff to include department directors, administrators, and others in coordinating risk management activities (development and implementation of risk management program).
- Administration—Coordinates the creation of risk management policies, programs, and procedures, which includes developing safety and loss control programs and procedures.
- Interdisciplinary committee—Facilitates an interdisciplinary risk management committee that reviews health and safety concerns and recommends remedial action to senior management and the board of directors.
- Insurance—Establishes and manages relationships with various risk management and insurance consultants and vendors, including the organization's broker or agent. Coordinates the process of applying for and renewing insurance coverage consistent with the risk financing goals and objectives developed in concert with the risk management committee.
- Performs other related job duties as required.

Supervisory Responsibilities

Yes ____ No ____

Number of staff members who report to this position ________
Job titles of those reporting staff members:

Position Qualifications

College degree in X. Minimum of X years of risk management and insurance experience. Requires an insurance generalist with managerial and administrative ability. Must have the ability to interface with management, volunteers, insurers, and outside agencies and organizations. Nonprofit experience preferred.

---

tapped for this responsibility are finance director, director of operations, deputy director, director of human resources, director of administration, or special projects manager. Among small nonprofits the executive director is likely to consider himself the nonprofit's risk manager.

- *Establishing a committee composed of staff; volunteers; and outside advisors, such as the nonprofit's insurance professional, CPA, and outside counsel.* The deployment of risk management committees is becoming increasingly common. Many nonprofits see this approach as a cost-effective alternative to hiring a professional risk manager. Others recognize that the use of a committee can be an effective way to benefit from the perspectives of a diverse group. Still others view the use of a risk management committee or task force as essential to obtaining buy-in from key stakeholders. The responsibilities of a risk management committee can be quite diverse but might include:

- Establishing the goals of a risk management program to be adopted by the nonprofit's board of directors
- Identifying the major risks facing the organization
- Developing risk reduction and loss control strategies for the organization's most troubling risks
- Recommending a risk financing strategy (or strategies) to the board of directors
- Selecting the organization's insurance advisor (agent, broker, or consultant)
- Coordinating the purchase of various insurance coverages for the organization
- Reporting to the board on a periodic basis the organization's priority risks and strategies for managing those risks

The level of involvement of the risk management committee varies from one organization to the next. These variations may be based on whether there is a professional on the nonprofit's staff who has responsibility for risk management and supports the committee's deliberations. In cases in which a staff professional works hand in hand with a committee, the committee's agenda is more likely to focus on policy issues rather than day-to-day risk management activities, such as implementing loss prevention measures or buying safety supplies and equipment.

When an organization has not assigned the risk management function to a lead staff member, the committee's advisory or policy role may be dwarfed by its operational responsibilities. The nature of the committee's work will also be affected by the experience and background of committee members and the nature and magnitude of the risks facing the organization. For example, when the committee includes people with long histories of experience in the insurance industry, those committee members or the committee as a whole are more likely to want to participate in the nonprofit's insurance procurement process. The committee might want to interview prospective brokers or review the detailed proposals from alternative carriers. The risk management committee for a youth recreation program whose members include parents and coaches is likely to want to focus its efforts on loss prevention activities related to the provision of recreation services, leaving responsibility for the insurance renewal process in the hands of the nonprofit's finance director.

Some of the approaches described above are used in combination. For example, a nonprofit might designate an employee as the organization's risk manager and create a risk management committee that will be staffed by the risk manager. In organizations in which the individual responsible for risk management wears many hats, the presence of a risk management committee may lift some of the responsibilities from the overburdened staff member.

In other cases a risk management committee or safety task force may be created as part of the planning of a one-time or otherwise unusual event or activity. For example, a nonprofit that provides after-school tutoring to elementary school students may create a safety task force as part of the planning activities for a large fundraising event. The task force disbands after the successful conclusion of the special event.

There is no easy formula to apply for choosing an approach to coordinating risk management activities. Each organization should examine its culture, financial resources, and unique risk management challenges or opportunities in deciding how to structure the risk management function. Where significant, ongoing risk management challenges exist, the creation of a full-time position may be in order. For an organization that relies principally on volunteers for planning and service delivery, the use of an all-volunteer risk management committee may be the best approach.

The Risk Management Process

Some nonprofits manage risk intuitively by thoughtfully conducting cost-benefit analyses of proposed new programs or by considering whether there are affordable steps the organization could take to prevent harm or increase positive outcomes in current programs. Other nonprofits manage the risk of harm without realizing that they are increasing the chance of positive outcomes at the same time. For example, an organization that adopts a rigorous screening process for its volunteer mentors may argue that the process reduces the risk of a predator infiltrating the nonprofit's ranks. Yet the same rigorous screening process also increases the program's chance of choosing appropriately committed volunteers whose temperaments make them suited for the challenging job of mentoring a child. An organization manages risk when it seeks multiple bids for products and services the nonprofit needs. By doing so it reduces the risk that it will pay too much for good and services.

If risk management strategies and techniques are common and often intuitive to nonprofit managers, then why is a formal framework or process required? A framework or deliberate process enables a nonprofit's managers—who are understandably distracted by competing demands for attention to fundraising activities, financial management, accountability to stakeholders, and more—to methodically cover the wide range of programs and activities of the organization in the most cost-effective manner possible. The risk management process described in this section is applicable on an organization-wide basis or with respect to a single program or activity. It can be applied successfully in a small, all-volunteer organization as well as a national, multisite nonprofit with a budget in the tens of millions of dollars. The process can be initiated in a short time frame or introduced over the course of a year or more.

Risk management experts in the United States and elsewhere offer varying interpretations of the risk management process, ranging from three, four, or five steps to complex charts depicting numerous inputs and outputs. There is no single universally accepted risk management process. The five-step process described below was adapted by the Nonprofit Risk Management Center in 2000.

Step 1: Establish the Context

This first step is critically important because of the vast range of differences in the nonprofit sector. Each organization pursuing a risk management program is well advised to begin by considering a range of contextual issues that either bode well or present challenges for a risk management effort.

Risk management experts in this country have been slow to adopt this step as the launching point for a risk management effort, whereas the step has been embraced by and integrated into the Australian/New Zealand Risk Management Standard (AS/NZS 4360:1999) published in 1999 by Standard Australia. Chapter 2 discusses in greater detail what is involved in establishing the context for risk management activities in a nonprofit.

Step 2: Appraise Risks

The second step in a nonprofit's risk management journey is the systematic identification and evaluation of the risks the organization faces. This process can involve examination of a single program or activity or an in-depth review of the entire organization. For example, a nonprofit cultural institution may wish to give special attention to the risks and opportunities associated with a proposed fundraising event. The interest in risk management stems from the institution's concern that it has never conducted a gala open to the general public. Its goals for the event include raising enough money to fund the purchase of several new exhibits, attracting media attention for the organization's educational programs for elementary school students, and showcasing the organization's current exhibits and displays while avoiding damage to the facility and assets. A nonprofit providing residential treatment for adults with a history of drug or alcohol abuse may embark on a risk management process to both strengthen the organization and enable it to meet the criteria for accreditation. In order to achieve these goals the treatment center may embark on a process that will uncover risks in client counseling, administrative operations, fundraising, governance, staff recruitment and supervision, and facility management. The same techniques and approaches to risk identification can be used in a narrow effort focused on a single program or activity or in a more comprehensive, organization-wide effort.

As is true with the risk management process, there is no single acceptable or advisable method for risk identification. The selection of approaches to uncovering risks may be based on or sensitive to the culture of the organization. For example, a nonprofit that tends to operate informally, relying on consensus building for key decisions, may elect to brainstorm its risks using a committee of staff members from all levels of the organization. A nonprofit with a traditional top-down bureaucratic decision-making style may task all members of its senior management team with responsibility for identifying risks falling within their sphere of influence and activity. In both cases the risks identified through these very different processes should include opportunities (upside risks) as well as threats to mission fulfillment (downside risks). Both approaches are likely to lead to the identification of long lists of risks. Some of these risks will be deemed to require immediate attention, whereas others will be less significant or even negligible. The task of sorting the serious risks from the less so is another activity under Step 2.

There are additional approaches to risk identification aside from informal brainstorming by a risk management committee or the tasking of senior managers with responsibility for risk identification in their areas of influence. These include:

- Reviewing the agency's history and experience in order to identify risks that have materialized in the past
- Reviewing the experience or data from other nonprofit organizations
- Conducting interviews or focus groups
- Conducting inspections of programs and equipment in order to spot exposures
- SWOT analysis (review of an organization's strengths, weaknesses, opportunities and threats—typically conducted as part of a strategic planning exercise)

The risk identification step requires that members of the risk management committee ask two very different questions. First, what risks do we face, or what could happen? Second, how might the risk materialize in the nonprofit? The second question forces the discussion to move beyond simple statements such as "a client gets hurt" to identify more specific exposures, such as "a client could be dropped while a volunteer is helping him or her leave the wheelchair-accessible van."

Possible sources of risk that may be helpful to consider in this phase of the process include:

- *People risks.* People risks are those that result from the behavior of paid and volunteer staff, clients, and members of the general public. These risks might materialize when staff follow or disregard instructions or act in the absence of instruction. Some risks might be based on the backgrounds or other characteristics of the nonprofit's client population. In some cases a nonprofit may be concerned about what people it does not know or serve directly—the general public—will do.

- *Management risks.* Certain risks relate to the failure of controls the nonprofit has established to protect its assets and operations. For example, a nonprofit might adopt internal controls to reduce the risk of embezzlement. The failure of the control system could lead to a theft. In another example, a nonprofit seeking to hire people without criminal records for teaching positions might decide to forgo background and reference checks because a top applicant is a relative of a major donor. Later the nonprofit learns that forgoing its regular screening process was a mistake.
- *Economic conditions.* Every nonprofit exists as a small institution in a larger, dynamic economy. Nonprofit managers spend a great deal of time securing funding for operations and accounting for the use of these funds, but economic conditions and events beyond the nonprofit's control can have serious effects on the organization's ability to achieve its mission. During the economic downturn of the early twenty-first century, countless foundations saw the value of their endowments shrink to record low levels because of stock performance. As a direct result of these investment losses, foundations began reducing their targets for grant-making, in some cases eliminating entire eligible program areas. With fewer dollars available to support nonprofit organizations, managers faced the difficult tasks of curtailing programs, laying off staff, and spending more time cultivating alternative sources of funding for critical programs.
- *Political change.* The fortunes of many nonprofits are affected by changing political conditions, election results, and the policies of chief executives at the city, county, state, and federal level.
- *Technology.* Advances in technology have led to unprecedented opportunities for nonprofits. Nonprofits regularly use computers to raise funds, reach and serve clients, and keep stakeholders informed. With the power of information technology come risks for which many nonprofits are ill-prepared. The exposure to claims alleging the nonprofit

failed to protect an individual's privacy is just one example of the dangers that accompany the use of information systems.

- *Relationships.* To accomplish their missions, nonprofits rely on relationships with other nonprofits, with government agencies, and with private businesses. Many nonprofits enter into these relationships with high expectations, assuming that the parties to an agreement (too often not committed to writing) will do all they have promised to do. The possibility of a partner failing to live up to its promises is a risk nonprofits should consider.
- *Inherent program issues.* Certain programs sponsored by nonprofits have inherent exposures. For example, a nonprofit that provides after-school tutoring as well as instruction in tennis faces the risk that its clients may suffer injuries while playing tennis. While the risk cannot be eliminated altogether without discarding an important part of the nonprofit's mission, it should be identified as a risk so that it can be considered thoughtfully.

When a group of nonprofit personnel completes a risk identification process—even when that process focuses on a single area of operations or a single activity—they are likely to have a long list of possibilities. For example, a group working to identify the risks of a nonprofit's 10K walkathon might identify several dozen risks, including:

- The possibility that attendance will fall significantly below the expected 250 walkers and 500 observers
- The possibility that extreme weather will force the nonprofit to postpone or cancel the event
- The possibility that a participant will suffer a serious injury or die while participating in the walk
- The possibility that attendance will surpass the nonprofit's expectations and supplies of water and T-shirts will be inadequate.

Without a secondary review to determine relative significance, the organizers of the 10K are likely to be frustrated—how will they determine what risks require immediate attention? Are there risks for which mitigation measures are available but are beyond the financial means of the nonprofit?

The second step in the risk management process reminds us to take a systematic approach to assigning values to risks in order to create a list of priorities for decision-making. The focus of this phase of the process is to examine two important dimensions of each risk: likelihood and magnitude. The *likelihood* dimension answers the question of how often will this risk materialize, and *magnitude* addresses how detrimental or how beneficial the risk could be. Both dimensions are critical to deciding what action is appropriate. Here are several methods for further analyzing the nonprofit's identified risks.

- *Brainstorming.* The simplest approach to this task is to rank-order the risks identified under Step 2 based on the team's brainstorming and instinctive feelings about what the nonprofit's first concerns should be. For example, using the four risks listed above for the 10K walkathon, the organizers may agree that while all risks could materialize, the most likely risk is that attendance will fall below the ambitious goals established for the event. With this in mind, the committee focuses its attention and efforts on increasing attendance at the event.
- *Quantitative approach.* Large nonprofits and large umbrella or parent organizations of nonprofits can draw on their long experience with risk and loss and use a quantitative approach to appraising risks. These organizations can examine claims data and loss costs to predict the likelihood of risks materializing and the estimated costs of these risks. Most small and midsize nonprofits do not have such detailed data available for the simple reason that they have experienced few minor losses. A quantitative approach is also available to a group of nonprofits that have banded together for the purpose of establishing and operating an insurance program. Claims information from the program is invaluable in predicting both the magnitude and frequency of future losses.
- *Review of past experience and failure/success analysis.* This approach calls for a systematic review of the nonprofit's past experience with similar events or activities in order to identify past outcomes that can be helpful in predicting the future. Using the example of the 10K walkathon, if the event were an annual undertaking, the planning group might list outcomes from prior years. For an event held regularly over a decade or more, the list might include both minor events and those requiring management attention and financial resources. For example, the group

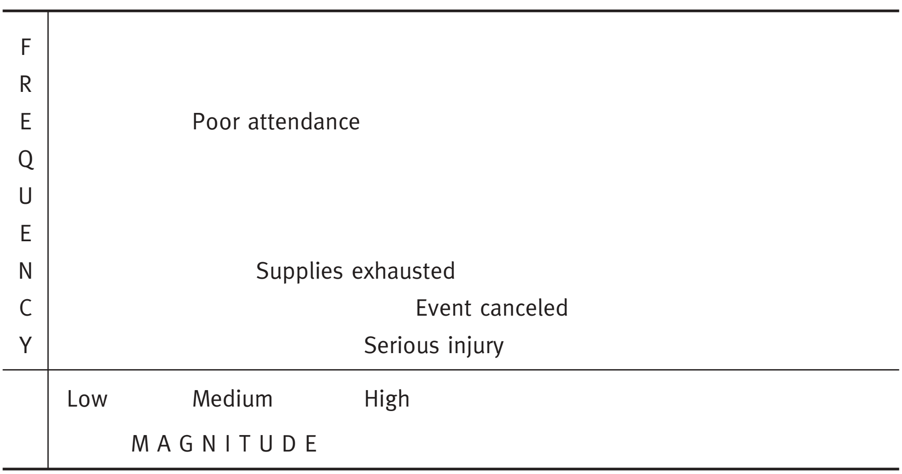
might determine that over the past decade, one year the event was rained out, twice attendance fell below the expected number, once attendance was 20% more than expected due to last-minute radio ads, and another time the contracted supplier of water did not deliver the water bottles on time. Using this information the group can estimate the probability of these risks materializing. If this is the first year of the event, the group might look to the experiences of other nonprofits operating in different parts of the country or similar groups holding similar events in the same community.

- *Risk mapping.* Another approach to evaluating risk is to map risks using a chart that depicts an assessment of frequency along the vertical axis and an assessment of magnitude along the horizontal axis.

  Using the risks identified for the 10K walkathon, a risk map might look like the one in Exhibit 1.2.

- *Scenario analysis.* Scenario analysis is a technique the planning group could use to identify possible outcomes and determine their potential effect on the organization. For example, the group might examine the scenario of a participant having a serious or fatal injury during the event: How quickly will we be able to call for medical assistance? Is the entire route accessible to medical personnel? Would this type of occurrence attract local media attention? If so, what level of media attention can we expect?

EXHIBIT 1.2 Risk Map for a 10K Walkathon



- *Semiquantitative analysis.* Some planning groups might prefer to use a quantitative method for differentiating the risks they have identified, yet it is difficult, if not impossible, to accurately assign numeric values to the likelihood of a risk materializing (its frequency measure) or the magnitude of the risk (how much? how big? how significant?). One approach to a semiquantitative analysis of risks is to apply a scoring system such as high, medium, or low to a list of risks with respect to both frequency and magnitude. The scores assigned to each factor are added together to produce a total score for each risk. This enables the planning group to rank the identified risks using total score as the ranking system.

  One approach to defining a scoring system with high, medium, and low values follows:

	Frequency (likelihood, probability)	**Magnitude**
High	Likely to happen	Serious disruption of the event or serious impact on the organization
Medium	Might happen	Moderate effect on the event or organization
Low	Unlikely	Negligible effect on the event or organization, if it happens

The following chart depicts the application of the simple semiquantitative scoring system to the risks of the 10K walkathon.

Risk	**Frequency Rating**	**Magnitude Rating**	**Total Score**
Low attendance	Medium	High	Medium-high
Adverse weather cancellation	Low	High	Medium
Serious injury or death	Low	High	Medium
Supplies exhausted	Low	Medium	Medium-low

What the results of the above exercise suggest is that the risk management team should consider working on the risk of low attendance before devoting attention to the other risks associated with the event.

The semiquantitative approach can be expanded to include additional descriptive categories for frequency and magnitude. By including descriptive language in addition to a level or grade label, a planning group may find it easier to associate identified risks with frequency and magnitude scores. Keep in mind that these scores are not intended to be precise measures of risk, but they are helpful in comparing dissimilar risks in order to rank and prioritize exposures for decision-making. The following examples are adapted from *Guidelines for Managing Risk in the Australian and New Zealand Public Sector*.

MEASURING FREQUENCY

The first example uses six categories to define frequency. The nonprofit's risk management committee examines each risk in turn and chooses the appropriate frequency measure, using the description of each level as a guide.

Level	Description
A	Almost certain—is expected to occur in most circumstances and may occur once a year or more often
B	Likely—is likely to occur in most circumstances and has actually occurred in recent years
C	Possible—might occur at some time in the future, perhaps once every 10 years
D	Unlikely—has not occurred in the past but could occur at some time in the future
E	Rare—may occur but only under extraordinary conditions; has perhaps happened elsewhere
F	Very rare—has never happened to the nonprofit's knowledge
G	Incredible—would only happen under extraordinary circumstances, perhaps once every 1,000 years

MEASURING MAGNITUDE

The magnitude measure represents the committee's prediction of the consequences the nonprofit will face when a risk materializes. As shown in Exhibit 1.3 the Australian Risk Management Standard uses a five-part table to describe the possible consequences of risk.

By assembling the two dimensions—frequency and magnitude—into a single chart, it is possible to see how a nonprofit might approach deciding what to do about a particular risk. Exhibit 1.4, also adapted from the

EXHIBIT 1.3 Describing the Magnitude of Risk

Magnitude	Description
Catastrophic	The consequences would threaten the survival of the program or activity as well as the nonprofit itself. The risk might cause significant problems for service recipients, for the paid and volunteer staff of the nonprofit, for stakeholders such as funders, and perhaps for the general public. The nonprofit would face a significant loss of revenue.
Major	The consequences would threaten the ability of the nonprofit to continue the program or activity. The nonprofit is likely to face a loss of revenue and the event/circumstances would require attention by senior management.
Moderate	The consequences may not threaten the organization or program's survival but would require some changes in structure or delivery. Some revenue loss may occur.
Minor	The consequences threaten only the efficiency or effectiveness of the program and organization, not its survival. The consequences can be handled by mid- to senior-level managers, and clients are likely to be affected.
Insignificant	The consequences would have a negligible impact on the nonprofit, and the risks can be handled by existing routine procedures.

EXHIBIT 1.4 Evaluating the Level of Risk

	Consequences				
Frequency	**Insignificant**	**Minor**	**Moderate**	**Major**	**Catastrophic**
A Almost certain	H	H	E	E	E
B Likely	M	H	H	E	E
C Possible	L	M	H	E	E
D Unlikely	L	L	M	H	E
E Rare	L	L	M	H	H
F very rare	L	L	L	M	H
G incredible	L	L	L	L	M

Legend:

E = extreme risk; immediate action by senior management is required

H = high risk; senior management attention needed

M = moderate risk; management responsibility should be assigned

L = low risk; routine procedures to address issue represent sufficient response

Australian Standard, suggests a way to consider frequency and magnitude in relation to each other.

Step 3: Decide What to Do and Communicate

The results of the nonprofit's risk identification and risk analysis efforts provide a foundation for the development of strategies for addressing risk. Committees that devote a great deal of effort to Steps 1 and 2 are likely to discover that Step 3 flows naturally as part of the process. In contrast, a committee that is anxious to do something about its risks without first understanding the organization's context and identifying and evaluating risks could make serious blunders during Step 3. For example, a committee intent on addressing perceived loopholes in a volunteer screening process may not see that program design issues, such as the organization's failure to notify parents about the dates and times of meetings involving their children, require more immediate attention. An organization concerned about the possibility of a terrorist strike on its facility may ignore the less dramatic but potentially serious risk of an assault in its poorly lit parking facility.

The first element of Step 3, deciding what to do, is called *risk treatment* in some risk management texts. The work generally begins with a decision about which risks the organization will focus on. When a committee has compiled an exhaustive, ranked list of risks, it may be appropriate to select the top 10 or 20 issues for treatment priority in the first cycle of the committee's or staff's efforts. There are four phases of activity under Step 3:

Phase 1 Identify options

Phase 2 Evaluate options

Phase 3 Design risk management strategies

Phase 4 Communicate

PHASE 1: IDENTIFY OPTIONS

Every nonprofit has many options from which it can choose to address its high-priority risks. From changing design or operational aspects of an activity to partnering with another organization better able to prevent harm, few nonprofit risk management committees will conclude that they have no available choices for tackling even the trickiest or most frightening exposures. For example, a nonprofit social organization concerned about the possibility of terrorists infiltrating its upcoming event may decide to:

- hold its event in a more secure facility
- restrict parking to those who have been issued permits
- use student volunteers to search the bags and parcels carried by attendees at the event
- hire a security firm to patrol the facility during the event
- train a team of volunteers to patrol the facility during the event looking for suspicious behavior or items
- install working or dummy security cameras at the facility
- postpone the event

Although the options available to the event planners may seem limitless, a closer examination reveals that all of the options can be characterized as falling into one of four broad categories: avoidance, modification, sharing, or retention.

Avoidance Avoidance is an appropriate risk management strategy when a downside risk (threat) to the nonprofit is significant in frequency and in magnitude and available risk management strategies are either too costly or too difficult to implement. Some nonprofits regard avoidance as the appropriate response when a downside risk is unacceptable. Avoidance may be selected as a risk treatment option in too many or too few instances. A nonprofit that is risk averse may miss opportunities to fulfill its mission because it avoids activities in which harm could result. Other organizations are arguably too bold in their risk taking, believing that their history of operating without incident or loss in some way protects the organization from harm. Others may believe that they are protected from liability by their status as charities. A nonprofit should select avoidance as the treatment method whenever its leadership believes that the potential harm from some proposed activity presents too great a threat to the nonprofit's mission and survival.

Modification Modification, the most common risk treatment strategy, refers to any steps that either reduce the likelihood of a downside risk materializing, reduce the consequences should the risk materialize, or both. For example, a nonprofit that delivers meals to homebound residents of a community may elect to use a special packaging system for its meals to reduce the likelihood of leakage. It does so after examining an incident in which a service recipient slipped on her front porch after retrieving a meal that had leaked. The organization also adopts a policy of responding immediately to any reports of harm suffered by a recipient of a delivered meal. It believes this approach will allow staff to respond compassionately and offer to provide appropriate help, thereby avoiding costly claims and lawsuits. Modification strategies can be inexpensive and simple to implement, or they can be costly investments. If there is fear of a terrorist attack at an event, the use of volunteers to search the bags and backpacks of guests requires little or no financial investment by the nonprofit. What is required is time to instruct the volunteers in the process, and perhaps the risk of some lost goodwill by patrons who are subjected to the search process. However, the nonprofit is likely to generate additional goodwill among participants who appreciate the organization's efforts to keep attendees safe. A more costly approach would be the installation of active or dummy security cameras or the hiring of a professional security firm to search the premises before the event and patrol during the event. This strategy is also likely to both harm and bolster goodwill for the nonprofit.

Sharing Most risk management texts use the term *transfer* to describe the option of transferring the risk, in full or in part, to another party. We use the term *sharing* to emphasize the reality that a nonprofit can never fully transfer any of the risks it faces to someone else. When a nonprofit obtains a contractor's written agreement to assume responsibility for the cost of harm suffered by passengers on the contractor's buses, the nonprofit retains the potential threat to its reputation, credibility, and mission in the event the bus is involved in an accident and any service recipients are injured or killed. Even though the bus company has financial obligations stemming from the accident, the nonprofit's reputation may be tarnished when a local news station reports that the nonprofit failed to check the references of the bus company, whose safety record was suspect. The organization may experience a sudden drop in enrollment as parents look elsewhere in the community to provide recreational opportunities for their children.

Retention When a nonprofit retains risk, it does nothing to reduce either the likelihood or the consequences of a risk and instead deems the risk acceptable. Retained risks may include those that are either so remote that the organization deems the use of resources to address the risks imprudent, as well as risks whose consequences are negligible. The conscious retention of risk is an everyday occurrence in a nonprofit. The most important thing to remember about risk retention is that an organization should strive to retain risk by design, and not by default. The retention of risk after careful consideration of a threat's magnitude and consequences is a thoughtful approach. Retaining risks that were never considered by the nonprofit is retaining risk by default.

PHASE 2: EVALUATE OPTIONS

In Phase 2 the risk management committee or professional risk manager carefully examines the options available to address each of the nonprofit's high-priority risks. In some cases the risks are sufficiently significant and the options so varied as to warrant a full cost-benefit analysis. For example, a nonprofit considering how to retrofit its building to accommodate disabled service recipients may compare the cost of installing an elevator and handicapped-accessible bathrooms inside the building to the cost of reconfiguring its operations to limit service delivery to the first floor and constructing necessary exterior ramps. The analysis may take into account how service recipients and others will view the nonprofit's approach. Although retrofitting the building to accommodate disabled clients on every floor is likely to be the most expensive option, the benefits of doing so may include allowing the nonprofit to expand its service delivery to include a population whose needs are a perfect match for the nonprofit's capabilities.

PHASE 3: DESIGN RISK MANAGEMENT STRATEGIES

Phase 3 involves the development by the committee or risk manager of recommended strategies or techniques to address the organization's priorities. In some cases the committee or staff professional will be empowered to implement these strategies without first obtaining buy-in or approval from the nonprofit's boards. In other cases, perhaps due to the cost of the recommended strategy or its likely impact on various areas of operations, board approval may be necessary. In both instances, it is wise to focus on the issue of communication. Almost without exception, risk management strategies involve a change in direction or the reliance on a new policy, training program, or piece of equipment. The change is more likely to gain broad acceptance if it is announced—along with the rationale for its selection—prior to implementation. The committee or professional risk manager should explain how the policy or program works and why it was selected. For example, a nonprofit daycare center operating out of a church may decide to increase the rigor of its screening process for daycare workers and eliminate part-time positions from its payroll. The leadership of the organization may decide to take the latter step in recognition of the high cost of the new screening procedure and its experience with part-time workers, who the daycare believes are far more likely than full-time workers to quit before completing one year of service. The executive director meets individually with the current part-time workers to explain the rationale for the new policy and offer each employee the opportunity to continue on a full-time basis. For those who cannot work full-time, the executive director offers outplacement assistance and a small amount of severance pay. The executive director meets with the remaining staff to explain the safety rationale for the new screening process and the timetable in which it will be implemented. She also explains why the organization has adopted the new policy and invites comment and feedback from the staff on implementing the new policy.

Phase 3 continues with the completion of detailed plans for implementing risk management strategies. For example, with respect to a nonprofit's adoption of a new, more rigorous screening strategy for prospective volunteers and staff, the implementation of the new strategy requires the development of:

- A new application for paid and volunteer employment
- Revised text for the staff and volunteer handbooks
- A new interview guide for use by the volunteer coordinator and director of human resources
- New text for the organization's hire letter and volunteer agreement
- Training materials for all supervisors involved in the hiring process

In addition, the nonprofit's executive director, human resources director, and risk management representative must meet with the organization's outside counsel to review the new written materials for legal sufficiency before using the new materials.

PHASE 4: COMMUNICATE

Many organizations make the mistake of waiting until implementation plans have been finalized before announcing to staff impending changes in process, policy, or equipment. Some managers believe this approach minimizes the disruption of the organization, akin to removing a bandage quickly rather than pulling it off slowly. In most cases withholding information about new risk management strategies is a mistake because the organization thereby increases the likelihood that the change will be viewed with suspicion and forfeits the opportunity to obtain early buy-in from the people affected by the change. Since many risk management strategies affect outside stakeholders, such as service recipients, donors, and others, gaining the support of paid and volunteer staff is a crucial first step to obtaining buy-in from others outside the nonprofit.

Step 4: Act on Your Decision

Step 4 of the risk management process involves the actual implementation of the plans and strategies formulated by the committee and staff during the prior phases. Implementation may involve making changes to the physical structure of an organization, delivering new training on safety issues or procedures, taking time to document efforts and activities already underway, or implementing a new policy that will either reduce the likelihood or magnitude of a downside risk facing the nonprofit. In some cases implementation of a risk management strategy may be the responsibility of a single staff member, while other cases will require a larger number of participants. Here are some examples of the wide range of implementation efforts:

- A nonprofit school decides to discontinue use of its in-ground swimming pool after the organization determines that the benefits of providing swimming as a recreational activity for students are not sufficient to warrant the costs of maintaining the pool, particularly after a harsh winter; hiring, training, and retaining qualified lifeguards; and purchasing liability insurance. To implement its decision the nonprofit obtains bids from three contractors who are capable of filling in the pool. The nonprofit selects the lowest bidder, verifies the company's business references, obtains necessary approval to fill in the pool, and enters into a contract for the work.

- A youth-serving nonprofit whose members meet at the organization's facilities decides to adopt a procedure requiring the advance notification of parents concerning the schedule of meetings. The organization sends a letter to the parents of all enrolled members explaining the new policy and schedules a series of briefings to inform parents about the change in policy. A standard form is created for use as a calendar of events, and each parent is contacted to confirm e-mail and home address information. The organization begins posting the calendar on its web site, sending a monthly e-mail to all parents with the calendar attached, and mailing the printed calendar to parents two weeks before the beginning of the new program month.
- A nonprofit residential facility for seniors decides to adopt a new policy restricting access to the building to those with keys. Residents who are unable to come to the lobby to greet visitors may request that a building attendant accompany approved visitors to their units. Visitors must wait in the lobby until a staff member of the facility is available to escort them to the appropriate unit. The facility holds a series of briefings for residents to explain the new policy, keeping track of the identities of residents who attend. The facility staff contact residents who do not attend the briefings to explain the reasons for the policy and to request the names of approved visitors. The list of approved visitors for each tenant is entered into the facility's database to enable the efficient processing of visitors. When a visitor who is not preapproved arrives at the facility, the front desk staff are trained to obtain a copy of the visitor's ID card and then check with the resident concerning the nature of the visit before escorting the visitor to the resident's unit.

Step 5: Follow Up and Adjust

Nonprofits are dynamic organizations that face an ever-changing array of risks. As a critical risk facing a nonprofit begins to subside, another issue takes center stage. In addition, strategies selected or set aside by the risk management committee or professional staff at one time during the nonprofit's history may become more or less attractive to the organization over time. Reviewing risks and selected strategies on an ongoing basis is necessary to make certain that new risks have not been neglected and that strategies remain relevant. Issues that affect the likelihood (frequency) and consequences (magnitude) of risks change over time. In addition, the cost and availability of risk management strategies also change over time. The need for ongoing review is one reason that the steps of the risk management process are most appropriately depicted as a cycle rather than a five-step process with a beginning and an end.

Some of the ways in which the organization can review its risk management strategies include:

- *Hiring an independent reviewer or consultant to evaluate the effectiveness of the organization's risk management strategies.* A nonprofit that has recently completed the first cycle of its risk management program may hire an independent consultant to review the approach taken by the risk management committee, the high-priority risks, and their accompanying risk management strategies.
- *Conducting inspections to determine if safety measures are being implemented as planned.* A recreation facility that has adopted a new policy on window and door exits may conduct an unannounced inspection of the facility to make certain that all exits are in working order. A school that has adopted a policy requiring all visitors to pass through screening at the primary entrance before being admitted to other parts of the school may conduct a test to determine whether it is possible to bypass the screening procedure by entering the school through another door.
- *Reviewing files and other paperwork to determine if risk management protocols are being followed.* For example, a church that has adopted a procedure for handling complaints from congregation members may detail a staff member or outside person to review the records of all complaints processed during the past several years in order to determine whether the procedures adopted by the church are being followed.
- *Interviewing key personnel in order to determine the staff's views about the relative effectiveness of risk management policies and practices.* For example, in a mentoring program's new, more rigorous screening procedure, have there been any unanticipated negative effects that threaten the success of the program?

Some of the questions the nonprofit should ask about its chosen risk management strategies and high-priority risks include:

- Are the strategies working to reduce either the frequency of loss or the magnitude of any loss that occurs?
- Are the assumptions made about the risk still valid?
- Are the new policies adopted as risk management strategies being followed or circumvented? If the latter, why?
- Do the people who are responsible for implementing various risk management strategies understand the rationale for the strategies?
- Do the nonprofit's risk management strategies fully meet requirements or conditions imposed by regulatory bodies and funders?
- Are there any strategies that have cost more to implement than projected? Does it still make sense to continue these strategies, or should alternative, less costly measures be considered?

Managing Risk for Mission Fulfillment

Some nonprofits aspire to implement risk management programs in order to meet the requirements imposed by regulatory agencies or funders, whereas others look to risk management as a means of avoiding entanglements with the civil justice system. Although these are powerful motivators that lead thousands of organizations to look more closely at risks and strategies for coping with risk, a nonprofit need look no further than its mission for the most important reason to focus on risk management. The mission of a nonprofit—the organization's sole reason for existing—is reason enough to devote time and resources to identifying events and circumstances that could make the realization of the mission impossible. Uncovering these risks and discovering cost-effective approaches to reduce the likelihood of their occurrence and any consequences is a process that takes place over the lifetime of an organization. It cannot be accomplished in an afternoon or during a single budget cycle. However, the collective effort devoted to this task has a certain payoff: greater confidence on the part of the nonprofit's leadership that its resources will be well spent pursuing the mission of the organization.

CHAPTER 2

Recognizing the Context for Risk Management

As discussed in Chapter 1, before a nonprofit begins to identify the risks it faces and the strategies that make sense from practical and economic perspectives for addressing risks, it should thoughtfully consider the context in which its risk management program will unfold. At worst, failing to consider the contextual issues may jeopardize the ultimate success of risk management activities and at best, will make it more difficult for the organization to take steps to address risk.

For example, a nonprofit may be undergoing a period of belt-tightening following the loss of a large grant or an overall reduction in demand for the organization's fee-generating services. Despite this difficulty, the leadership remains committed to launching a risk management program and names a committee of staff and outside volunteers as the nonprofit's first risk management committee. After considering a range of threats to client safety, the committee proposes installing cameras in the lobby of the building as well as on the exterior. In addition, the committee proposes that the nonprofit hire a security firm to provide 24-hour building security. Both proposals are soundly rejected by the executive director simply because the nonprofit cannot afford the high cost of these risk management responses. Had the committee used the nonprofit's economic situation as a contextual backdrop for its deliberations, it would have focused its strategizing efforts on identifying low-cost but effective strategies. Besides being a failed process, this approach has convinced senior management that the organization cannot afford to focus on risk management and so they abandon their prior commitment.

One simple approach to examining the context for risk management in a nonprofit is to consider a series of questions about the circumstances facing the organization. For example:

- What factors, events, or circumstances are fueling the nonprofit's motivation to focus on risk management?
- What has been the nonprofit's past experience, if any, with risk management activities?
- What level of support for risk management has been expressed by the nonprofit's senior management and board of directors?
- What barriers or circumstances might make it difficult to implement new risk management policies or practices?

The answers to these questions will provide contextual background for the remaining steps in the risk management process, allowing the planning group to avoid the pitfalls that result when contextual issues are ignored.

A more thorough approach to examining the context for risk management activities is to look at various aspects of context for the nonprofit. Contextual issues can generally be divided into three broad categories: risk management context, organizational context, and strategic context.

Risk Management Context

The risk management context for a nonprofit consists principally of the objectives the nonprofit seeks to achieve by focusing its attention and resources on risk management. Some nonprofits approach the discipline of risk management intending to examine all facets of operations for hidden or misunderstood risks. These organizations aim to root out risk and do something about it as quickly and efficiently as possible. Other nonprofits approach the process by recognizing that the organization's risks are dynamic and that by the time the leadership has a grasp on today's risks, circumstances will have evolved and new risks will be present. Groups with this perspective may decide to address one or more areas of concern within the organization, such as volunteer screening and supervision or facility security.

Risk Management Objectives	
Organization-wide scope	Program specific actions
Long-term health	Fixing problem
Long-term, continuous effort	Short-term project
Only focus on accidents	Upside and downside risks

A nonprofit's objectives for its risk management program may differ from those of a similar organization with regard to the perspective or motivation for the activity. Some see risk management as a way to improve the health of the organization, similar to beginning a moderate exercise program, while others focus on risk management to fix a problem. It is not unusual for a nonprofit that has been unsuccessful in defending a lawsuit alleging negligence in the delivery of professional services to focus immediately on what it can do to avoid a similar loss. The group may hire a consultant to examine its practices and recommend changes in program design and supervision. When an organization takes a broader, long-term view and sees risk management as a path to a healthy future, it may have a harder time obtaining support from key personnel, who question the devotion of time and resources to an effort when "nothing bad has ever happened here." When the commitment to risk management follows a painful and costly loss, it is easier to rally personnel around the risk management effort. The likelihood that the activity will enjoy support from key personnel is another facet of the context for risk management and is generally considered a component of the organizational context.

The following questions may be helpful in uncovering the risk management context for a nonprofit:

- What goals does the nonprofit hope to achieve by implementing a risk management program?
- Does the organization view risk management only as a way to counter or avoid downside risks or as a way to counter threats and increase mission-related opportunities?

- Has the nonprofit ever faced a serious loss that threatened the organization's ability to continue? If so, were lessons from that experience translated into new policies or practices?

Organizational Context

The organizational context for risk management includes the available resources (human and financial) for risk management deliberations and strategy implementation, as well as the attitudes and capabilities of key personnel. If the board of directors believes that the nonprofit's status as a charity makes it immune from suit and the resulting liability, it is unlikely to approve proposed changes in policy or operations proposed by the risk management committee or outside consultants. Furthermore, if the board or executive director believes that risk management begins and ends with the purchase of insurance, the risk management committee is likely to face opposition when it proposes a new screening process for volunteers or the purchase of new equipment for the recreation program.

Additional issues that create the organizational context for risk management include the management structure and style of the nonprofit. A nonprofit that relies on consensus building as a tool for decision-making will be in the strongest position to benefit from the work of a risk management committee consisting of paid staff, volunteers, and outside advisors. A nonprofit with a more traditional, top-down decision-making style may be better suited to the assignment of risk management responsibilities to a staff person who reports to the CFO or CEO.

The key to examining contextual issues is to uncover the factors, issues, dynamics, and conditions that will either threaten the realization of the program's goals or support the effort. These positive, negative, and neutral factors should be considered as the committee or staff embark on the identification of risks and development of strategies.

The following questions may be helpful in uncovering the organizational context for a nonprofit:

- What are board and staff views about the relevance of risk management to the organization's health and viability?
- How are critical decisions about the nonprofit's operations typically made? Are most decisions made by senior management and communi-

cated to those affected? Or are decisions frequently arrived at through bottom-up, consensus-building activities such as staff committees and informal brainstorming?

- What personnel at the nonprofit are available to participate in risk management activities?
- Does the nonprofit have trustworthy outside advisors (such as legal, financial, and insurance experts) who would be willing to participate in a risk management program by serving on a volunteer committee?
- What is the organization's experience with and perspective on insurance? Does it purchase as much coverage as it can afford? Does it struggle to purchase the insurance it believes it requires? Is there a staff member who has special expertise and experience with insurance issues?

Strategic Context

Strategic context includes the environment in which the nonprofit operates, its economic circumstances, political pressures or considerations, regulatory requirements, legal requirements, and historical events. A nonprofit's strategic context also includes the desires and perceptions of stakeholders.

For example, a nonprofit may decide to undertake a risk management program in order to address its past failure to meet various regulatory or legal requirements. When the group discovers that its practice of awarding compensatory time to staff in lieu of time-and-a-half on an hour-for-hour basis is illegal, it begins a thorough review of its human resource practices and policies. The goal of the program is to bring the organization into compliance as quickly as possible. The urgency of this matter forms a backdrop for the risk management effort. There is no time to convene a risk management committee that includes volunteers; the effort must be coordinated by a full-time staff member who can devote her full attention to working with legal counsel until the matter is resolved. Unlike a risk management effort whose results are "sold" to the staff, the result of this effort is likely to be a policy change that will be communicated in writing and in person to the nonprofit's staff.

The following questions may be helpful in uncovering the strategic context for a nonprofit:

- In what type of environment does the nonprofit exist: competitive? collegial? Is there stiff competition for grant funds, competent staff, and other resources among organizations that provide similar services in the community?
- What is the nonprofit's history of compliance or noncompliance with regulatory and legal requirements?
- Has the nonprofit faced significant claims or lawsuits in the past? What were the lasting effects, if any, of these losses?

Part II

Understanding the General Risks Facing Nonprofit Organizations

Part I explains the rationale for integrating risk management into a nonprofit's operations, as well as the framework for doing so: the risk management process. Part II explores critical areas of risk common to nonprofits and suggests methods for appraising and addressing these risks.

As explained in earlier chapters, risk is a measure of the possibility that a given peril will cause an unexpected loss to one or more of a nonprofit's key resources within a specified time period. As the chapters in Part II show, these key resources can be classified as the property, income, people, and reputation of a nonprofit. There are three measures of any risk. The first measure of a risk is its frequency or *probability*: the chance that this peril will occur within a particular time period. The second measure of a risk is its *magnitude*: the physical extent or dollar value of the loss the peril will cause when it strikes. The third measure of a risk is its *variability*: the peril may strike once or possibly several times within a given time period, and the extent of the resulting loss may be fairly predictable or highly variable.

Properly appraising a nonprofit's risks requires careful attention to all three measures—probability, magnitude, and variability—as well as to the perils that may cause loss and to the physical extent or dollar value of lost resources. Thus, to appraise any specific risk that may face a nonprofit, one must identify or estimate (1) the item or type of resource, such as property in the form of owned vehicles; (2) the peril causing loss, such as theft, a human peril; (3) the typical frequency with which the peril strikes within a given time period; (4) the usual severity of each loss; and (5) the variability of the frequency and severity within a given time period.

Part II of this book—Chapters 3 through 12—describes the reasoning behind and the process for making risk appraisal statements for a nonprofit's key resources. Chapters 3 through 6 deal with nonprofits' *general* risks: losses of the types of resources that virtually all nonprofits and most other organizations use in daily operations. Chapters 7 through 12 focus on *special* risks of losses peculiar to nonprofits. Each chapter in Part II emphasizes the types of information and the reasoning that the leaders of any community-serving nonprofit need for realistic appraisal of the specific risks that threaten their organizations.

Almost all organizations, whether nonprofit, governmental, or for-profit, rely heavily on three broad types of resources to advance their goals: property, income, and people. Any event that seriously threatens one or more of these categories is a significant risk management concern. Chapters 3, 4, and 6 describe property, income, and people resources and how they may be lost to various perils. Economic and technological perils are treated in Chapter 4 because they are closely related to other threats to a nonprofit's income. The fourth key resource, a nonprofit's reputation for fulfilling its community-serving mission, is treated in Chapter 7. In addition, any nonprofit may find its key resources endangered by legal and economic perils. These legal perils—and the ways they may threaten a nonprofit's property, income, reputation, and people—are the focus of Chapter 5.

Chapter 3

Property Risks

To pursue its mission every nonprofit uses various kinds of property. Some of this property the nonprofit owns; other property it has the right to use.

Here are a few examples of the varied kinds of property:

- Some nonprofits own the buildings they occupy; most rent office or other space and thus they have only the right to use the buildings.
- Most nonprofits own the records of their contributors' past donations; some also rent lists of potential contributors from firms that compile data on donors likely to empathize with their mission.
- Some nonprofits own the vehicles they need for daily operation, and some lease such vehicles. Others rent vehicles for a few days or ask to borrow their employees' or volunteers' vehicles.
- Many nonprofits own or lease other long-term equipment to use in their offices, for recreational programs, or for recurring seasonal events.
- Like organizations in the private sector, many nonprofits hold licenses from state or local governments that are necessary for engaging in the activities that are essential to their community-serving missions, such as providing virtually free food, housing, or medical care to clients.
- Many nonprofits issue publications to which they own the copyrights. Some nonprofits reprint in their publications substantial portions of others' copyrighted materials with the permission of the holder of the copyright on the reprinted material.

- Some nonprofits hold property borrowed from others for extended periods. Examples are museums or community theaters that borrow works of art or staging materials for particular presentations and thrift shops that hold others' property on consignment until sold. These groups often lend property they own to others for similar purposes.
- All nonprofits have some form of financial assets, including cash on hand, bank accounts, stocks, bonds, promissory notes, records of accounts, and pledges of promised payments.
- Virtually all nonprofits have current inventories, such as office supplies or foodstuffs or merchandise for sale, to sustain daily operations for a few months at a time.

Beyond the *present* rights to own or use different kinds of property, many nonprofits have, or expect to have, *future* rights to own, use, receive income from, or otherwise benefit from property under the terms of supporters' wills, grants from foundations or other benefactors, or other arrangements that underlie various planned giving programs. Even though future property rights can be crucial to a nonprofit's success, this chapter focuses only on losses to the property a nonprofit currently owns or uses. There are two reasons for excluding future interests in property from this discussion. First, a future interest may not materialize: A supporter may change his or her will to eliminate a previous or a promised bequest; a present or anticipated grantor may change its priorities or disavow a commitment under circumstances that make it difficult for a nonprofit to pursue what it thought were firm commitments. Second, property laws regarding future interest and the wills, deeds, and other documents conveying such interest can be very complex and vary by jurisdiction. A nonprofit looking to safeguard future interests in any kind of property should consult competent legal counsel about the details of specific cases rather than relying on general statements offered here.

To provide a comprehensive framework through which the managers of virtually any nonprofit organization can understand and manage the property losses that threaten it, the major sections of this chapter explore:

- Types of property subject to loss
- Perils causing property losses
- Interests harmed by property losses

- Financial impact of property losses
- Mission-critical consequences of property losses
- Methods of identifying potential property losses

This chapter aims to establish a general framework that the leaders of any nonprofit can apply to appraise the specific property losses that may strike their organization. This framework is consistent with the five aspects of all accidental losses: (1) resource threatened, (2) peril causing loss, (3) usual frequency of loss, (4) typical severity of loss, and (5) variability of loss frequency and severity. This chapter also explains, in a property-loss context, the fundamental reasoning process for appraising any type of loss potential. Such reasoning process will help assess income, liability, people, and reputation losses in the chapters that follow.

Types of Property Subject to Loss

Very broadly, property is anything that can be owned. Driven partly by history and partly by logic, the law has for centuries divided all property into two broad categories: *tangible* property (physical, or capable of being touched, such as a building, a car, or window draperies) and *intangible* property (having no physical substance, such as a copyright or a $10,000 bank account). Evidence of intangible property, such as a document from the copyright office or a bank statement showing the $10,000 balance, is not the intangible property itself. Tangible property falls into two broad categories: real property and personal property. Real property is roughly equivalent to the more common term *real estate*, meaning land and things of value permanently attached to it, such as buildings, other structures, road pavements, and things growing on land, such as crops or other vegetation. Personal property is all tangible property other than real property.

Tangible Property

A nonprofit may own or have the right to occupy real property, such as its offices, and personal property, such as the office equipment or vehicles it owns, leases, or borrows. To get a good general grasp of the range of a nonprofit's tangible real and personal property, think of all the places it operates. Any facilities it occupies regularly it almost certainly owns or leases.

In each of those facilities, it uses many items of equipment, furniture, and supplies, most of which is either owned or rented. Even when a nonprofit does business in places it does not regularly occupy—as when it delivers meals to people's homes or runs a public information booth at some association's annual meeting in a convention center—that nonprofit uses its own or rented vehicles, equipment, and supplies to conduct these facets of its operations. A nonprofit's tangible property, real or personal, is everywhere that nonprofit has a presence, including the overhead projectors, display racks, and posters in the homes, cars, luggage, and hotel rooms of its staff when they are preparing for or in the midst of a trip, sometimes even a pleasure trip after a major business meeting.

Intangible Property

Virtually every nonprofit owns intangible property, much of it symbolized or documented by something tangible that itself has little value. Consider a nonprofit's financial assets, which may include cash on hand, bank and investment accounts, and corporate or governmental stock certificates or bonds. The cash is tangible personal property, its value printed on its face, and is best kept locked away because anybody can use it for anything. The same is true for stock and bond certificates, although they usually are more difficult than cash to exchange because their value is determined in the financial markets. These certificates typically cannot be sold in legitimate markets without documentary proof of rightful ownership.

Bank and investment account records have no inherent value—they are just pieces of paper. But these pieces of paper may represent great intangible value—conceivably, a nonprofit's greatest single value—depending on how much a bank or investment broker will let a nonprofit withdraw on the basis of these account records. This may be many millions of dollars for a philanthropic foundation whose nonprofit mission is to help others; it may be nothing for a nonprofit that is in bankruptcy and who current bank accounts have been frozen by the courts.

Closely related to bank and investment account *records* are banking and investment account *documents*: checks, deposit slips, investment order slips, and the like. These are inherently very valuable because they are like keys to the vault, giving their holder access to all the intangible assets in those banking and investment accounts, especially if other procedural safeguards fail. Therefore, these documents should be carefully guarded under lock and key or kept in the hands of a nonprofit's most trusted people, who follow money- and document-handling procedures that shield them from both temptation and suspicion.

The most valuable asset of virtually every nonprofit is an intangible one: its mission, the community-serving goal that defines its distinctive purpose, its reason for being. The law specially recognizes this purpose as worthy of particular privileges because it serves the public good. The nonprofit's efforts in pursuing this goal, its mission, often relieve the government of activities it otherwise would have to undertake. An intangible asset, the nonprofit's mission, is the basis for a very practical benefit for each nonprofit: not only some special postal rates but, perhaps more importantly, freedom from paying most taxes and power to grant tax deductions to those who support it financially.

This intangible asset—a distinctive, government-sanctioned mission coupled with a favored tax status—is symbolized by each nonprofit's charter and tax-exemption documents issued by a state or the federal government. But as an intangible asset, the mission exists separately from the charter and the tax documents. Their destruction does not directly endanger the nonprofit's privileged status, although a nonprofit's management almost always specially guards these documents and moves immediately to replace them if they are damaged or destroyed. Nonetheless, the mission and the special tax status are vulnerable to some special dangers that are just as intangible as the mission asset itself. The dangers include tax penalties and loss of reputation because of (1) abandonment, by pursuing activities and income unrelated to the mission; (2) neglect, by failing to devote the greater part of income and other resources to serving clients; or (3) disloyalty, by officers, employees, volunteers, or others associated with the nonprofit becoming more interested in their own financial or other personal well-being than in pursuing the mission.

Mission-related values, perils, and safeguards are very important in all aspects of risk management for nonprofit organizations. Later chapters on income, liability, people, and reputation losses will return to these values and threats to a nonprofit's mission and other intangible resources. The balance of this chapter concentrates on losses to a nonprofit's tangible property.

Perils Causing Property Losses

Experts in preventing or coping with accidents, crimes, lawsuits, disasters, and other unforeseen events often divide the perils that cause these losses into three broad categories: natural perils, human perils, and economic perils. Although this three-way grouping can lead to confusion or honest debate, it often helps in thinking about the root causes of losses and, therefore, how to prevent or where to place responsibility for those losses. Exhibit 3.1 is a chart of some typical natural, human, and economic perils that can unexpectedly damage real and personal property.

Exhibit 3.1 is by no means a complete listing of the perils a nonprofit organization faces. In fact, the number of items in each column is arbitrarily limited to 10, although each category could contain scores of perils. To stimulate thought about perils that could threaten a nonprofit, some of the listed perils are described very broadly, (e.g., windstorm, crime), while others are more specific (e.g., mold, currency fluctuation). Finally, the perils selected for the chart illustrate that their relative importance may shift over time: riots are not the news-making threat today that they were 30 years ago, and neither terrorism nor mold were major property loss concerns in the United States until 5 or 10 years ago.

EXHIBIT 3.1 Typical Natural, Human, and Economic Perils

Natural	Human	Economic
Collapse (gravity)	Carelessness	Currency fluctuation
Drought	Crime	Interest rate or price change
Earth movement (quakes, etc.)	Explosion, human origin	Legal and regulatory change
Fire, natural origin	Fire, human origin	Political change
Flood	Lawsuit	Population shift
Mold	Pollution (air, noise, etc.)	Preference shift
Rot	Riot	Recession
Temperature extremes	Sabotage	Resource depletion
Vermin	Strike, boycott	Technological change
Windstorm (hurricane, etc.)	Terrorism	War

Natural Perils

Natural perils are forces of nature that act without any human intervention. Gravity, for example, can cause the collapse of an aging building, especially one that has not been adequately maintained. Poorly maintained properties are also particularly susceptible to flood, rot, and windstorm, whether from a hurricane in the eastern United States, a tornado in the Midwest, or an Asian typhoon. Vermin—pesky, destructive wild animals—also vary by territory. Raccoons and deer are vermin in temperate climates, snakes in more tropical areas, and bear in colder regions, and rats and insects are everywhere. Fire occurring naturally, usually ignited by lightning, is another universal natural peril. All natural perils can damage both real property and any personal property located in or on that real property

Natural perils cannot be avoided, they "come with the territory," and a nonprofit that is not free to move to another region (or at least to higher ground above a local flood plain) is vulnerable to the natural perils that characterize a particular location. For example, some areas experience losses from various forms of earth movement, such as earthquakes, volcanic eruptions, sinkholes, or landslides, much more frequently than do other areas. A nonprofit that is committed to a given geographic area or specific area cannot fully prevent losses from natural perils. It can only reduce them through appropriate, usually architectural or other physical loss controls: good construction, walls and dikes to shield property from wind and water, and tight roofs, foundations, windows, and doors to prevent wind, water, and vermin from entering the premises. A nonprofit that owns its facilities can take these steps directly; a nonprofit that is a renter may have to negotiate these safeguards with its landlord or move to a more secure location.

Human Perils

Human perils include all the destructive conduct (actions or failure to act) of individual people acting alone or the destructive conduct of people acting in concert. Two of the most prevalent human perils are the most difficult to define and to control: carelessness and crime. Carelessness can encompass unsupervised or inattentive operation of an automobile or other machinery that causes damage, stumbling into and smashing valuable antiques, or failing to maintain buildings or equipment until they crumble or fail to function. Crimes against property, causing its theft or destruction—robbery, burglary, shoplifting, embezzlement, fraud, arson, vandalism, invasion of copyright—are as varied as the forms of real, personal, and intangible property and as changeable as human imagination can devise. Witness the recent explosions in fraud against the elderly and identity theft. Fire, a human peril when ignited by human action or inaction, can overlap with crime when it is arson and with carelessness when fires started by good people for good purposes somehow get out of control.

Lawsuit is a human peril because people cause other people property losses when they sue one another. It is the act of bringing suit that triggers property losses for the defendant, whether the suit is later settled out of court or by a final legal ruling. Usually the defendant's loss is money paid to the plaintiff as damages or to the government as fines. Depending on the nature of the civil or criminal suit, however, the defendant also may lose ownership of other tangible or intangible property that has become the center of a legal dispute. As later chapters will explain, lawsuits also can cause an organization to lose income or reputation when, for example, it agrees to—or is ordered to—stop doing something that generated a good income or a fine public image.

Most of the other human perils listed involve targeted hostility between one specific group of humans and another group, typically resulting in some intentional damage to property, such as in a riot, planned acts of sabotage, a strike, or terrorism. Note that war is not included as a human peril, because war usually is an act of one government or country against another, not an event that begins as a person-against-person or small group conflict.

Human perils arise from human failings: lack of knowledge or skill, of attention, of focused motivation, or of respect and concern for the well-being of others. The key to countering losses caused by human perils is to avoid or correct these human failings in oneself and in others or to minimize the contact that the organization has with such people. No one is perfect, but everyone can try to improve; therefore, trying improves safety.

Economic Perils

Economic perils include actions of many individuals acting independently but responding similarly to a particular set of conditions. Their similar responses to these conditions, although often sensible as individual actions, often have harmful economic consequences for many people.

Economic perils are economy-wide (or macroeconomic) events, which can be quite normal in competitive markets—events that no one person or organization causes or can control. For example, an organization that buys raw materials from or sells its output in other countries can lose money as exchange rates fluctuate. Other domestic price changes can also cut into an organization's income or surplus. These include increases in the costs of raw materials or in wage and salary costs or a decrease in what people are willing to pay for the goods or services an organization sells. Many organizations, especially nonprofits serving local populations, lose clients and funding from donors if the general population declines in these areas or if recession occurs. A major local employer may falter because its products have become obsolete or are no longer the ones consumers prefer, or because that employer is dependent on a natural resource, such as a mine, a water source, or soil that is especially well suited to a particular crop. Any such adverse economic change is likely to drain a nonprofit's cash reserves, especially if its clients' needs increase just as its funding sources dwindle.

Other community-wide or nationwide changes that affect a nonprofit's general legal environment may have damaging effects on its financial resources. A nonprofit's costs may be increased by federal, state, or local statutes governing what a nonprofit may do, how it is funded, or how it must report to the government or to its constituencies—or by the regulations implementing these statutes. These statutes and regulations can also reduce its revenues or deprive it of the use of some of the facilities on which it depends. A change in the political party in power, nationally or locally, also may cloud a nonprofit's financial future. Such adverse changes, although they may be basically legal or political, are important to a nonprofit because they threaten its economic prospects, and thus its ability to fulfill its mission.

Economic perils are beyond the direct control of a nonprofit or any other single organization; no organization created these perils, and none can stop such a peril from running its course. The best strategy for protection from economic perils is to insulate the nonprofit from their effects. The key is to diversify, to reduce any overdependence on any single group of clients, funding source, product, or service—and, if possible, from any single community or geographic area. Another key is to develop a contingency plan:

Decide what will be done if an economic peril—or a combination of economic, natural, and perhaps human perils—all strike within the same month. Contingency planning does not always provide ready, workable solutions, but it often does open the eyes and minds of a nonprofit's leaders so that future losses, whatever they may be, are less of a shock and more of a survivable challenge.

Financial Impact of Property Losses

Any peril striking tangible or intangible property that a nonprofit owns or uses causes it two kinds of financial losses: the cost of replacing the property and a decrease in the income (from decreased revenues or increased expenses) that the nonprofit may have derived from the property. There also are some circumstances in which loss of special items of property, such as a museum's prized work of art or historical artifact, may threaten its reputation or interfere with pursuing its mission.

Cost to Replace

The property that a nonprofit owns or the property of others that it uses typically can be readily replaced if the organization can generate the needed funds. Property that a nonprofit has leased or borrowed also can be leased or borrowed from other sources, although sometimes at considerable cost, including the cost of compensating the owners of the now lost property.

Loss of Income

Virtually all nonprofits use their tangible property to generate income, even if that use is nothing more than using office space to serve clients and vehicles to deliver needed items and services to them. Some nonprofits use highly specialized items of property to generate income: medical equipment, cooking or recreational facilities, bookmobiles, or musical instruments for symphonies. Loss of these items of property lowers the income of the affected nonprofit by either cutting the revenue that this property produces or imposing extraordinary expenses to replace the property without delay.

Mission-Critical Consequences of Property Losses

Even fairly major property losses, such as the destruction of a vehicle or the gutting of a rented facility by fire, may have no appreciable negative effects on a nonprofit's real or publicly perceived ability to continue pursuing its mission. Other, more severe property losses, such as damage to a client's medical records at a nonprofit clinic or destruction of a historic church, may cause only temporary disruption of a nonprofit's progress toward its mission until these items of property can be restored, although a significant cost may pertain. Other property losses, however, can strike at the heart of a nonprofit's mission: contamination of a blood bank's total inventory or a conflagration that reduces to ashes the entire contents of a museum devoted to the memory of a cowboy hero or a popular music legend. These mission-threatening events damage property essential to a nonprofit's mission and, perhaps more importantly, can also shatter the public's perception of the nonprofit's credibility. In such extreme cases, a nonprofit that hopes to survive as a functioning entity may well be compelled to redefine its mission.

Methods of Identifying Potential Property Losses

There is no foolproof technique or combination of techniques for identifying all the potential property losses that a nonprofit may suffer. Nonetheless, there are a number of tools on which experts in preventing and financing recovery from accidental losses to property have come to rely. In the hands of an experienced professional conferring with the managers of a nonprofit who are truly familiar with its operations and willing to be totally forthcoming about the nonprofit's actual activities, these tools can do much to anticipate a nonprofit's accidental losses: what may happen, how often, and with what financial and operational consequences.

A significant unrecognized loss exposure is a weakness in any risk management program. An unrecognized loss exposure cannot be effectively managed. Because any nonprofit organization's activities are constantly changing, exposure identification must be an ongoing process. To bring order to this process, and to involve many members of a nonprofit's staff in this process, it is important that each nonprofit follow some well-defined procedures for identifying loss exposures. Although the procedures are valid for identifying all types of loss exposures—property, net income, liability, and reputation losses—the following discussion treats the procedures in the context of property losses so that, in later chapters, these procedures will already be familiar. Eight procedures for appraising a nonprofit's exposures to potential accidental losses are widely used:

1. Standardized surveys or questionnaires
2. Loss histories
3. Financial statements and underlying accounting records
4. Other records and documents
5. Flowcharts
6. Personal inspections
7. Expertise within and beyond the nonprofit
8. Scenario (what-if) analysis

Standardized Surveys or Questionnaires

A standardized survey (often called a risk analysis questionnaire) is a document listing general questions that, at some level, should be relevant to the loss exposures of every nonprofit, indeed every organization. These sets of questions are standardized in the sense that most questions are meaningful for most nonprofits—a feature that is both a strength and a weakness. Standardization is a strength because all the questions aim to be universally relevant, allowing comparisons of loss exposures between any two organizations at any given time or for one organization at various points in time. This uniformity also means that a standardized set of questions, properly drafted, can be understood and answered by staff members who have no particular expertise in risk management. However, this standardization is also a weakness because no one questionnaire can uncover all the loss exposures of any particular nonprofit or even of two nonprofits serving similar clients in a given city or region. Each nonprofit will have some loss exposures that are virtually unique to it.

Loss Histories

Almost any loss a nonprofit has suffered in the past it can suffer again. Indeed, a given nonprofit can suffer any loss that any other nonprofit has suffered. Loss histories gather and organize information about past losses for a given nonprofit and for comparable nonprofits. A meaningful loss history identifies not only the peril that caused a past loss and the property or other resource that the peril damaged, it also describes the circumstances that preceded the loss and how the nonprofit—together with its insurers and fire, police, or other public officials—tried to control the extent of the loss. Knowing how many losses of a given type a nonprofit and similar organizations have incurred gives some indication of the frequency or probability of this particular type of loss. Knowing the circumstances that preceded a loss and the measures taken to limit the loss gives some insight into hazards that may lead to especially severe losses, as well as post-loss steps to reduce loss severity. In general, the more detailed the loss histories are, the greater their value in appraising possible future losses.

Loss histories deal with the past—often the past of some other organization. To judge how relevant these past losses may be to estimating a group's future losses, its leaders must consider (1) whether recent changes within the nonprofit have affected the organization's vulnerability to similar future losses and (2) whether differences between one nonprofit and others are so great that others' experience may not apply. For example, suppose a nonprofit used minivans for two decades to transport clients but three years ago switched to a smaller number of 30-passenger buses. The former minivan loss data and incident reports are not likely to be helpful in forecasting or preventing accidents with the newer buses because the two types of vehicles, and perhaps their drivers, are too dissimilar. The bus accident frequency and severity record may turn out to be better or worse than the old record with the minivans. Again, one youth recreation nonprofit may hear that another youth recreation center in a neighboring state is experiencing an increasing number of play-yard fall-injury lawsuits. Before assuming that similar suits also will sweep over it, the managers of the first nonprofit should explore the extent to which the two organizations are comparable in the characteristics of the play-yard equipment, the youth playing in the yard, the adult supervision of the yard, and even the weather conditions.

Financial Statements and Accounting Records

A nonprofit organization's financial statements almost always include at least its balance sheet, showing assets, liabilities, and surplus at a given time, and its income statement, indicating revenues, expenses, and the resulting increase or decrease in its surplus over a given period of time.

The logic for using these accounting statements and the supporting bookkeeping records is direct: Any accidental losses a nonprofit may suffer will have adverse effects on one or more of its financial statements, and the details of that loss will be reflected to some extent in its underlying accounting records. Hence, these statements and records provide a basis for reasoning backward from the values in the statements and records to the kinds of accidents that could splash red ink on them.

The first of these financial statements, the balance sheet, lists a nonprofit's assets on the left side or top of the sheet and its liabilities on the right side or bottom of the sheet. On the left are the nonprofit's overall surplus or reserves. The two sides of a balance sheet must always balance—that is, the total of the assets on the left (or top) of the sheet must always equal the sum of the liabilities and surplus or reserves on the right (or bottom) of the sheet. Indeed, a nonprofit's surplus as of the date of any balance sheet usually is computed as the amount by which its assets exceed its liabilities:

$$\text{Surplus} = \text{Assets} - \text{Liabilities}$$

Thus, the core purpose of risk management can be expressed as preserving a nonprofit's surplus by safeguarding it from accidents that could reduce the value of its assets or increase the amount of its liabilities, or both. Applying this logic, a nonprofit's management should inquire into each category (sometimes, as with major equipment, each item) of its assets, imagining what kinds of events could decrease the value of those assets. The answers to these inquiries are all the possible pairings of assets on the nonprofit's balance sheet with the natural, human, and economic perils presented earlier in this chapter. Some of these pairings, such as fire damage to inventories, are significant threats. Other pairings, such as the asset of pledges receivable and earthquake peril, may initially seem impossible or at least nonsensical. Nonetheless, pondering each pairing can be enlightening: Would apparently ruinous earthquake damage to a nonprofit's headquarters dampen pledgers' enthusiasm for fulfilling their pledges? If those who had pledged but not yet paid be less able to pay if an earthquake damaged their properties? Neither of these questions has a universally correct answer, but every nonprofit should consider them and many other similar questions about whether and how specific perils could damage particular kinds of property.

Comparable reasoning should encourage a nonprofit's management to explore how specific perils could increase the size or the burden of paying a nonprofit's liabilities when they fall due. For example, if a peril against which a nonprofit had only $50,000 of coverage caused $200,000 worth of damage to its premises, should it attempt to borrow the remaining $150,000, thus increasing its overall liabilities by this uninsured amount of loss? With respect to existing liabilities, would an event like extremely unseasonable weather during the month of a nonprofit's annual fund drive decrease available cash to the point that some of its equipment or other property would have to be sold to make mortgage or rent payments on its buildings?

The second major financial statement for virtually every nonprofit is its income statement, sometimes called an operating statement, which summarizes a nonprofit's revenues and expenses over a period such as a month or a calendar or fiscal year. Any excess of revenues over expenses increases the nonprofit's overall surplus, and any shortfall decreases the surplus for that accounting period. The income sources and amounts typically appear in the top section or left side of the statement, and the expense categories and amounts, together with the net change in the organization's surplus, appear in the bottom section or right side of the income statement.

Like the balance sheet equation of assets, liabilities, and surplus at a particular time, a nonprofit's income statement for a particular period of time also has an underlying equation. For any specific month or year,

$$\text{Revenues} - \text{Expenses} = \text{Change in Surplus}$$

In the context of an income statement, the central objective of risk management is to cope with accidents that threaten to lower a nonprofit's net income by either lowering its revenue or increasing its expenses for the period the statement covers. Many kinds of accidents, both on and off a nonprofit's premises, can have these adverse effects (see Chapter 4). With respect to property losses, a nonprofit's net income statement can point to items of property that, if seriously damaged, will greatly reduce the organization's net income. Such property includes places where clients are served or where items that the nonprofit sells are manufactured or inventoried, off-premises properties of key suppliers, and off-premises roads, bridges, and other transportation facilities. The greater the stream of income that depends on a particular facility or item of property on or off the nonprofit's premises, and the more crucial that property is to maintaining that income stream, the greater the priority assigned to that facility or property item.

Other Records and Documents

Every record or document that a nonprofit generates, as well as every document from any outside source that a nonprofit receives—even correspondence and memos—may conceivably contain crucial insights into a nonprofit's property, liability, net income, and reputation loss exposures. Although it would be ideal, it is not feasible to examine every piece of paper or e-mail communication that a nonprofit creates, sends, or receives. Nonetheless, sound risk management practice does require a systematic approach for examining nonfinancial records and documents that are particularly likely to point to changes in a nonprofit's property and other exposures to accidental losses. These include:

- Minutes of board and committee meetings
- Memoranda exchanged among senior management or issued to all staff
- Major contracts into which the nonprofit has entered and proposals for future major contracts
- Planning documents—whether architectural, production, fundraising, marketing, or long-range strategic
- The nonprofit's own legal correspondence, files, and records, as well as selected legal and nonprofit-sector publications, that could give warning of future legal difficulties

The key goals here are (1) to keep the nonprofit's risk management decision-makers fully informed about all the organization's present and contemplated activities and (2) to remind the nonprofit's managers and front-line staff of their continuing duty to remain aware of and help cope with the organization's continuing exposures to accidental loss.

Flowcharts

A flowchart graphs and sequences the activities in a production process. Such a chart highlights the key operations, equipment, and people through which an organization creates value. For a nonprofit the values it creates consist mainly of meeting clients' daily needs and advancing the organization's ultimate mission. A flowchart may focus on activities within a single facility, within the entire nonprofit, or within a wider economic setting that encompasses the nonprofit, the sources from which it draws physical and financial resources, and the clients and communities it benefits.

Flowcharts often reveal bottlenecks, or points in its process through which all or most of its resources routinely or procedurally must flow, such as the nonprofit's headquarters, a machine in some physical production process, a funding agency, or a transportation link. Bottlenecks call for special risk management attention to protect the flows of value they carry: equipment or other property that supports the flow must be kept safe or quickly repaired; the people (including board and committee members) working at these bottlenecks must remain productive; and no legal impediments or political protestors can be allowed to block bottlenecks. Flowcharts are essential to finding and protecting these bottlenecks.

Personal Inspections

All the preceding risk-appraisal tools could be used by someone who simply sits behind a desk. A perceptive person familiar with risk management and any particular nonprofit's activities probably could visualize most of its property and other loss exposures—but certainly not all of them. To make it more likely that most of a nonprofit's exposures will come to light and receive needed attention, this perceptive, risk-oriented person—or carefully selected group—must step from behind the desk to visit and inspect all key facilities in and beyond each of a nonprofit's own facilities.

During each visit, an inspector should speak firsthand with a wide range of the nonprofit's personnel to find out what they perceive to be the greatest accident potentials in their own daily work for the organization.

They know better than anyone if there is trash that may catch fire sitting behind the boiler that heats their building, where a creaking stair is likely to collapse, where an air conditioning exhaust vent is clogged, or where the hurried executive director sometimes parks his car behind the building, out of the path of traffic but right in the middle of the major emergency evacuation route for most of the building's occupants. One has to have been there in person to know about and correct hazards that no chart is ever likely to show. To benefit fully from these visits, the inspecting visitor must put his or her hosts at ease and bring everyone to realize that no one is witch-hunting for past risk management errors; instead, everyone should be working together to safeguard the organization's future.

Internal and External Expertise

A risk management generalist is well qualified to conduct an overall inspection visit to all the facilities of a nonprofit and of the organizations on which it relies. Similarly, most members of a nonprofit's staff who have long experience in particular aspects of operations naturally have become rather expert in the hazards of their work. To learn if a nonprofit's fleet of vehicles is safe, an inspector should ask the drivers or the maintenance crew. This is a fine source of internal expertise about this particular accident threat. To obtain more general, comprehensive, and perhaps more objective guidance on fleet safety concerns, a risk management specialist could consult such external experts as the major trucking or busing associations, even the American Automobile Association or the federal Department of Transportation or the state counterparts where your vehicles operate regularly. To discover how a dishonest staff member could embezzle funds, one could ask a trusted bookkeeper, treasurer, auditor, or tax-form preparer. Externally, fine expertise on detecting and stopping embezzlement is available from any of the general or industry-specific associations of accountants and auditors. An Internet browser or the local public library can lead to additional specific sources of preventative external expertise.

Today, almost any threat of accidental loss is very much like what the National Health Council has been saying in its advertising for nonprofits whose missions focus on health. To paraphrase: "Whatever health or disability problem you may have, whatever your personal situation, there are others out there who have the same problem and can help you overcome it. Find these people, and let them help." For risk management, change *health* to *risk*, change *disability* to *loss*—and then follow the National Health Council's advice. The Council seeks a healthier, happier world. Good risk management seeks a more certain, safer world.

Scenario (What-If) Analysis

Scenario analysis is a relatively new tool for appraising the threat of accidental loss that has developed as the executives and general staffs of more organizations have become more accustomed to thinking constructively about risk. Traditional, more fearful thinking about accidents started—and stopped—with the question, "How can we keep some bad thing from happening?" Scenario analysis recognizes that accident prevention and loss reduction are good things, but it asks a further, more positive question: "What if, despite our best safety efforts, some bad thing still does happen, how might it hurt us, and what would we do about it?"

This is disaster preparedness, applied at the specific-nonprofit or specific-peril level and practiced by the nonprofit's own staff, perhaps with advice from an insurance or safety professional. It reflects the catchphrase *worst-case scenario*. Real scenario analysis of potential accidents does include the worst case, but it also prepares for some not-so-horrific possibilities.

Really effective scenario analysis starts with a question that pairs each peril that confronts the nonprofit and each resource used in normal operations. It uses a fairly immediate imaginary time horizon: next Tuesday, over the weekend, within the next 30 seconds, or next Thanksgiving. Some scenario-analysis starters might be:

- What if a major earthquake hits our headquarters building next Tuesday morning at 10:00?
- What if armed robbers come through our front door within the next 30 seconds?
- What if our treasurer absconds to Brazil over the weekend with most of the organization's bank balances?
- What if our board chairman dies in his sleep tonight?
- What if the foundation whose unrestricted year-end grants have been covering 60 percent of our general administrative expenses for the last

decade sends us a letter next Thanksgiving saying that, as of the following January 1, our grant is terminated?

Those familiar with their own nonprofit's operations can think of 10 better, more realistic what-if scenarios for their own organization in the next 5 minutes—or of 20 more scenarios while sharing a pot of coffee with colleagues. Some can be humorous or seemingly impossible, but in risk management, nothing is impossible.

From these initial questions, scenario analysis spreads to consider a truly infinite range of possibilities—first negatively, and then positively. First (negatively), "How could this event hurt us? What could happen to our services to clients? our fundraising? What losses could result to our property, our people, our reputation? Would we face any civil or criminal liabilities?" Second (positively), "How could we respond—what should we be ready to do—in the first five minutes/before sundown/before the week is over/before the month or year is over—to recover from the adverse effects of this event and get back on track toward our mission?" The answers to these questions—specific answers to specific challenges posed by specific accidents—encompass all of risk management. But all of risk management begins with realistic, creative, insightful appraisal of an organization's risks.

Chapter 4

Income Risks

The flow of money through a nonprofit is the lifeblood that enables it to pursue its mission. Money flows into a nonprofit from its sales of goods and services, some to the clients who are the focus of its mission; from foundation, corporate, and governmental grants; and from a variety of other sources. Money flows out as payments for goods and services to benefit clients; as wages and salaries to employees and fees to contractors; as rent or mortgage payments for the buildings it occupies; and to purchase equipment, supplies, and materials it needs to sustain normal activities and occasional special events. Ideally, these inflows and outflows of money propel the organization toward its mission.

In the less than ideal reality that nonprofits confront, accidents, unwise business judgments, or adverse economic conditions may disrupt the flow of funds though a nonprofit. These disruptions reduce an organization's net income by either reducing its revenues or raising its expenses. A nonprofit's revenues can be reduced by fire that shuts down one of its revenue-generating facilities, by a board decision to undertake a new project that attracts few clients and even fewer funders, or by a major stock market downturn or recession that cuts deeply into expected contributions from individuals, businesses, and foundations.

A nonprofit's expenses will almost certainly rise if, after the fire mentioned above, the nonprofit must pay premium rent to hurriedly secure new substitute facilities. The same would happen if it greatly increases its publicity expenditures in hopes of alerting new clients and funders to the board's new project or if the recession forces the nonprofit to hire more paid employees to replace key volunteers who resign to become second breadwinners in their now financially strapped households.

Definition of Income Loss

In an accounting period (such as a month, calendar quarter, or year) when a nonprofit's revenues are greater than its expenses, its surplus increases by the excess of the money earned over the money spent in that period. Conversely, in an accounting period when a nonprofit's revenues are less than its expenses, its surplus decreases by the excess of the money spent over the money earned in that period.

To illustrate, suppose that a nonprofit had a surplus of $20 million at the end of the year 2000 that was accumulated over the seven years since the organization's founding early in 1994. If this nonprofit received in 2001 $17 million in revenues from all sources but had $14 million in expenses during the year, it would have added $3 million to its surplus, thereby bringing its accumulated surplus to $23 million as of the end of 2001. In 2002, however—for a variety of reasons examined in this chapter—this nonprofit had only $12 million in revenues but $19 million in expenses. Thus, in 2002 this nonprofit's accumulated surplus shrunk by $7 million: from $23 million at the end of 2001 to $16 million by the end of 2002. The $7 million reduction in accumulated surplus is the income loss for the year.

More generally, *a nonprofit's income loss for a given period is the excess of its expenses over its revenues from all sources during that period*. The income loss may result from accidents, poor business decisions, adverse changes in economic conditions, or the intentional use of a portion of the surplus to achieve an important goal. This chapter focuses on income losses caused by accidents, acknowledging but not dealing in detail with income losses caused by unwise business decisions, general economic reversals, or intentional actions by the nonprofit's leadership. Nevertheless, this chapter, like the book as a whole, takes a broad view of the accidents that may inflict income losses on a nonprofit: An accident is any event that may result in a property, liability, people, or reputation loss.

Values Exposed to Loss

Like any organization, a nonprofit seeking to protect its income must maintain its revenues and control its expenses despite accidental losses. Without proper management of these exposures, accidents that strike a nonprofit's property, people, or reputation, as well as accidents that give rise to liability claims against the nonprofit, will lower its revenue or increase its expenses, thus endangering its net income. Thus, the key values to protect are, first, an ample income stream and, second, controlled expense outflows.

Decreases in Revenues

The first goal is to protect revenues from being reduced because of accidents. Whether an accident affects property, liability, people, or reputation, it can threaten any or all of a nonprofit's sources of revenue. For most nonprofit organizations, these revenue sources are some combination of (1) the sale and delivery of goods and services; (2) contributions from a variety of public and private funders, including individuals, corporations, and foundations; and (3) earnings on endowments and other investments. Each of these sources of revenue is vulnerable to somewhat different kinds of accidental losses.

SALES OF GOODS AND SERVICES

Many nonprofits generate revenue by selling goods and services to their clients or to the general public, just like profit-seeking organizations. They may sell products such as furniture and clothing to low-income members of a community or sell conference registrations, publications, or other informative materials to their clients and to the general public. They may provide medical, educational, recreational, or other services to their clients for fees based on the type or level of service provided or for a time-based membership fee. In this phase of their operations, nonprofits are like any other business: They purchase materials and labor for a cost, apply hired or volunteer labor to perform some activity on these materials to produce the goods and services, and try to sell these goods or services for more revenue than the cost of the materials and labor that went into them. Any excess of revenue over costs adds to the nonprofit's surplus, just as the excess would add to profits in a for-profit organization. Any shortfall reduces the surplus.

Any number of possible accidental events may cause revenues to fall so that they no longer cover the nonprofit's expenses. Operations may be shut down by a fire, windstorm, flood, labor dispute, or police department action. A major accident on the premises of one of the nonprofit's suppliers of crucial materials may force the nonprofit to cease or greatly curtail operations until the supplies can be restored. Temporary shutdown or permanent closing of a major customer for a nonprofit's goods or services can also slash its revenues until a replacement customer or several new customers can be found. Even the closing of a key transportation link—a bridge, a rail line, an airport, or a canal—between a nonprofit and either its major suppliers or its crucial customers can interrupt revenues. It matters little what natural, human, or economic peril strikes a nonprofit's own facilities or those of an important supplier, customer, or transportation link: The effect on a nonprofit's revenues can be equally devastating.

General market price changes also can dramatically lower a nonprofit's revenues from sales of its goods or services. For example, if the price people are willing or able to pay for a nonprofit's output drops, perhaps because the public no longer wants what the nonprofit has to sell or because the public now has a less expensive source for what the nonprofit has been providing, demand for the nonprofit's output—and revenues from sales—will fall. Even some unfortunate event that damages the nonprofit's reputation without causing any physical disruption whatever, can knock the bottom out of the public's demand for—even tolerance of—anything even remotely associated with that nonprofit. Conversely, if the nonprofit's cost of providing these goods or services rises, perhaps because the rent for the space it occupies rises suddenly, the nonprofit's *net* revenue (income minus expenses) also will drop. Events that bring about general changes in market prices can be very diverse, including changes in the tastes of the public, the development of new technologies, a fire or flood that cuts off a vital source of supply, wars, changes in excise taxes, and new regulations on exports or imports. Such events can have unexpected, "accidental" effects on any nonprofit's ultimate income from sales of its goods or services. Changes in market prices also can change a nonprofit's streams of income from contributions and from investments.

CONTRIBUTIONS

A contribution is something of value, such as money, property, or personal labor and other efforts, given freely by a donor without receiving anything in exchange from the recipient, or donee. A nonprofit may receive significant contributions from a variety of public and private sources. Its volunteers contribute their personal energy and ability; the general public contributes to periodic fund drives; and major individual donors make special contributions of money and of real or personal tangible or intangible property, either while living or as bequests in their wills. Foundations, both individual and corporate, are regular contributors of grants to many nonprofits, and many agencies at all levels of government also make grants to support the work of nonprofits. Although many contributions are made without specific requirements that the nonprofit provide something in return, others are made as restricted gifts, which must be returned to the funder if the nonprofit fails to deliver the services indicated in its funding proposal.

These contributions are subject to many types of accidental losses, some occurring within the nonprofit's operations, others occurring at the contributor. Contributions once received by a nonprofit are exposed to all the perils that threaten property the nonprofit has always held. For example, money that has been contributed may be stolen by burglars, as may be tangible items of personal property. Property may be embezzled by the nonprofit's own employees or volunteers. A donated automobile, tractor, computer, or other equipment is subject to all the perils that could destroy purchased property, just as donated food intended for the needy can spoil as readily as food the nonprofit has purchased before it reaches the intended recipients.

Another major contribution on which many nonprofits rely is the donated energy and talents of volunteers. Although much more is said about volunteers in Chapter 6, it should be noted here that volunteers' labor contributed to a nonprofit greatly reduces its payroll costs and thereby increases income. Whenever an accident—injury, disease, or even a managerial oversight that offends volunteers and causes groups of them to resign—deprives a nonprofit of a volunteer, the loss of that volunteer lowers the nonprofit's net income. This can happen by either increasing payroll costs or depriving the nonprofit of the revenue that the volunteer work would have generated.

Accidents affecting contributors also can deprive a nonprofit of their contributions. For example, a man who has regularly given money to a nonprofit may no longer be able to do so if he dies, becomes disabled, loses his job, retires, moves to another state, or has some other financial reversal. A merchant or other organization that has donated its products, facilities, employees' efforts, or money to a nonprofit's work—either as direct charitable contributions or as resources for a joint venture with the nonprofit—may no longer be able or willing to participate if it is crippled by a devastating fire or flood, the death or retirement of a key executive, a lawsuit that strikes at the heart of its operations, or some serious economic downturn. When a particular merchant, organization, or group becomes so important to a nonprofit that it is effectively the nonprofit's partner, an accident to that partner also strikes the nonprofit, as well as its income stream.

Bequests are transfers of property under the terms of the last will and testament of a deceased person or legal transfers of property of a person who dies intestate, or without a valid will. The property a nonprofit receives through a bequest may be any kind of property: tangible or intangible, and if tangible, real or personal. The bequeathed property may be money or financial assets, such as stocks or bonds that generate income or can be sold for cash. The property a nonprofit receives from a deceased person may impose expenses, such as maintenance costs on a house or other building, that reduce a nonprofit's income. In any case, a contribution received as a bequest is likely to affect a nonprofit's income either positively or negatively.

Property that a nonprofit receives as a bequest is subject to all the natural, human, and economic perils that can damage any other property. Furthermore, the legal process of acquiring property as a bequest can create two types of risks of which managers should be aware. First, the will or the laws of intestacy under which the deceased person's property would pass to the nonprofit as an heir may be challenged by others who believe they rightfully should inherit the property. The legal expenses of defeating these competing claims to the deceased's property may be greater than the value of the property to the nonprofit, if it can be acquired at all.

Another risk of bequests is that the property may bring with it potential liabilities or other obligations or expenses that are so great that they "poison" the bequest, such as bequested land that is polluted or on which heavy property taxes have gone unpaid for several years. As with all contributions, a nonprofit should not automatically accept all contributions offered it, regardless of their nature or their source. Instead, each nonprofit should apply a due-diligence procedure to make sure that every contribution it is offered is something it really wants. Each nonprofit, like every other organization or person, has the right to refuse any contribution that it does not want for any reason. For example, sound due diligence would suggest refusing any bequest or other contribution that would be likely to:

- Impose too great costs on the nonprofit
- Be contrary to its mission
- Threaten the nonprofit's reputation
- Impose undue restrictions on its activities
- Offer a greater benefit to the donor (e.g., a tax benefit or an apparent endorsement by the nonprofit) than to the nonprofit
- Represent an inconvenience or distract the organization from its mission

A nonprofit should apply these and other due-diligence standards appropriate to its operations and experience before accepting any bequest or other contributions. Having once accepted a poisoned or otherwise harmful contribution, a nonprofit may have great difficulty getting rid of it or of the resulting stain on its reputation.

A final major source of contributions for some nonprofits is money received as grants from businesses, foundations, or governmental bodies. Grants may be unrestricted, with no further action required on the part of the nonprofit to qualify for the money, or restricted, meaning that the recipient must comply with various grant conditions. Grant restrictions are typically based on use or time. Money not used according to the specific purposes outlined in the grant agreement or not spent by the dates the grant requires may well have to be returned to the grantor.

As with contributions, income from grants is vulnerable to accidental and otherwise unexpected events that may affect the grant recipient (the grantee) or the organization that has granted it (the grantor). Any major accident or adverse publicity that affects the grantee's operations may prevent the grantee from fulfilling the terms of a restricted grant or from qualifying for renewal of even an unrestricted grant that might have helped fund its future general operations.

Accidents or other unexpected events within a grantor's operations also can endanger a grantee's income. It is unlikely that an accident that strikes a grantor will prevent a given grant from going to a grantee: A grantor's procedures for reviewing grant proposals and disbursing grant monies usually are not dependent on any particular physical facility or source of funds that an accident might strike, unless the grantor's headquarters are totally destroyed. At most, any single accident is more likely to delay rather than cancel a grant. However, a business or foundation that experiences a series of significant accidental losses may reassess its charitable and public service objectives for its remaining resources, thus leading it to reduce its future grant commitments. In the same vein, a private or governmental grantor may shift its grant-giving priorities because of a change in its leadership, in the political climate, or in other factors. When such a shift occurs, a grantee nonprofit may well find itself cut off from the regular stream of annually renewed grants on which it has come to depend. Even though no identifiable accident has occurred, the financial result is likely to seem like an accident to a former nonprofit grantee.

INVESTMENT EARNINGS

Some nonprofits receive money, securities, or other property whose value exceeds their immediate expense needs. This money or other property may come from virtually any source: major contributions, bequests from deceased supporters, or unanticipated windfalls, such as gold or oil found under real estate the organization owns or a gift of once almost worthless common stock in a corporation that suddenly became hugely profitable. These nonprofits can use this currently unneeded money or other property—frequently put into a reserve account or endowment fund, separate from a nonprofit's daily operating accounts—as resources that can produce investment earnings. To let these resources lie relatively idle, neither being used for routine operations nor generating investment earnings, would be to lose sight of any nonprofit's core mission: increasing the money and other resources it can devote to the needs of those whom it serves. Indeed, for foundations and other community-serving nonprofits whose principal activity is to gather funds and disburse them to other nonprofit organizations, regular investment earnings over the years often are the main sources of the new funds they can disperse in annual grants. Their mission requires that their funds be actively invested. For other nonprofits, investment earnings can add significantly to their mission fulfillment.

Conversely, losses to funds held as investments in a nonprofit's reserves or endowment can jeopardize its ability to achieve its mission. That is why these funds traditionally have been invested in conservative interest-bearing accounts, bonds, or low-risk equity instruments. Such investments face little market risk from disruptions of capital markets. However, when interest and dividend rates on relatively safe financial investment decline—as has happened in recent years—some nonprofit managers are tempted to seek potentially more rewarding, but more risky, opportunities to invest their currently unneeded funds. This investment strategy exposes both the anticipated earnings and the invested capital itself to devastating market losses. The risks of market loss are, however, risks that many nonprofits' executives willingly take in hopes of gaining greater dividend or interest income, as well as potential capital gains, than their organizations could expect to earn on bank deposits or other guaranteed investments.

Beyond market risks, any nonprofit's reserve and endowment funds are exposed to the same perils as are any other financial assets a nonprofit holds. Theft, especially through embezzlement by a nonprofit's own personnel, is the greatest single threat—although the certificates, account records, and other documentation of the investments may be destroyed by any natural or human peril. With one exception, however, destruction of the documentation does not destroy the value of these financial investments because a stockbroker, financial advisor, bank, issuing corporation, or other entity is almost certain to have detailed records of the investments. With some time and relatively minor expense, the destroyed documentation can almost always be replaced, so that the only real loss is the replacement expense. The investments and the income they generate are not dependent on the certificates or other documentation of ownership. The only exception is cash that is not kept in a fireproof safe; if destroyed or taken, this cash is almost always irretrievably lost, unless insurance applies and the amount of cash lost can be conclusively proven. For this reason, it is wise to severely limit the amount of petty cash on hand that is not held in an approved safe.

Increases in Expenses

A nonprofit's income for any given period is its revenue minus its expenses for that period. Therefore, its income will fall if either (1) its revenue decreases because of any of the reasons described in the preceding paragraphs or (2) its expenses increase for any reason, as explained in the following paragraphs.

A nonprofit's expenses may increase unexpectedly for many reasons that are almost too numerous and diverse to categorize. Some increases may relate to events that occur far away from the nonprofit, as when a supplier raises the price of a key component of a product or service the nonprofit sells, or when a nonprofit whose employees belong to a labor union must pay them higher wages under a new, nationally negotiated contract. Some other events that raise a nonprofit's expenses may happen right on its premises, as when a fire at a community recreational center forces it to rent temporary substitute space and equipment in order to continue serving the community while its permanent home is being restored. Or, suppose a nonprofit's executive director suddenly resigns and the board finds it must offer a much more costly salary and benefits package to attract a qualified successor. Other developments may unexpectedly raise a nonprofit's costs of using the channels that connect it with the various constituencies on which it depends. Telephone, postal, and freight rates may rise. A road, bridge, or tunnel on the main route to a nonprofit's facility may wash out or collapse, forcing the nonprofit to incur extra expenses to arrange for alternative transportation to provide uninterrupted service to its clients. A labor union action or police barricades for riot control may block access to a nonprofit's facilities, again requiring extra outlays to maintain uninterrupted operations.

To bring some logic to the virtually uncountable events that may raise a nonprofit's costs and thus lower its income is to classify them as events that happen (1) on a nonprofit's own premises, (2) on the premises of a key customer or supplier, (3) along a transportation or communication route to or from a nonprofit, or (4) throughout the economy generally. In general, human or natural perils bring about the accidents that lead to net income losses in the first three of these venues; economic perils threaten a nonprofit's net income in the fourth. Therefore, a logically sound way to analyze the causes and prevention of net income losses is in terms of the types of accidental losses that also produce net income losses—property, liability, people, and reputation losses—and then consider whether these other losses occur at or away from a nonprofit's facilities.

Events Causing Losses of Income

A nonprofit's net income flows from the coordinated, productive uses of its other resources—its property, people, and reputation—in ways that serve its mission without imposing liability on it. Therefore, accidents that strike or interfere with the productive uses of a nonprofit's property, people, or reputation or that bring liability claims against it typically cause a nonprofit to lose net income by lowering its revenues or increasing its expenses.

Property Losses

Nonprofits use many kinds of property to generate income in their normal operations. This property may be real or personal, tangible or intangible, owned or otherwise acquired. Physical damage or other impairment of property (such as the nonrenewal of a nonprofit's lease or successful legal challenge to one of its patents or copyrights) used in a nonprofit's regular income-generating activities can disrupt or stop those activities, thus reducing the nonprofit's net income. The kinds of property whose damage or other impairment can threaten a nonprofit's net income can be classified as (1) tangible property controlled by a nonprofit, (2) tangible property controlled by key suppliers or clients, (3) magnet locations that draw clients, (4) property of public utilities and transportation facilities serving the group, and (5) intangible property controlled by the organization.

TANGIBLE PROPERTY CONTROLLED BY THE NONPROFIT

When someone speaks about "this nonprofit's property," they usually mean the tangible property that the organization uses in its daily operations and that it owns, leases, or otherwise controls. They think of the buildings it occupies; the inventories of goods for sale, of office supplies, or of foodstuffs to feed its clients and staff; the exercise equipment or automobiles it may rent; perhaps the employees' automobiles it occasionally asks them to use to run errands for the nonprofit; and maybe even the portrait of the founder that hangs in the main entrance that is actually on long-term loan from the founder's granddaughter. All this property presumably supports some mission-directed and ultimately income-generating activity of the nonprofit. For example, food for the staff cuts down on the time they need for lunch so that they have more time to devote to clients. The founder's portrait is one of the executive director's favorite talking points when he tours the nonprofit's facilities with potential major financial supporters and asks them to help continue the nonprofit's long, unbroken tradition of public service begun by the founder. Destruction of, damage to, or theft of any of this property is likely to reduce the organization's net income. The reduction results from lowering revenues or raising expenses as the nonprofit works to replace or repair the property, making new leasing or borrowing arrangements for it, or, if necessary, struggling on without any of it.

Insurance or other sources of funding—perhaps special contributions, foundation grants, or money won in a lawsuit against some wrongdoer—may cushion part of the financial blow, both from the property loss and the resulting reduction in net income. But there will almost always be some elements of net income loss that go uncompensated, including:

- Reduced revenues to the nonprofit because some regular customers, clients, or contributors mistakenly conclude from media reports that the property damage has driven the nonprofit out of business.
- Revenues reduced because the organization's senior executives were too busy dealing with post-accident insurance and legal matters that they were distracted from their normal fundraising, legislative, and public relations activities.
- Increases in expenses because the cost of renting such essential items as equipment, vehicles, and recreational facilities and even office space probably will have increased since the property was acquired, especially for lessees that must rent quickly in order to continue operations.
- Expenses increased still further to counter potential long-term consequences of the accident, such as larger public relations expenditures in the wake of a major property loss that has shaken public confidence in the nonprofit's future or extra expense on safety measures to reassure clients and staff that it is safe to come to the nonprofit's facilities.

KEY SUPPLIERS' OR CLIENTS' PROPERTY

Just as major damage to a nonprofit's own facilities can suddenly disrupt the income stream, so can comparable damage to the property of a major supplier or customer. If an essential supplier is shut down by a severe accident for a time, perhaps permanently, a nonprofit may be forced to close or curtail any operations that depend on that supplier. Without a major customer that an accident has struck, the nonprofit has no market for, or revenue from, the goods or services it sold to that customer. Suppliers and customers are known as *contributing properties* because their ongoing relationships with the nonprofit contribute substantially to its income stream. When an accident halts or lessens the activities of a contributing property, the nonprofit must either (1) absorb its resulting loss of net income until the damaged contributing property resumes normal operations or (2) find a new temporary or permanent replacement supplier or customer. The replacement may have less favorable terms than the former supplier or customer if it realizes that the nonprofit seeking new business relationships is not in a strong bargaining position.

A MAGNET LOCATION FOR THE NONPROFIT

To become known in the communities they serve and to be convenient to clients, some nonprofits locate their principal offices and facilities in *magnet locations*, which naturally attract the general public or the segments of the public most likely to have an interest in a particular nonprofit's mission. For example, a nonprofit whose mission centers on a widespread health concern might locate near a large shopping mall or hospital, just as an animal rights group might have an office along the main highway leading to a municipal zoo and perhaps even rent kiosk space on the zoo's grounds. These specially selected magnet locations bring the nonprofit "business" by exposing it to likely clients, volunteers, and contributors.

At the same time, these locations also make the nonprofit dependent to some degree on the magnet that helps build their contacts with their chosen constituencies. If the magnet moves, is closed down by some accident, or simply loses business, its value in attracting the public to the nonprofit's door can decline sharply, perhaps leaving the nonprofit locked into a location that it otherwise never would have chosen. For example, if some of the zoo's major buildings burn, if the zoo is closed down by municipal authorities because some of its animals have contracted diseases transferable to humans, or if a very cold winter greatly decreases zoo attendance, the animal rights nonprofit with facilities located in or near the zoo is likely to experience a major revenue shortfall.

PROPERTY OF PUBLIC UTILITIES AND TRANSPORTATION FACILITIES

To maintain its income flow, a nonprofit must stay linked to its various constituencies. Any property damage that breaks these links threatens a nonprofit's net income. Such damage is likely to occur away from the nonprofit's property. The downing of power and telephone lines or transformers leading to the nonprofit, the collapse of a bridge on the major highway leading to the nonprofit's principal facility, a fire in an adjoining building that forces the police to close off the city block on which a nonprofit is headquartered—any of these kinds of property damage can keep clients and staff from reaching their workplaces. They could also interrupt a nonprofit's services to its clients and disrupt the nonprofit's fundraising activities. Some of these stoppages are quickly remedied; utilities usually are most prompt in restoring services, but an earthquake or flood might stop water or natural gas service for weeks. Other stoppages, such as from a bridge or building collapse, may extend for several months. If so, the affected nonprofit is likely to suffer severe net income losses unless it incurs additional expenses to find other ways of bringing people and supplies to its now isolated facilities or to locate and move to other temporary replacement facilities, for which it may well need to pay a premium rental. In any case, an extended interruption—all resulting from damage to property away from a nonprofit's ordinary facilities—will almost certainly lower its net income.

THE NONPROFIT'S INTANGIBLE PROPERTY

A nonprofit is likely to have several kinds of intangible property, such as a lease for office or other space it occupies, copyrights on its publications or advertisements, perhaps a patent on some device it sells or uses to serve clients, and one or more licenses to engage in public fundraising or to hold special events such as parades or fairs. These and other forms of intangible property are, in effect, exclusive rights to use tangible property (such as leased space or patented devices) or to conduct special activities (like raising funds or conducting a parade) under conditions that the owners of this property or the government generally finds appropriate.

Thus, intangible property has no physical existence; it is merely a legal right to use or do something that others cannot lawfully do. Intangible property usually is evidenced by some written document: a lease from a landlord, a patent or copyright issued by the federal government, or a license written by the appropriate local or state government. This documentation, however, is not the intangible property itself—not the legal rights expressed in these documents—although loss of the documentation for an intangible property right may complicate the exercise of that right.

Intangible property contributes greatly to the revenue of many nonprofits. Without the office space it leases, many nonprofits could not serve clients. Without leased classroom or recreational space, many nonprofits could not serve the youth of their communities. Without a license to solicit funds publicly, several well-known national nonprofits could not appeal for public financial support. Losing an intangible property right is likely to greatly increase a nonprofit's expenses if, for example, it must hurriedly find new office or teaching space because its lease has expired or find an alternative for the public fundraising event it had planned because it has violated the conditions of the license that authorizes this event. Expenses can also result from a legal battle to protect the copyright or patent rights that others are attempting to invade or that the nonprofit has carelessly allowed to expire. Thus, a nonprofit must guard its intangible property rights in order to preserve the net income that this special kind of property allows it to generate.

People Losses

When sickness, disability, resignation, termination, or retirement deprive a nonprofit of employees or volunteers who are accustomed to working efficiently within the nonprofit's structure, their absence is likely to both reduce the nonprofit's revenues and increase its expenses until suitable replacements can be found, hired, and placed in their new positions. For example, if a disabled or terminated employee or volunteer is not replaced, the members of the nonprofit's remaining staff must work harder, often less effectively, to make up for their missing colleagues. If, on the other hand, a disabled or terminated staff member is replaced by a new person, some time and money will be lost bringing the new person up to speed. As explained in Chapter 6, these revenue reductions and added expenses are the normal components of people losses.

Beyond these normal people losses, however, additional net income losses are likely to result if the absent staff member had special talents or other characteristics that no typical replacement can be expected to possess.

To illustrate, a particular employee or volunteer may be especially effective in fundraising, inspiring colleagues, or working with difficult clients. Without this individual, the nonprofit for which he or she works will almost certainly suffer

- reduced contributions because others cannot duplicate the missing staff person's fundraising skills.
- increased expenses because the remaining staff members must spend more time working with the clients whom the missing staff person was able to work with so effectively.

These highly individualized adverse revenue and expense consequences, stemming from the special qualities of the absent staff person, exemplify net income losses that flow from people losses.

Reputation Losses

A nonprofit's reputation—its status in the eyes of its clients, staff, contributors, regulators, and the general public—is often said to be that organization's most valuable asset. It is the asset that empowers a nonprofit to perform all its normal activities in pursuing its central mission. With respect to inflowing revenues and outflowing expenses, any significant loss of reputation, regardless of the underlying circumstances, will almost certainly have adverse affects by reducing revenues or increasing expenses.

Reputation loss can reduce revenues in several ways:

- Once faithful individual and corporate contributors look for more appropriate organizations to support.
- Foundations begin to question whether a nonprofit with a besmirched public image deserves their support.
- Members of the public shy away from purchasing goods or services from a publicly suspect organization.
- Potential clients, while still needing the goods and services around which this nonprofit has focused its mission, seek other sources of help, thus reducing the organization's visibility and the public's generally positive attitude toward it.

Reputation loss can cause increases in expenses as:

- Volunteers look for other outlets for their community-serving energy, forcing the nonprofit to hire workers it previously got for free.
- The nonprofit, seeking to restore its reputation, feels compelled to devote more of its resources to a positive public relations effort.

The reputation of any individual has been called a "pearl beyond price," implying that no amount of money can restore a reputation once it has been lost. So it is with a nonprofit: A good reputation is the ultimate source of a nonprofit's net income flow. A loss of that reputation halts the flow.

Liability Losses

As is explained in Chapter 5, a nonprofit found legally liable for harming individuals or organizations incurs civil liability. A nonprofit found to have violated the law faces criminal sanctions. Civil or criminal liability is likely to have several adverse consequences for a wrongdoing nonprofit:

- Payments of money in the form of civil damages to compensate for harm to others, criminal fines, or expenditures to cover legal and attorney fees, only some of which will be covered by any insurance
- Diversion of executives' time and energy away from their normal productive activities to emergency efforts in cooperating with defense attorneys to minimize the nonprofit's ultimate liability
- The consequences of mandated changes in the nonprofit's operations, such as when it must cease activities that a court has found to be harmful to others
- Termination or imprisonment of employees—possibly high-profile executives—found to be personally culpable for the nonprofit's wrongful activities

These consequences constitute legal liability losses to a nonprofit. Beyond these immediate consequences, the same wrongful acts may well have adverse implications for the nonprofit's future net income. One probable result is damage to the nonprofit's reputation, especially if the wrongdoing becomes notorious. This consequence belongs among the reputational losses mentioned above and is dealt with in detail in Chapter 7. In addition to reputation, however, the adverse effects listed above are likely to reduce a nonprofit's net income stream as:

- Money it pays out for civil damages, criminal fines, and related legal expenses is no longer available to be spent on the nonprofit's normal community-serving and revenue-generating activities.
- Required changes in the nonprofit's operations to avoid further liability to others lowers the nonprofit's operating efficiency, either in serving its clients or generating revenue.
- Imprisonment or termination of key executives—even though they are wrongdoers—deprives the organization of talented senior leadership.

In short, any organization found to have committed a major legal wrong cannot soon recover from the impact of its actions. While it recovers, its effectiveness in generating income will suffer.

Dimensions of Net Income Losses

As earlier chapters have explained, all accidental losses have three dimensions. The first is probability—the likelihood that a particular kind of accident producing a particular kind of loss will occur. Probability determines the frequency with which this type of loss will occur, on average, within a given time period. The second dimension of any loss is its severity, the physical extent or the dollar cost of the loss. The third dimension is the predictability of the loss, that is, the degree of certainty with which the frequency and the severity of an accidental loss can be accurately forecast. Predictability ranges between two extremes: no predictability and certainty. A loss that is unprecedented and for which there are no reliable indicators has no predictability. A loss that is certain to occur at a definite time and in a predetermined amount is not an accident at all, but a budgetable cost. A nonprofit's net income losses—either decreases in revenues or increases in expenses—have varying degrees of probability, severity, and predictability.

Probability

Many different events may cause a nonprofit to lose much of its net income, such as a fire on its own premises, storm damage to an important supplier or customer, the death of a key executive, or the collapse of a major highway leading to the nonprofit's headquarters. Therefore, it is not possible to estimate directly the likelihood that a given nonprofit will suffer a significant net income loss in the next month, year, or decade. Instead, it is necessary first to specify the types of events that may bring about a substantial net income loss and then estimate the probability of each type of event. From there, one may develop an overall estimate of the likelihood that a nonprofit will suffer one, two, or even more major net income losses within a coming time period.

Clearly, a given nonprofit may face a substantial likelihood of one or more significant net income losses if it is exposed to a wide variety of events, any one of which may result in a net income loss. Conversely, if only one or two kinds of events, such as a fire or flood, could inflict net income losses on a given nonprofit, the probability of either a fire or flood occurring within the next year or decade is easier to determine.

Because the world constantly changes, it is a serious mistake to think that the probabilities of the various events that may bring a net income loss to a nonprofit are constant. In fact, these probabilities change, becoming either greater or smaller as the conditions leading to these losses change. Thus, the mere fact that a nonprofit has suffered only one significant net income loss due to fire damage at its own premises does not mean that the probability of a fire-related net income loss in the coming year is 5 percent (1/20). The actual probability may be more or less than 5 percent, depending on, for example, whether the nature of the neighborhood has changed during the last two decades or whether unusual drought conditions are forecast for the coming year.

Magnitude

How serious the net income loss sustained by a nonprofit in the wake of an accidental loss on or away from its premises depends on three factors: (1) the time required to restore the normal operations and income levels after the accident occurs, (2) the extent of shutdown or interference the accident causes, and (3) the amount of the net income the nonprofit was generating at the time of the accident. Thus, the severity of the net income loss a nonprofit incurs in the wake of a particular accident will be relatively great if a long period of time is required to return to normal operations and income levels, if the accident forces a total shutdown rather than a partial one, and if the nonprofit was producing a substantial net income just when the accident occurred. Conversely, opposite conditions for each of these three variables is likely to cause only relatively minor net income loss.

Therefore, estimating the likely seriousness of any net income loss a nonprofit may incur in the coming year or decade requires making some assumptions about events leading to a loss. Some imagined scenarios will lead to serious losses, and others will generate only minor reductions in net income. Contemplating a variety of scenarios and the likely severity of the resulting net income losses is important because doing so not only leads the nonprofit's management to consider a variety of possible circumstances, but also leads to contingency plans that can reduce the severity of any net income losses that do arise. For example, when considering some potentially devastating net income loss scenarios, a nonprofit's leaders may recognize that some loss prevention measures should be considered. These could include arranging in advance with neighboring organizations for use of their facilities if the nonprofit's own facilities are seriously damaged or contracting with alternative suppliers in case the nonprofit's current principal supplier is shut down for any reason for an extended period.

Predictability

All the accidents with which risk management traditionally has dealt share one characteristic: They are, to one degree or another, unplanned and unpredictable. If these accidental events were fully predictable, the losses they inflict would in fact be normal business expenses, perhaps even expenses that could be totally avoided. For example, if a nonprofit's leaders knew that one of their facilities was going to be struck by a fire or a flood on a particular day, they could take appropriate preventive actions. They might evacuate the facility, ask the fire department to stand by on that day, or pile sand bags around the property to stave off flood waters. They could also shift their operations away from this doomed facility to other locations so the resulting net income loss would be minimal.

In fact, the world does not work this way. Accidents by nature cannot be predicted. However, to the extent that a nonprofit can ready itself for accidental events by being prepared for a variety of imaginable but not specifically forecast circumstances—that is, to the extent a nonprofit can make the unpredictable ordinary or routine—it can reduce any adverse effects on its net income. In the long term, such readiness can make the unexpected more tolerable and less destructive to a nonprofit's property, its operations, and the net income those operations are designed to produce.

Methods of Appraising Potential Net Income Losses

With respect to property losses, Chapter 3 described various methods of developing information on accidental losses. The following paragraphs apply the same methods to a nonprofit's potential net income losses, focusing on the information that each method can yield about possible decreases in revenues or increases in expenses for a given nonprofit. Please remember that none of these methods, alone or together, is foolproof or complete. They are designed to stimulate further thought by those who know the most about a particular nonprofit and who are therefore best equipped and most highly motivated to explore all the possible accidents that may block a nonprofit from achieving its mission.

Standardized Questionnaires

Standardized questionnaires ask a certain set of questions about every organization, whether it is a recreational facility, a civil rights advocacy organization, a daycare center for the elderly, or a nonprofit zoo. Therefore, none of the questions can be tailored to the particular exposures of any specific nonprofit. Those who use the questionnaire answer its queries in the context of their own organization.

Several areas of inquiry in a standardized questionnaire gather information about net income loss exposures. Every such questionnaire asks about the sources of an organization's income, the operations that produce that income, the major customers or other sources of revenue for the organization, its major categories of expenses, and the suppliers of service firms to which it pays these expenses. This information may or may not include specific dollar amounts. With or without these amounts, however, the answers to these inquiries give a general picture of the organization's activities and their relative importance. When related to information developed through some of the other methods of appraising net income loss exposures, the general picture developed by a standardized questionnaire gives a good background for more detailed analysis. For example, by identifying the specific activities in which a nonprofit engages and attaching what are known as Standard Industrial Code (SIC) to various parts of a nonprofit's operations, a standardized questionnaire provides the basis for comparing one nonprofit's activities with the activities of other organizations that have the same SIC codes.

Loss Histories

Even though specific accidents are individually unpredictable, accidents that have happened in the past will almost certainly eventually recur. If a long-established nonprofit has experienced fires, falls, or vehicle accidents in the past, it probably will experience more of them in the future, unless it improves its safety efforts or there is some other fundamental change in its activities. Even for a new nonprofit, with little accident history, the experiences of other nonprofits that are similar in the clients they serve, in their operations, or in their geographical locations indicate similar experiences that this new nonprofit is likely to repeat.

The circumstances of these past accidents, whether they occurred to a given nonprofit or to other organizations, can suggest similar circumstances that a nonprofit should strive to avoid or control so as not to be victimized by comparable accidents. For example, knowing the length of time required to resume normal operations and income levels in the wake of specific kinds of past accidents should help a nonprofit's present leaders estimate how long they can expect their operations to be shut down or impaired by similar accidents.

Financial Statements and Records

A nonprofit's financial statements and supporting records include its balance sheet, income statement, and its statement of sources and uses of funds, all backed by detailed accounting records over several accounting periods. These records attach numbers to the income-generating activities sketched by the standardized questionnaire and the loss histories. These financial statements should make clear which activities within a nonprofit produce the most revenue and which produce the least, as well as the expenses associated with each of these activities. From this information, a nonprofit's management can determine which of its activities it should strive to maintain at all costs or to resume as soon as possible after any accident that curtails its operations. The detailed records underlying this financial information also identify the relative importance of each of the nonprofit's suppliers, customers, or groups of clients and, therefore, the extent of the net income loss the nonprofit would suffer if a particular supplier, customer, or client group were no longer available because of some accident that befell it.

These financial statements also reveal the overall financial strength of the nonprofit: the composition of its assets (whether liquid or fixed), the structure of its liabilities (whether due immediately or payable over several years), the ratio of its assets to its liabilities (both current and long term), and the extent to which the nonprofit can convert its assets quickly and reliably into cash if needed for an emergency. In general, a nonprofit's ability to survive despite an accident that may temporarily interrupt or reduce its current net income increases as its assets become more liquid, as its liabilities become payable over longer periods, as its assets become greater relative to its liabilities, and as more of its assets can be converted into cash if needed.

Other Records and Documents

In addition to all this financial information, a nonprofit—or kindred organizations with which it is familiar—is likely to have other records that suggest other possible net income losses. Minutes of past board or committee meetings may record circumstances in which the nonprofit's activities were disrupted—or almost disrupted—by unexpected events. Maintenance or repair department records can suggest items of machinery, types of vehicles, or portions of the nonprofit's buildings that are particularly vulnerable to mishaps that, in the future, may halt or slow down some or all of its activities. Even such seemingly elementary records as lists of staff suggestions or client complaints may bring to a manager's alert mind circumstances that could lead to significant net income losses. Without being overly pessimistic, nonprofit leaders who are alert to risk management concerns habitually look for things that may someday go wrong and for which they as leaders should prepare the organization.

Flowcharts

The activities of virtually every nonprofit are characterized by routine flows of people, materials, or funds to, from, and through its facilities. In an adult daycare center, for example, clients arrive in the morning, gather throughout the facility for various activities throughout the day, and disperse at day's end. The center's staff does much the same. Various items of food, supplies needed for daily living, and cash receipts of payments also flow through the center. If these flows are interrupted, the activities of the center also break down and, during this interruption, the center is no longer fully effective in pursuing its mission. Consequently, its net income also slows or halts.

Comparable disruptions and income losses can occur because of accidents within any nonprofit. A flowchart that graphically depicts movements of people, objects, and money through an organization will highlight places at which accidents can have their most devastating effects on the organization's net income. Each organization's flowchart will be different, but each chart inevitably shows how and where a seemingly small accident can have serious net income implications. Critical areas may be at the points where people and materials flow into the nonprofit, a crucial location within its walls where all activities come together, or a bottleneck through which everyone and everything coming to and leaving the nonprofit must pass. Locating these crucial points within or beyond a nonprofit's premises highlights where special precautions should be considered in order to safeguard the nonprofit's operations and net income.

Personal Inspections

People who are accustomed to thinking about accidents can visualize them occurring almost anywhere. Therefore, those within a nonprofit's staff who are especially safety conscious can contribute greatly to its risk management efforts by simply walking through its facilities looking for potential hazards, that is, situations that make accidents more likely to occur and potentially more severe if they do occur. For example, someone trained in fire safety or even general accident prevention might recognize the net income loss potential of storing a nonprofit's promotional materials in a single warehouse that is particularly vulnerable to fire or flood damage. Without such a personal inspection, and without storing these materials in a safer location or dispersing them among several locations, this nonprofit's annual fundraising campaign could be a failure if all the material were destroyed three days before the campaign was to begin.

Internal and External Expertise

Regardless of whether they are trained in safety or other risk management concerns, no one knows an organization or any of its operations better than the people who, day in and day out, work within that organization performing those operations. These people naturally become internal experts on the risks inherent in their tasks and in their organizations. For example, no one knows better what can go wrong within a nonprofit paratransit bus operation for taking elderly and disabled people to doctors, social events, and their places of employment than do the bus drivers, schedulers, and mechanics who run the system. Therefore, often as an adjunct to personal inspections of the facilities of a paratransit operation or of any other nonprofit organization, it can be very instructive to ask the typical staff members of a nonprofit such questions as: "What could go wrong here?" "Is there anything about this job that frightens or worries you?" "Have you had any close calls recently?" or "What would make your work safer?" The answers to these questions are likely to suggest possible accidents that could cost a nonprofit much of its net income unless improvements can be made.

People outside a nonprofit whose work keeps them alert to potential accidental losses can be external experts on net income loss potentials. Management consultants, safety engineers, and insurance agents or brokers may have become knowledgeable about the accidents that may strike an orchestra or foundation through their experience with community orchestras or charitable family foundations. Their knowledge can become a valuable resource to the managers of other such organizations who know enough to call on this expertise.

CHAPTER 5

Liability Risks

When a nonprofit is legally responsible for harming one or more individuals, other organizations, or society itself, it suffers harm in the form of liability losses. The harm to the nonprofit may take one or more of eight forms:

1. Money the law requires the nonprofit to pay those it has wronged to repay them for their losses (compensatory damages)
2. Additional money the nonprofit must pay to those it has harmed to punish the nonprofit and to deter it from repeating such conduct (punitive damages)
3. Money the nonprofit may have to pay the government if the nonprofit's conduct violated laws or regulations (fines)
4. Court orders to cease practices that have been ruled to harm others (injunctions)
5. Court orders that a nonprofit return money or other property that it has wrongfully obtained from others (restitution)
6. Court orders that the nonprofit carry out the specific terms of a valid contract into which it has entered, even though the contract is not favorable to the nonprofit (specific performance)
7. Jailing (incarceration) of a nonprofit executive who directed the nonprofit to engage in activities that the executive knew were criminal acts
8. Expenses to defend the nonprofit against claims brought against it (defense expenses)

Legal sanctions and legal expenses interfere with a nonprofit's pursuit of its mission, even if it carries liability insurance, because these liability losses may do the following:

- Drain away funds (including dollars to pay higher liability insurance premiums) that it would otherwise devote to serving clients and to other mission-centered activities
- Distract the attention and personal energy that a nonprofit's leaders, legal counsel, and other staff normally devote to the nonprofit's mission
- Through court orders, bar a nonprofit from actions that would greatly serve its mission or, conversely, require a nonprofit to take actions that are contrary to its mission
- Deprive a nonprofit of the talents, insights, or expertise of any of its executives who are found individually liable for legal wrongs (especially crimes) committed while acting on behalf of the nonprofit
- Damage the nonprofit's reputation and, therefore, its ability to attract contributors, other funders, volunteer and paid staff, and perhaps even clients

Legal claims against nonprofits may be proper or completely unfounded. A nonprofit suffers a liability loss in both cases because it must bear the cost and distractions of investigating and defending every claim. If no claim is brought against a nonprofit, it incurs no liability loss, even though it may have been directly responsible for severe harm to many others. In short, every legal claim against a nonprofit generates a liability loss for that nonprofit, and that loss may be very large or very small.

Legally Protected Interest

The mere fact that a person or an organization suffers harm while somehow interacting with a nonprofit does not make that nonprofit legally liable for that harm. For example, the fact that an elderly client of a senior daycare center has a heart attack while having a heated political argument with another client during lunch at the center does not, in itself, make the center liable for the medical expenses or even the ensuing death of the argumentative client. As another example, the mere fact that the caterer who has contracted to prepare and serve all the meals that this center serves to its clients loses money because the caterer severely underestimates its costs does not make the senior daycare center legally liable for the caterer's financial losses. The center faces no potential liability in these cases because the potential claimants—the argumentative client and the caterer—had no legally protected right for the center to keep them safe from the harm each suffered. In fact, the argumentative client had a constitutional right to discuss political matters with another client—a right which the center was duty-bound to honor unless the center specifically knew that such vigorous discussion would endanger this client's health (or might seriously disturb other clients). Similarly, the caterer has a right to bargain freely for contracts that it believes are to its business advantage—including the right to bargain unwisely. In the absence of some fraud or other unfair dealing by the senior center or some breach of contract or criminal act by the center, the caterer has no legally protected interest growing out of its business losses here.

However, the caterer, along with the senior center and everyone who is a client or staff member there—indeed, every person and organization subject to the laws of our country—enjoys a wide range of legally protected interests. These interests, which are both a foundation of the United States legal system and a good point to begin cataloguing a nonprofit's potential liability losses, include the right to:

- Performance of contractual promises
- Personal safety
- Freedom of personal movement
- Protection of property
- Security of reputation
- Privacy
- Economic freedom
- Community safety from crime

The legally protected interests of any one person or organization are limited by the legal interests or rights of others. Any one person's or organization's exercise of these rights cannot be allowed to interfere unduly with another person's or organization's comparably important rights. For example, one person's right to drive a car (freedom of personal movement) does not extend to running over pedestrians (which would interfere greatly with their right to personal safety). Nor does anyone's right to freedom extend to driving the getaway car in a bank robbery (which interferes unacceptably with the general community's right to be safe from crime). Furthermore, once properly convicted of bank robbery, the getaway car driver may find his or her freedom of personal movement limited to the confines of a prison yard or the geographical boundaries set by his or her parole order. In short, for anyone to enjoy reasonable rights, everyone's rights must be realistically limited.

Performance of Contractual Promises

The right to expect all people to carry out their business promises is the basis for the entire law of contracts. A promise is a commitment, however expressed, that something will happen or that it will not happen. For example, a nonprofit children's daycare center may promise its clients that it will make every reasonable effort to provide a safe, educational environment for their children. The center may promise suppliers that it will pay them for their services as outlined in their respective contracts. The center may also promise a foundation funder that it will comply with the terms of a restricted grant awarded by the foundation.

A breach of contract is a failure to perform a promise expressed in a contract when the failing party has no legally valid justification for failing. To illustrate, note that the daycare center mentioned above promised its clients only that it would make every reasonable effort to provide their children a safe and educational environment. The center would have been unwise to promise clients that their children would be safe and become educated at the center. It can realistically promise only an effort and a process, not a result—as can most nonprofits that work to change others' lives. If it had promised a result, it would greatly increase the probability that disappointed parents would sue the center for breach of contract even though the center had done all it could for their children.

If some parents could show that the center had not made reasonable efforts to educate and protect their children, and that the children had been somehow harmed as a result, these parents might go to court to sue the center for breach of contract. If the court agreed with these parents, it would apply an appropriate legal remedy. As explained near the end of this chapter, a suitable remedy might be money damages paid to these parents, a court order of specific performance to improve the center's programs, or perhaps an injunction to close the center. The center's costs of doing these things, and of paying its lawyers to represent it throughout the legal process, would be the center's liability losses in this situation. So, if the center were ordered to close, its resulting liability loss would be all the future revenues it would have generated and, ultimately, the center's entire mission.

Personal Safety

Every human being has a protected legal interest in his or her physical safety—to be free from being struck, touched, given medical treatment, stalked, or physically threatened without his or her actual or implied permission. This interest does not exist for intangible entities such as corporations and other organizations. The extent to which animals held in animal shelters, special animal-training facilities, and zoos have similar legally protected interests in their own safety is an evolving "animal cruelty" issue, especially for nonprofits whose missions involve animals.

Like other legal interests, any individual's right to personal safety has its limits. For example, while it is normally a legal wrong (technically, a battery) to touch a person in a harmful or offensive way without his or her permission, a person committing a violent crime has implicitly waived this right. The police or any citizen may strike or use other reasonable force to halt the perpetrator. By participating in an organized boxing match, a boxer—even a rank amateur in his or her first match—agrees to be hit as boxers normally are, even by accident below the belt; but he or she still has a legally protected right to be protected from being stabbed in the ring by an opponent. Similarly, a spectator at a scheduled baseball or football game or practice is legally presumed to know that spectators at such events sometimes accidentally get hit by flying balls or careening players and to have "assumed the risk" of being struck. Thus, while sponsors of these and other sporting events have a duty to take reasonable care to protect all participants and spectators, these sponsors—whether nonprofit or profit-seeking—are not guarantors of everyone's total safety.

Incidentally, in these and virtually all other situations, the standard of care required of a nonprofit organization is almost always the same as that required of a profit-seeking organization. Contrary to what many of the general public may think, nonprofit status does not lessen the legal standards nonprofits must meet. In the past, charitable nonprofits were able to successfully raise their status as charities as a defense to negligence claims. Courts once gave charities broad immunities so that their funds could be preserved for broad, socially beneficial purposes rather than drained off to compensate specific individuals who happened to have been harmed in charities' essential services to needy groups. The courts also once reasoned that governments were immune from suits because governments, being sovereign, defined what was legal and, therefore, logically could not break the law.

The doctrine of charitable immunity has been eroded over the past several decades, but it still exists as a defense in a small number of jurisdictions. For example, the courts in New Jersey continue to accept charitable immunity as a defense to claims of simple negligence by a nonprofit. The courts in most states, however, have long abolished the defense of charitable immunity. At the same time, however, the tort reform movement has gained momentum, and some of the developments in this area include the adoption of tort damage caps that apply to charitable nonprofits.

Freedom of Movement

The legal interest that every person has in his or her right to move about is similar to each individual's interest in physical safety: Both interests apply only to people, not to intangible legal entities. For example, a person has a protected legal interest in being able to move about for business, recreational, or other purposes as long as one person's exercise of this right does not interfere with others' similar rights. This means, for example, that in traveling about one must obey traffic rules, and one must also carry proper documentation, such as passports, when crossing international borders. To not adhere to traffic rules interferes with others' right to travel; violating these rules also endangers others' safe travel. To enter another country without the required documentation exposes the residents of the country being entered to potentially dangerous terrorists. In both these cases, individual safety is the fundamental legal interest being safeguarded. Those who commit serious crimes also lose their freedom of movement when they are jailed, again losing their freedom of movement to preserve the safety of those whom they might otherwise victimize. Nonprofit organizations that advocate for the rights of prisoners face on a daily basis the challenge of balancing a specific individual's right to freedom of movement with society's often opposing right to be kept safe from the actions of truly dangerous people.

Protection of Property

Anyone or any organization rightfully owning or possessing any kind of property—real or personal, and if real, tangible or intangible—has the right to continue owning or possessing that property as long as exercise of this right does not interfere unduly with others' rights. Protecting the property that a nonprofit itself owns or uses is discussed in Chapter 3. The following paragraphs discuss the liability of losses a nonprofit may incur when it invades others' rights in their own properties. Three types of invasions are particularly important here: trespass, nuisance, and conversion. Trespass and nuisance interfere with others' rights in real property; conversion interferes with others' rights in personal property, both tangible and intangible.

A trespasser is a person who is on a premise without actual or constructive consent of the rightful possessor. The trespass can occur on the surface of the land, beneath it, or over it. The trespasser need not physically be on the land itself: A person is guilty of trespass by constructing a dam on his or her own land that backs up water on another's land. A person who dumps garbage on another's land is also a trespasser, even if the garbage is dumped in an area that the owners use for their own garbage. Similarly, a person can commit trespass by building a structure that is partly on another's land.

A careless nonprofit can commit each of these forms of trespass quite readily. In its fundraising activities, an overzealous nonprofit can place its posters on others' buildings or land without first obtaining the owners' or occupants' permission. In attempting to collect donations door to door or on a public street, the representatives of a nonprofit may cross into property marked with "No Trespassing" signs or may interfere with potential customers reaching merchants' stores. Likewise, a nonprofit disposing of any materials left over after a fundraising or other public event may commit trespass by leaving these waste materials somewhere other than at a public dump or on the nonprofit's own premises.

Nuisance is interference with the right of the owner or occupier of real property to undisturbed enjoyment of the premises. There is a fine line between trespass and nuisance. Trespass is the wrongful intrusion onto the real property of another. Nuisance invades the owner's enjoyment of the property without physically intruding. For example, a factory, a kennel, or a slaughterhouse in a residential area could constitute a nuisance without physically crossing the boundary of any residential property. However, because it is socially advantageous for such businesses to exist somewhere, they are not nuisances when conducted in areas specifically zoned for them.

A nonprofit also can create nuisances against neighboring properties by conducting activities that are out of character with neighbors' uses of their respective properties. For example, an animal rights nonprofit clearly must take care that sheltering abused animals on the nonprofit's land does not create levels of noise or pollution to which neighbors may rightfully object. Similarly, when conducting events that draw large crowds to its own premises or to some other public location, a nonprofit needs to avoid interfering with others' access to their own facilities.

Conversion occurs when one person, without permission, takes possession of the personal property of another for the converter's own benefit or destroys or alters this personal property. Conversion would occur, for example, if an automobile dealer, entrusted with a used car with instructions to sell it, took the car for a long vacation trip. As another illustration, the crime of theft is also the tort of conversion against the rightful owner of the stolen property.

A nonprofit can inadvertently commit conversion (effectively, "steal") others' personal property—both tangible and intangible. For example, when picking up property that a nonprofit believes has been donated to it—such as furniture left on someone's lawn or an automobile parked at the curb—the nonprofit's representatives must be careful not to confuse the intended donor's property with similar property that belongs to someone else. Likewise, if attempting to capitalize on the popularity of another organization's advertising slogans, trademarks, or jingles, a nonprofit must be sure that it either has the originating organization's permission to adapt this intangible property to the nonprofit's own use or that the adaptation is sufficiently different from the original that it does not constitute conversion.

Security of Reputation

The law protects the legal interest that all people and organizations have in their reputation, their right not to have their "good name" harmed by purposely false statements made in public that reflect badly on their competence, honesty, or moral character. Historically, the law classifies these knowingly malicious false statements into two categories: libel, which is a written statement, and slander, which is a spoken statement. Together, libel and slander are known as defamation. Physical gestures that are defamatory are slanderous, because these gestures resemble speech more than written material. Likewise, e-mailed communications to a specific person also are considered speech, because they are akin to conversation. However, defamatory statements placed on a web site for public access is considered libel, much as a newspaper or magazine might publish such statements as printed material.

A nonprofit, like any organization, can commit defamation in many ways. In explaining its mission to the public, a nonprofit can make statements that exaggerate the evils that it is trying to alleviate and may thereby defame those whom it alleges are responsible for these evils. When discussing the nonprofit's internal management concerns, matters that should be treated within the confidential confines of their boardrooms, the leaders of a nonprofit may unwisely make false, harmful statements about others that are overheard in public places. Such thoughtless public airing of slanderous material not only exposes the nonprofit and its board members to potential liability for slander of others' reputation, it also reflects badly on the nonprofit's own reputation.

Right of Privacy

Every individual has a right to be left alone—physically, financially, and emotionally—in many aspects of life. An individual has a right to keep his or her private affairs, family dealings, and financial status safe from the public eye unless revealing this information serves some greater public purpose. Thus, a person has a right to prevent his or her photograph, financial information, or intimate personal communications from public exposure. The right of privacy is distinct from the right to be protected from defamation: The essence of defamation is the falsity and malice that underlie injurious communications; the essence of the invasion of privacy is the publicity of information that, even though true, ought not to be revealed.

Nonprofits can invade others' right of privacy in various areas. To assist its clients a nonprofit may collect personal information about its clients' medical conditions, personal histories and more. The nonprofit risks a claim of violation of privacy when it fails to protect this personal information from disclosure to third parties. Every nonprofit retains personal information about its employees. When the human resources (HR) director leaves a list of employees, social security numbers, home addresses, and salaries on her desk at the end of the day, the theft of the document and its use to steal the identity of one or more employees leaves the nonprofit vulnerable to claims that it has violated the privacy of these employees. When a nonprofit publishes photos of clients receiving services from the nonprofit without first obtaining the express permission of its clients, the nonprofit is exposed to an invasion of privacy claim.

Nonprofits run the risk of invading others' privacy through fundraising activities that inadvertently make public their contributors' financial information. At one level, this invasion may be failure to protect a major donor's desire to remain anonymous. This failure not only opens the nonprofit to the donor's charges of violating the terms of the donor's gift, but it can also turn a supporter into an adversary, a long-term, perhaps silent but still effective, opponent of the nonprofit's mission. At a higher level, a nonprofit's carelessness in protecting credit card and other personal data that members of the public give in response to general fund drives can lead to these contributors falling victim to identity theft, perhaps by wrongdoers who have only distant connections with the nonprofit. In such cases, the nonprofit probably is not the direct identity thief, but the nonprofit does remain subject to suit for failing to protect others' right of privacy.

Economic Freedom

The right to fairly compete economically is open to all in the business community; freedom from wrongful interference with one's business advantage is a legally protected right for all. For example, a person or organization that makes or markets a product or service is legally protected from anyone spreading false rumors that disparage its products or services. Committing business disparagement is similar to defaming an individual.

Economic freedom, or the right to compete fairly, also is the foundation for legal protection against a group of wrongs collectively known as *wrongful interference with economic advantage*. For example, it is wrongful interference to damage a competitor's advertising signs, to physically block or harass the customers or employees of a competing organization, or to suggest falsely that a competitor's goods or services are ineffective or somehow harmful.

Community Protection from Crime

The interest of society as a whole, beyond the interests of individuals and organizations that make up a society, are protected by criminal law. Many wrongful acts have both public and private consequences. Therefore, persons and organizations committing these acts—including nonprofits and those on their staffs—are subject to both criminal and civil liability. Criminally, a wrongdoer, whether a person or organization, is answerable to the community and to punishment through a fine or imprisonment. Civilly, a wrongdoer is directly liable to the crime victim for money damages or for some other appropriate legal remedy. These are separate legal actions, with crimes being dealt with by a public prosecutor on behalf of society as a whole, whereas civil wrongs can be corrected only through legal remedies sought by the victims or their legal representatives.

Nonprofits—like the employees, volunteers, and others who work for them—can be guilty of crimes. However, a nonprofit can be liable for criminal conduct only if its senior management actively directed employees, volunteers, or others to commit acts that senior management knew were crimes. If the senior management of a nonprofit is ignorant or merely negligent in allowing its employees or other representatives to undertake criminal acts, then only these individuals—not the nonprofit—are vulnerable to criminal prosecution.

Wrongful Invasion

To summarize this chapter to this point, a nonprofit can face legal liability only if it is responsible for harming someone's legally protected interest. As explained earlier, this interest is the first of seven elements of potential legal liability. The balance of this chapter deals with the remaining six elements.

Wrongful invasion of a legally protected right is the second element of liability.

A wrongful invasion of any legal right is either a civil wrong or a criminal wrong. As suggested a moment ago, a civil wrong is the invasion of a legally protected right of some specific individual(s) or organization. Conversely, a criminal wrong (crime) is the invasion of a right that society as a whole has to be safe from actions or inactions that potentially harm everyone. Civil wrongs are categorized as either (1) breaches of contract or (2) torts—with *tort* being rather inclusively defined as a civil wrong other than a breach of contract. There are many ways of invading others' legal rights—many wrongful invasions. Indeed, recent headlines focusing on Internet stalking and identity theft suggest that technology and malevolent imagination are combining to discover new ways to invade traditional legally protected rights.

Breaches of Contract

A promise made under conditions that fulfill the four essential requirements for a contract creates an obligation to fulfill that contract. These four essential requirements are:

1. *An agreement.* One party must make an offer that is accepted by another. Real assent—not affected by fraud, duress, concealment, or mistake—must occur between the parties.
2. *Competent parties.* The legal capacity of the parties must not be restricted because one or more of them is a child, insane, intoxicated, or otherwise mentally deprived of the ability to make or understand the contractual promise.
3. *Legal consideration.* Legal consideration, which is anything of value paid or bargained for (including another promise), must be given in exchange for the promise being enforced. The value of the exchange need not be in any way comparable, but the exchange must be intended.
4. *Legal purpose.* Every valid contract must have a lawful purpose consistent with sound public policy. A contract that promotes activities that are illegal is not enforceable.

In addition, some contracts must meet certain formal requirements. For example, the Statute of Frauds requires that certain contracts—such as those for the transfer or use of real estate or contracts that cannot be fulfilled within a year—be in writing.

A breach of contract is a failure to perform a contractual promise under circumstances in which the law does not excuse that failure. When a party to a contract believes that it has been harmed by breach of a contractual promise, the harmed party may file a complaint with an appropriate court to enforce an appropriate remedy. Several examples of nonprofits' potential breaches of their contracts with others are presented earlier in this chapter.

The courts will excuse an apparent breach of contract under special circumstances. A party to a contract will not be held to its promises if it has been wronged because any of the four essential requirements for a contract has not been fulfilled, such as if the party alleged to have breached the contract is not legally competent or has not received legal consideration in exchange for the promise that others seek to enforce. Furthermore, what seems to be an apparent contract will not be enforced against a breaching party if there is no true underlying agreement, if the contract does not serve a legal purpose, or if the contract is not in the legally required form.

Torts

A tort is a civil wrong, other than a breach of contract, for which the law provides damages. The person or organization committing the tort is known as the *tortfeasor*. Conduct that constitutes a tort may, or may not, also be a crime. A person or organization that believes it has been the victim of a tort can secure an appropriate legal remedy only by bringing a specific suit against the alleged tortfeasor; the fact that the tort may also have been a crime is not directly helpful to the tortfeasor. However, once a conviction has been gained in a criminal case, evidence from that case may strengthen subsequent tort cases against the alleged tortfeasor.

The preceding discussion of legally protected interests has included many examples of tortious conduct. In fact, all the examples relating to interests in physical safety, freedom of movement, protection of property, security of reputation, right of privacy, and economic freedom—all the examples except those related to performance of promises and community safety from crime—have been torts.

Torts are classified into three broad groups, depending on the blameworthiness (or culpability) of the tortfeasor. These three groups are intentional torts, negligence, and strict liability (for which actual culpability of the tortfeasor does not matter). In committing an intentional tort, the tortfeasor intends both the action that the individual or the organization took and the harm that the victim suffered (that is, the tortfeasor wants—or is legally presumed to want—the victim to be harmed). For example, a person whose actions constitute battery, slander, or interference with another's economic freedom is guilty of an intentional tort. Negligence is characterized by another state of mind: failure to take the degree of care for others' safety that the law requires under the circumstances. The torts that constitute negligence are marked by carelessness, or inattention to others' well-being, not by the malice to cause harm that characterizes intentional torts. For example, a nonprofit daycare center for the elderly that fails to screen its employees for past sexual misconduct may be liable for negligence in screening and supervising staff who commit sexual assaults against clients. However, if this same nonprofit acts positively to facilitate such sexual abuse, it may well face liability for the intentional tort of assault (defined earlier as an unpermitted harmful touching of another) against any clients who have been abused. Furthermore, the nonprofit's overall conduct promoting this abuse may rise (or, perhaps better, fall) to the level of a crime whose precise definition will vary with the wording of the applicable statutes.

The third category of torts includes conduct for which the law imposes strict liability for any harmful results, regardless of the responsible party's state of mind. The law imposes strict liability, sometimes called liability without fault, in situations involving inherently dangerous activities—activities so hazardous that justice requires that anyone responsible for managing these activities bear the cost of any harm these activities inflict on others. Historically, the activities that lead to strict liability typically have centered around keeping wild animals, engaging in naturally destructive activities, and manufacturing inherently dangerous products. Regardless of their utmost care for the safety of others, individuals and organizations performing these activities may face strict liability for any resulting harm to others, even if those harmed have not taken adequate precautions to safeguard themselves.

Nonprofits may conduct, or contract for others to conduct, any of these activities that lead to liability without fault. Many animal shelters and zoos operate as nonprofits. If an animal that the community would consider *wild*—not customary in that community and not easily controlled by its typical resident—escapes from such a facility and causes others physical injury or property damage, the nonprofit probably would be held strictly liable for this harm, regardless of what the nonprofit had done initially to confine the animal or later to recapture it. As another example, many courts consider any use of explosives to be an inherently dangerous activity, especially if the public is exposed to the explosions. Therefore, a nonprofit that presents a large fireworks display to attract crowds to a fundraising or other public event may well be strictly liable for any injuries or property damage that the fireworks cause. Even if this nonprofit contracted with a pyrotechnics expert to conduct the fireworks display, it would almost certainly share with the contractor strict liability for any resulting harm to others.

Finally, strict liability caused by use of what courts may deem an inherently dangerous product can generate serious liability losses for nonprofits that market, or that give away as promotional incentives to donors or volunteers and employees, such potentially dangerous items as knives or other sharp items, toys with small parts on which infants may choke, safety devices such as car seats for children or fire extinguishers that turn out to be defective, or foods to which a significant percentage of the population may be severely allergic. Nonprofits should take steps to avoid distributing anything that could be considered inherently dangerous because, having once distributed such an item, an organization can do very little to avoid strict liability for any resulting harm. It may be able to limit the extent of the harm by trying to recall the hazardous product but, especially for a nonprofit, the adverse publicity may lessen its reputation almost as severely as the legal claims will shrink its financial resources. Effective risk management must simply avoid any association with anything that could be or become inherently dangerous.

Crimes

At first glance, a nonprofit would seem to have little concern about potential criminal liability. Except in the very extreme cases in which a nonprofit may be initially established or later subverted to serve its senior management's criminal purposes, a nonprofit as an organization is unlikely to face direct criminal liability. Even if a board member, employee, or volunteer uses a nonprofit's resources in committing crimes for which that wrongdoer is personally responsible—perhaps fraudulently collecting in the nonprofit's name donations that the individual personally pockets, reporting to tax authorities inflated contributions to the nonprofit and then altering the nonprofit's records in order to reduce the wrongdoer's income taxes, using one of the nonprofit's vehicles to commit a bank robbery, or perpetrating a criminal sexual assault on a client or another person associated with the nonprofit—the nonprofit is not likely to be criminally indicted. (Events such as these may, however, bring tort liability on such a nonprofit for negligence in failing to adequately screen or supervise its personnel.) The nonprofit also may be protected from criminal charges in these and similar cases because law enforcement officials now tend to pursue and punish individual perpetrators rather than the nonprofits with which they may be associated so that the honest members of a nonprofit's staff can continue to serve its mission.

At a deeper level, however, crimes committed by a nonprofit's staff clearly may impose losses other than liability losses on that nonprofit. Money embezzled from a nonprofit, a property loss, is often money forever lost to that nonprofit. If a nonprofit's staff member is arrested as a suspected criminal, the nonprofit loses that person's time and talents—a people loss—until that person returns to fully productive work, if ever. The value of any time the nonprofit's management devotes to dealing with criminal charges against staff members, including restructuring the remaining staff or recruiting and training new staff, is another people loss to the organization.

Common and Statutory Law

The third aspect of a nonprofit's legal liability is the nature of the laws with which it must comply. In general, these legal requirements may rest on either common law (derived from court rulings) or statutory law (based on the enactments of state or federal legislative bodies or rulings issued by state or federal administrative agencies).

The laws under which a nonprofit may become liable may come from several sources. These laws may be local (city or county), state, or federal.

Therefore, a nonprofit with facilities or activities in several communities or states must comply with various, sometimes conflicting, local legal requirements with respect to fire safety, sanitation, wage-and-hour employee reporting practices, and so on. State statutes or state court rulings also vary across state boundaries and usually take precedence over local requirements. Federal statutes and court rulings may also come into play, overriding both local and state requirements where conflicts arise. Therefore, a nonprofit may have to follow different legal requirements in different jurisdictions, or if practicable, adhere to the most demanding standard throughout its operations.

Common Law

The notion of common law is an English legal tradition based on the principle that courts should resolve today's legal disputes by the same rules that were used to resolve similar disputes in the past. Like cases should receive like rulings so that the law becomes predictable, so that past precedents are followed. Current cases should follow past precedents unless the facts of these current cases are significantly different from the facts of past cases. Thus, within any given jurisdiction, a nonprofit usually can rely on past court rulings to be followed in the future, thus eliminating an important potential source of uncertainty in determining what legal rights and requirements a nonprofit can expect to apply.

Statutory Law

However, state or federal statutes, along with state or federal administrative rulings, may completely override common law precedents. Such statutes usually are quite precise in their requirements and in specifying the activities and individuals or organizations to which they apply. Unlike common law principles, which tend to be rather general in their content and wide-sweeping in their geographic scope, statutes are much more precise and can change with the turning of a single calendar page. Therefore, statutes and administrative rulings can generate diverse, changing patchworks of legal requirements. On one hand, statutes greatly simplify a nonprofit's challenge of knowing the precise legal requirements it must meet and, on the other hand, they substantially complicate a nonprofit's task of meeting different, perhaps conflicting, legal demands.

Responsibility

A nonprofit may or may not be liable for all the wrongful acts that take place on its premises or in its name. For example, as previously explained, the members of a nonprofit's staff may commit personal wrongs outside the scope of their staff responsibilities for which they alone are legally responsible. At the other extreme, a nonprofit may be responsible for the activities of independent contractors—activities that the nonprofit does not directly supervise but for which the law imposes liability, usually because the nonprofit did not take adequate care in selecting or directing these independent contractors. Consequently, the fourth aspect of a nonprofit's potential liability is the extent to which it is responsible for both its own and others' actions.

The key to understanding this fourth aspect of a nonprofit's liability is the basic principle that any legal entity—any person or organization—is responsible for its own actions and for the actions of its agents. Thus, a nonprofit organization is responsible for any harm that results directly from actions or inactions that follow the instructions or procedures, explicit or implied, of the organization's management. Conversely, the organization is not responsible for actions or failures to act that are contrary to management's instructions or normal procedures. It follows that a nonprofit typically is not legally responsible for harm that results from a staff member's (1) failure to comply with the organization's instructions or (2) independent actions that are either contrary to such instructions or fall completely outside the scope of the staff member's typical duties. For example, if a staff member operates a vehicle as directed by his or her supervisor in a way that violates the law, both the staffperson and the nonprofit are likely to face legal liability because the organization is responsible for the consequences of the actions it directs. On the other hand, if a staff member goes beyond his or her instructions, any harm to others probably will be that staffperson's sole responsibility. An exceptional situation, in which both the staffperson and the nonprofit are responsible, would arise if the nonprofit simply failed to give the staffperson sufficiently specific instructions. In this case, the nonprofit's liability would arise out of its negligent supervision of the staffperson.

Like any legal entity, a nonprofit is legally responsible for the actions of those whom it has chosen to be its agents—who "stand in the nonprofit's shoes" to perform activities on the nonprofit's behalf. Under the general common law of agency, a nonprofit is said to have *vicarious* liability—as opposed to direct liability—for the wrongful acts of its chosen agents while they are acting within the scope of their agency. For example, a nonprofit may hire a construction firm to erect or to refurbish a building for the nonprofit, contract with a caterer to serve food at a banquet, or choose to pay a fundraiser to conduct a telephone campaign to solicit contributions from the general public. In each of these cases the nonprofit remains legally responsible for the conduct of the organizations with which it has contracted, and of their individual staff members, just as if these organizations and their staff members were the nonprofit itself.

In short, shifting to others activities that a nonprofit otherwise would have done for itself does not shift responsibility for performing those activities properly. If, however, an organization with which a nonprofit has contracted violates the nonprofit's instructions for performing an activity or the normal procedures for that activity, then the nonprofit typically is excused from responsibility for the independent or substandard work of the contractor.

Harm Directly Caused

Even if a legally protected interest of a client, staff member, or other person associated with a nonprofit is wrongfully invaded under circumstances that are somehow related to the nonprofit, it may not be liable to anyone if (1) this invasion has caused no harm or (2) the actions or inactions of the nonprofit were not the direct cause of any harm that did result from the invasion. Thus, the fifth element of a nonprofit's liability is that its action or inaction directly causes harm to others. If there is no harm, then the television sports commentator's maxim, "No harm, no foul," applies. If someone else was more directly responsible for any harm, the nonprofit still is likely to escape liability.

For example, a member of the public attending a winter fundraiser may fall on the ice in a nonprofit's parking lot, but if this fall in no way bruises or otherwise harms the fallen person, she cannot sue the nonprofit for negligence or other harm from the fall—there has been no harm. Continuing the same example, if this woman fell on the ice because she was distracted and turned quickly when someone called her name from across the parking lot, the nonprofit still may not be liable for any injuries resulting from the fall. Even though the ice may have contributed to the fall, the distraction caused by hearing her name called may have been a more direct cause than the ice of the woman's injuries. The nonprofit may have been at fault in not clearing the ice from the parking lot, but this fault was, in this case, not the most direct (proximate) cause of any injuries the fallen person may suffer.

Without Justification

Even if a nonprofit is legally responsible for directly harming another person's or organization's legally protected interests, it will not be held liable if the nonprofit has an affirmative justification for causing this harm, a justification which supersedes the interests it has invaded. Such justification can be found in either a legal privilege or a legal immunity that protects the nonprofit. The absence of any such justification is the sixth aspect of a nonprofit's potential liability.

Privilege

A privilege is a right that, under specified circumstances, an individual or organization has to invade a legally protected interest in order to serve a more important, legally protected individual or social interest. For example, the protection of human lives is generally more important than the protection of property. Therefore, in striving to control a raging fire that threatens a large hotel and the people trapped inside it, a nonprofit volunteer fire department has a privilege to destroy property not threatened by the fire in order to create a firebreak between the fire and the hotel. Moreover, because preserving life is a socially more important interest than preventing injury, a fire department volunteer carrying a person out of a burning building is privileged to invade this person's privacy, and even to unintentionally injure the person, if necessary to successfully evacuate him or her. Neither the owners of the properties destroyed to create the firebreak nor the person embarrassed or injured while being carried from the building is entitled to sue the fire department or any volunteer—under these circumstances, their actions were privileged. (However, legal privileges are limited to the actions that, under the circumstances, serve the greater interest. Thus, this fire department would not be privileged to intentionally destroy property not needed to create the firebreak, nor would a fire department volunteer be privileged to maliciously break the leg of anyone the volunteer was rescuing from the hotel.)

Immunities

Privileges arise from specific circumstances. Immunities, in contrast, are rather broad blankets of protection against potential liabilities (especially tort liabilities) that are sometimes spread over particular entities. In most cases immunity does not prevent a suit from being filed; it is a defense that can be raised in the early stages of litigation. Entities that enjoy some form of immunity include governmental entities and their officers while acting within the scope of their duties, young children, the insane, and in some cases, charities. The legal reasoning underlying immunities is twofold: (1) Persons or organizations granted immunity are not capable of recognizing or performing the obligations to which others are subject, or (2) the benefits that society gains from granting immunities to particular classes of persons is greater than the costs society incurs by allowing immune entities to occasionally harm others with impunity.

In order to determine whether nonprofits enjoy any protection against suits or limitation on liability, it is necessary to examine both statutes and case law concerning the availability of a charitable immunity defense. Although charitable immunity has been abolished in majority of the states, vestiges of this common law doctrine remain in various jurisdictions. The common law doctrine of charitable immunity exists—to some degree—in nine states: Alabama, Arkansas, Georgia, Maine, Maryland, New Jersey, Virginia, Utah, and Wyoming. The states with the least restrictive forms of charitable immunity are Arkansas, New Jersey, and Virginia. In Alabama nonprofits are immune only with respect to claims from beneficiaries. In Georgia nonprofits enjoy immunity unless the nonprofit fails to exercise ordinary care in the selection or retention of competent officers and employees or the plaintiff is a paying recipient of services from the nonprofit. In Maine charitable immunity only applies if an organization derives its funds mainly from public and private charity. In Maryland charitable immunity applies only if an organization's assets are held in trust and the nonprofit has no liability insurance. In New Jersey nonprofits are not liable for negligently causing injury to a beneficiary of the organization (see *N.J. State. Ann. § 2A:53A-7*). In Virginia nonprofits are immune from suits by beneficiaries alleging negligence, absent a finding of corporate negligence. However, charities are not immune from the negligence of their employees if they fail to exercise ordinary care in the selection and retention of those employees. In Utah there is a statute that limits the liability of a tax-exempt nonprofit, under certain circumstances, for acts or omissions of a volunteer:

> *Utah Code Ann. § 78-19-3, Organization liability*
> A non-profit organization is not liable for damage or injury that was caused by an intentional or knowing act of the volunteer which constituted illegal, willful or wanton misconduct, unless the non-profit should have had reasonable notice of the volunteer's unfitness to provide services under circumstances that make the organization's use of the volunteer reckless or wanton. A non-profit organization is also not liable where under the law a business employer would not be liable for an employee.

In Wyoming a charitable immunity defense is available to nonprofits that provide services without charge (see *Wyo. Stat. § 1-1-125*).

The following states limit the liability of nonprofits by capping the amount that may be awarded as damages. These provisions are sometimes described as a form of charitable immunity:

- *Colorado.* In Colorado, lawsuits against nonprofits are not prohibited, but judgments are limited to the extent of existing insurance coverage (see *Colo. Rev. Stat. Ann § 7-123-105*).
- *Massachusetts.* In Massachusetts a tort cap of $20,000 applies to non-profits for torts committed in the course of any activity carried on to accomplish directly the charitable purposes of the organization (see *Mass. Gen. Laws Ann. ch. 231, § 85K*).
- *South Carolina.* Awards against charitable organizations are limited to $250,000 in actions for injury or death caused by the tort of an agent, servant, employee, or officer (*S.C. Code Ann. § 33-56-180*).

Legal Remedy

The seventh and last aspect of a nonprofit's potential legal liability exposures—the range of legal remedies—encompasses the costs, actions, or penalties that the law imposes on or requires of a nonprofit that is found legally liable for harming others. As explained in the following paragraphs, some remedies apply to several forms of legal wrongs—breaches of contract, torts, and crimes—while other remedies apply to only one type of legal wrong.

Money Damages

The most frequent remedy for a breach of contract is money damages. These payments aim to compensate the other party(ies) to the contract for the harm caused by the breach and therefore are called compensatory damages. The reasoning behind such damages is that an injured party should be placed in the same financial position as if the contract had been properly performed. Compensatory damages strive to equal the difference between the value of the promised performance and the injured party's cost of obtaining that performance elsewhere. As an alternative to compensatory damages, the parties to a contract may agree in the contract on an amount of money damages to be paid for any future breach. These are called liquidated damages. The sum specified as liquidated damages must represent a good-faith effort to estimate each party's actual damages from a future breach, rather than being a penalty intended to punish the breaching party.

Money damages—specific or general—also are the most frequent legal remedy for tortious wrongs. Specific damages compensate a tort victim for out-of-pocket expenses the victim incurs as a result of the tort or that must be paid on the victim's behalf to restore the victim's condition before the tort occurred. These specific damages often include the costs of medical care or of replacing or repairing damaged property. In bodily injury cases the victim often is awarded general damages for any extraordinary pain or mental suffering caused by the tortfeasor's wrongdoing.

Specific Performance

When money damages are not an adequate remedy—for example, when a nonprofit may have contracted with a renowned artist for a portrait of its founder or has entered into a binding contract to purchase a specific building or piece of real estate—the party harmed by a breach of contract may seek performance of the contract as the only adequate remedy. To determine whether money damages could be an adequate remedy, making specific performance unnecessary, courts generally consider the difficulty of valuing the subject matter of the contract, any sentimental or esthetic qualities of the subject matter that make it unique, and the difficulty or impossibility of obtaining a duplicate or substantial equivalent of the subject matter. For example, a nonprofit school that is world famous as the best for the training of the blind might be required to carry out the terms of its contract to train a specific child rather than simply paying the child's parents the tuition and boarding costs of training their child at another, supposedly comparable, school. The parents would argue that there is not a comparable school.

Injunction

An injunction is a court order to a wrongdoing individual or organization to act, or to not act, in a particular way. Injunctions can be appropriate remedies for contractual and tort wrongs. For example, if a nonprofit enters into a contract with its resigning executive director to pay him or her severance money for five years in exchange for this executive director's promise not to work for a competing organization during this period, the nonprofit may ask a court to issue an injunction against this executive director if he or she does in fact work for a rival organization before the five years have passed. Similarly, if a nonprofit marching band continues to disturb neighboring residents by practicing outdoors at odd hours, these neighbors may seek an injunction against such loud music as part of its tort suit against the band for creating a public nuisance.

Remedies for Crimes

Persons and organizations convicted in criminal courts may be subject to a variety of remedies that are effectively penalties for their wrongdoing. The most common of these are fines, paid to the government to deter repeated misconduct and, to some extent, to cover the government's costs of enforcing the criminal law. Fines are the best remedy for effectively punishing organizations, as opposed to individuals, for criminal wrongdoing. A second remedy is incarceration, again penalizing the individual criminal and ideally preventing future crimes. Third, restitution—requiring a criminal to return or restore property stolen or damaged—attempts to return the victim to the position he or she enjoyed before the crime occurred. Finally, individuals or organizations that are convicted of crimes but not incarcerated for them may be enjoined from conduct that might enable them to repeat their crimes. For example, a person found guilty of harassing or assaulting another individual might be placed under an injunction not to come nearer than 100 yards from that person, the person's home, or any members of the person's family for the next three years.

Chapter 6

People Risks

For community-serving nonprofit organizations, people are their most important resource. Different groups are important for different reasons, and any one individual may fit into several groups and thus be important to a nonprofit for several reasons. For example, a person needing the services of a nonprofit may first come to it as a needful client. Having been strengthened or otherwise benefited by this nonprofit's services, this person may wish to work for the nonprofit as a volunteer or employee. In time, no longer needing services but committed to the organization's mission, the person may become one of its chief spokespeople or financial supporters, perhaps even serving on its board of directors.

One reason people are a nonprofit's most important resource is that people in a local, state, regional, national, or even global community typically are at the heart of a nonprofit's mission. These people—a nonprofit's clients—are the people whose lives nonprofits seek to improve in myriad ways. To survive, a community-serving nonprofit needs the people in the special community it serves.

People are a nonprofit's most crucial resource for another reason: It is the people inside a nonprofit who energize and direct its mission-seeking activities. People who work for a nonprofit, typically as paid employees and volunteers, strive to transform the nonprofit's vision of a better tomorrow into today's reality. These energizing and directing people may be the nonprofit's senior executives and board members, who devote much of their time, managerial and leadership qualities, and often personal resources to a nonprofit's mission. Other people may work for a nonprofit as consultants, independent contractors, or other outside experts who are paid or volunteer to bring their uncommon knowledge or talents to the nonprofit's service as needed. Even some clients can be an energizing and directing force for a nonprofit by giving concrete and rewarding purpose to the work of the staff and, by example and word-of-mouth, drawing new clients to the nonprofit's threshold.

There is one more reason people are a nonprofit's most important resource: People are the true source of a nonprofit's reputation. Broadly speaking, a nonprofit's "people"—its supporters in the community—are both the wellspring and the reservoir of its reputation. Reputation is a crucial resource for every community-serving nonprofit, at least equal in importance to people, property, and income. Yet reputation does not create itself or stand alone. It can come only from people who,

- As staff, volunteers, or independent contractors, serve a specific or broad community by striving to achieve the nonprofit's mission
- As clients, appreciate and speak favorably to others about the benefits the nonprofit has given them
- As special donors or typical members of the public responding to a fund drive, contribute funds or other property
- As government officials, certify that the purposes and conduct of the organization continue to merit the special privileges that American law bestows on private organizations designated as public-serving nonprofits

A nonprofit's "people"—those whose actions and attitudes can be key to its success or can bring on its demise—are those who

- Are served by the nonprofit—its clients
- Work for the nonprofit—its employees, volunteers, independent contractors, and board or committee members

  Support the nonprofit—its financial supporters or advocates in public, legislative, or regulatory forums

Should bad luck, unfortunate news, misleading rumors, or actual misconduct linked to a given nonprofit cause it to lose the allegiance of its people, the resulting loss of their loyalty, enthusiasm, and implicit endorsement of this nonprofit's work may severely hamper its progress toward its mission. What people—correctly or incorrectly—perceive a nonprofit to be is, for them, what it truly is. With respect to the resource of reputation, the prevailing popular perception is the prevailing reality.

People Exposed to Loss

The preceding section suggests that the people who are crucial to a nonprofit's success can be grouped into three broad categories: clients, workers, and supporters. More specifically, a nonprofit's clients are the people whose lives are bettered by the nonprofit's service activities. For example, a youth-serving nonprofit's clients are the young people with whom it works, together with their families and friends, as well as the general community in which these youth live and work. Other examples are people whose health is bettered by nonprofits with the missions of combating various diseases, feeding the hungry, or lessening abuse or violence against vulnerable populations.

The second group of people who are key to a nonprofit's mission are those who devote their energies to advancing the nonprofit's mission. These workers can include (1) the members of a nonprofit's board of directors or any of its key committees; (2) the nonprofit's paid and volunteer workforce; (3) spokespeople for the nonprofit, whether they speak for it to the public or in legislative or regulatory forums; and (4) independent contractors, who bring to a nonprofit materials or talents that it could not otherwise easily obtain or afford.

The third set of key people for any nonprofit are its supporters. These may include (1) major donors of funds or property, be they individuals or organizations, such as representatives of corporate givers or foundations; (2) the general public, who respond to fund drives because they have a generally favorable view of the nonprofit's mission and operations; and (3) people such as current clients, celebrities, politicians, or regulators, who are in a position to advance the nonprofit's activities by bringing in new clients, additional resources, or a more favorable operating environment.

At first glance, one may be tempted to consider a nonprofit's key workers as distinct individuals, while thinking of its clients and supporters as merely interchangeable member groups. Thus, it can be easy to think of a board member, an executive director, or a development chairperson as particular individuals whom a nonprofit might lose because one of these people died, retired, or moved to another organization. In contrast, it can seem convenient to think of clients and supporters as anonymous members of larger groups, implying that the retirement, disability, or death of any one of these individuals is not crucial as long as the total number, needs, and resources within the client and supporter groups remain adequate. This way of thinking leads to the conclusion that all a nonprofit's key people come to work within its walls every day or at least weekly.

This natural tendency to consider those who work more closely with a nonprofit to be more important than clients and supporters who are more distant from a nonprofit and not part of its organizational structure is incorrect for two reasons. First, workers, clients, and supporters are overlapping, fluid groups. An individual may move from one group to another; for example, a well-served, successful client may eventually become a worker and simultaneously a generous supporter. Second, it is a person's effort and commitment to a nonprofit's mission, not his or her official or unofficial tie to a given nonprofit, that make him or her vital to its life as a community-serving organization and to the improved lives of those whom it serves.

Within any group of workers, clients, or supporters, some individuals naturally stand out while others blend into the crowd. One highly personable energetic client may inspire other clients—indeed, a nonprofit's own employees and volunteers—to bring extra effort and dedication to their part of the nonprofit's mission. Within an organization's supporters, a long-standing major contributor, a person whose will leaves a significant portion of his or her estate to the nonprofit, or a member of the grant-allocation committee of a foundation clearly is more important to the nonprofit than is a typical member of the general public who gives $10 a year. In any organization—private or public, nonprofit or profit-seeking—some individuals are leaders who personally excel and get things done. These outstanding leaders are critical to a nonprofit's success, regardless of whether they relate to a nonprofit as workers, clients, or supporters, and regardless of whether they energize the nonprofit from inside or outside its organizational structure.

Perils Threatening a Nonprofit's People

Like every human being, a person who is a key client, worker, or supporter of a nonprofit is vulnerable to a number of universal perils that may end or disrupt his or her life, health, or career. From the nonprofit's perspective, the significance of each of these perils depends on how often, how severely, and how irreversibly each peril may deprive a nonprofit of the talents, knowledge, and other resources of that key person or group. Moreover, a peril that may affect many key people poses a greater threat to a nonprofit than does another peril that strikes only a single person. Arrayed in likely order of decreasing significance to a nonprofit, the following paragraphs treat the universal human perils of death, retirement, termination, permanent disability, gradual loss of ability (as from natural aging or repetitive minor trauma), and temporary disability due to routine injuries and diseases.

Besides being subject to threats to life, health, and productivity that affect everyone, people who serve, support, or are served by nonprofit organizations are particularly susceptible to two further perils that may sap their enthusiasm and willingness to be active for a nonprofit organization: loss of dedication and loss of material resources.

For those who labor in or are dedicated to supporting the nonprofit sector, personal commitment to a particular nonprofit's mission often is a more important driving force than a paycheck or other material rewards. Many people devoted to nonprofit activities put mission over money in their personal hierarchies of values. If adverse events befalling a nonprofit suggest that it is no longer worthy of its followers' efforts or support—if, for example, scandal, gross inefficiencies, or departures of inspirational leaders put a nonprofit's future in doubt—-a significant number of its most productive people may go elsewhere in search of more personally satisfying outlets for their community-serving drives. Similarly, if a nonprofit's directors, volunteers, or benefactors lose their financial resources because of personal misfortunes or widespread economic downturns, they may no longer have the free time or resources available for their nonprofit interests—they may need to work first for their own well-being.

Death

Because everyone eventually dies, it is not the fact of death but rather the timing or the circumstances of death that creates unexpected losses for an organization. If a key worker, client, or supporter dies after a long illness or after having retired from active participation with the nonprofit, the loss to the organization may be minimal. In contrast, sudden death from an accident, short illness, or other cause is likely to inflict serious losses on a nonprofit, with the nature and extent of these losses depending on whether the deceased was a worker, supporter, or client.

First, consider clients. The death of a typical client ordinarily causes a nonprofit no noteworthy loss. However, if the deceased client was a leader of a significant group of other clients, his or her death may cause these other clients to drift away from the nonprofit. This would decrease the volume of services the nonprofit provides and therefore the level of service-related funding it may have been receiving from a foundation or government agency. The unexpected or accidental death of a client while receiving services from a nonprofit is a different matter. Under these circumstances, such a death will cause trauma for the organization. The staff involved in the client's care will question their actions and may find it difficult to continue in their roles. An investigation into the causes of the death is likely to result, consuming the nonprofit's human and financial resources. Furthermore, if the circumstances surrounding a client's death suggest that the nonprofit's negligence was the cause of the death, serious financial losses or damage to the nonprofit's reputation are certain to follow.

The death of an important worker for the nonprofit is more likely to cause it serious losses, again depending on the circumstances of the death. The passing of a highly influential board member, a senior executive, or an employee or volunteer who brought unique talents to the organization will almost certainly cause it to suffer several kinds of losses:

- Disruption of activities in which the deceased played a major role
- Additional expenses incurred to reassign others to perform the deceased's work and to locate, train, and orient a replacement
- Uninsured expenditures the nonprofit may choose (or may be legally obligated) to make on behalf of, or to the dependents of, the deceased

How severely a worker's death adversely affects a nonprofit varies with a number of circumstances. First, if other workers—board or committee members, employees, volunteers, or independent contractors—step in promptly to replace the deceased person, the loss to the nonprofit may be relatively small. This is one of the reasons many well-managed nonprofits cross-train personnel. Second, for a nonprofit whose work is seasonal, such as recreation-centered nonprofits that are active during the spring and summer months or those whose activities peak during certain holidays or annual fund drives, the death of a key person during a slow period may be less disruptive than it would be at a busy time. Third, simultaneous fatalities of several key workers, such as board members or officers who die in an accident while traveling or meeting together, may be devastating to a nonprofit. Equally damaging may be the deaths or sicknesses of constituents who suffer food poisoning from a poorly prepared holiday meal hosted by the nonprofit.

The third group of key people for a nonprofit, its supporters, are key to achieving its mission because they:

- As individuals, donate money or other property to the nonprofit or persuade other individuals to donate
- Hold positions with corporations, foundations, or governmental bodies from which they can direct or influence the distribution of money or other resources to particular nonprofits
- As legislators or regulators, make or influence governmental decisions as to how a given nonprofit or class of nonprofit is authorized to function or is taxed

The importance of a given supporter to any nonprofit depends on how much money or other resources or how much freedom each supporter is willing to provide to a particular nonprofit. Supporters who provide more now or may provide more in the future are more crucial to a nonprofit's mission than are those who do or may provide less. The value of a supporter also varies with costs the supporter imposes or seeks to impose on the nonprofit. These include the expense of enlisting that supporter (especially a member of the general public, who may or may not respond to a general mailing or media campaign), the personal attention a supporter requires, and restrictions a supporter wishes to impose on the nonprofit as a condition for gaining or keeping that support. The lower the costs a supporter imposes on a nonprofit relative to the value of the benefits that supporter provides, the greater the value of the supporter.

Ordinarily, a supporter's death brings only minor losses to a nonprofit because the departed supporter is only one of many. However, the passing of a perennial major donor, a particularly effective advocate, or a sympathetic and especially influential regulator often deprives a nonprofit of the financial and other resources that the outstanding supporter's loyalty once provided. In extraordinary cases, the unforeseen death of a founder or outstanding moral leader of a nonprofit is followed shortly by the demise of the nonprofit itself if its surviving key people—workers, clients, and other supporters—cannot, or choose not to, continue functioning effectively. Such a result is a greater danger when both the founder or leader and the nonprofit are relatively young; in this case the nonprofit is less likely to have a seasoned management team with the foresight to prepare for the day when a leader, donor, advocate, or government official dies.

These unfortunate cases aside, the death of one supporter usually does not cause severe losses to most nonprofits. Typically, a nonprofit has groups of supporters from which to draw resources, just as it has groups of clients to which it provides services. From most nonprofits' financial perspective, the size, resources, and commitment of the populations in these support groups are more crucial than the business value of a single life. Thus, although the passing of one major individual donor may be mourned and may even call for some short-term budget adjustments, the nonprofit's resulting financial losses often are not severe. The deceased's family may well continue donating in his or her memory.

Termination

In this context, *termination* refers to a client, volunteer, independent employee, or board member of a nonprofit either (1) resigning from the organization on his or her own initiative or (2) being dismissed from the organization on the initiative of an authorized person. Donors and corporate or foundation grantors also leave nonprofits but, as discussed below, their departures result from their loss of dedication to a nonprofit or loss of resources to continue supporting it.

Most terminations are the result of deliberate choices or negotiations by managers, employees, or volunteers working for nonprofits, not the consequences of accidental or other chance events. Individuals can choose to resign their jobs or volunteer posts; managers can choose to dismiss employees or volunteers; either individuals or organizations can choose not to renew business contracts. Thus, most terminations are not sudden surprise events, unless one party to the arrangement being terminated has not been aware that the other party has been considering termination. Furthermore, if one party wants to terminate an arrangement but the other really wishes to continue it, the terms of the arrangement often can be renegotiated so that only some adjustment, not a termination, needs to occur. Terminations usually are accidents only when one party is unaware of what the other is thinking or is unwilling or unable to negotiate continuation of a revised, continuing arrangement.

However, some exceptional terminations can surprise a nonprofit's management if it has not prepared for them. For example, the top management of a well-run nonprofit normally would not fire an employee or release a volunteer who alone has skills or knowledge especially valuable to that nonprofit until other employees or volunteers have developed comparable knowledge or skills. However, extraordinary circumstances may compel a nonprofit's executive director to summarily dismiss or suspend a wrongdoing employee or volunteer whose conduct gravely endangers others or is clearly illegal, regardless of his or her uniquely valuable talents or knowledge. For example, an employee or volunteer who commits unprovoked criminal violence against another person that is witnessed by many others on the nonprofit's premises clearly must be suspended or dismissed as promptly as possible, as must another employee or volunteer caught red-handed stealing from the safe.

An employee, volunteer, independent contractor, or other worker for a nonprofit may initiate an unanticipated departure from a nonprofit. To illustrate, sudden pressing events in an individual's personal life—such as relocating within the month to care for a parent who had a heart attack yesterday while living alone in another state—may trigger a totally unexpected overnight resignation of a key employees, volunteers, or independent contractors. Several of a nonprofit's employees or volunteers may share a common personal interest that prompts most or all of them to resign simultaneously. Perhaps they are joint purchasers of a winning multistate lottery ticket that paid each of them tens of millions of dollars and at least some of them choose to work no longer. Another group might resign in the wake of some situation the group considers untenable, such as the appointment of a new CEO with political views a group of staff strongly oppose. Or the social leader of a very close-knit group of employees or volunteers may resign to work for another organization, prompting at least some of this leader's group to follow.

Apart from these highly unusual firing or resignation situations, terminations should not cause a nonprofit any significant surprise losses. When a nonprofit is considering terminating an employee, volunteer, or other relationship with a person or another organization, the nonprofit's management can avoid losing any valuable knowledge or skill the person or organization possesses simply by first making sure that this knowledge or skill already resides with someone else within the nonprofit. To protect itself from losing essential knowledge or skills due to terminations initiated by others, a nonprofit should cross-train several employees and volunteers to perform each critical function within the nonprofit. (This is wise even for those frequent times when some key person is only out sick for a few days.) All information essential to the nonprofit's activities should be available to its senior management in a form these executives can understand and apply. These loss-control safeguards are effective in dealing with all termination situations, whether initiated by a nonprofit or by others.

A person whose work with a nonprofit is terminating, especially a person who is angry, may cause it additional losses by taking with him or her information or skills that the nonprofit considered proprietary "trade secrets" that are confidential or otherwise exclusive to it. For example, an office worker may take lists of donors' personal information and latest contributions, a once-trusted board member may leave with confidential program-planning information, or a young virtuoso trumpet player may resign as an employee of the nonprofit community orchestra at which he developed his talents to join a major recording vocalist's band. The nonprofit may try to prevent such losses by escorting the terminated worker from the premises as soon as the worker has been fired or by revoking his or her information-access privileges as soon as the worker has announced his or her intent to resign. However, these precautions may not be effective if a worker, anticipating possible termination, has removed the valuable information earlier.

As another loss-control device, a nonprofit may ask its workers to sign confidentiality or noncompetition agreements, promising not to provide proprietary information to or work for other organizations whose activities are similar for three or five years. These agreements may or may not effectively protect a nonprofit because courts may strike them down as too broad in restricting economic competition or individuals' freedoms. An association's noncompetition agreement with the staff member who solicits ad space for the association's monthly magazine might prohibit the staff member from soliciting the magazine's current advertisers for another publication for a period of two years. This sort of agreement is more likely to be upheld than a noncompetition agreement through which a community orchestra might try to limit the career opportunities of one of its paid musicians.

Retirement

As used here, *retirement* is voluntary planned withdrawal from the workforce at a predetermined age and usually after a career of at least several years. A person who retires does not plan to return to work for a nonprofit or for any other organization. Typically, both the nonprofit and an employee, volunteer, board member, or independent contractor who retires from his or her work with a nonprofit has anticipated this retirement, as has the nonprofit for which he or she has worked. Thus, as used here, *retirement* typically involves no surprises. Therefore, a so-called early retirement, perhaps because of a person's changed circumstances or at the request of the nonprofit, before the anticipated retirement age is considered a termination rather than a retirement. Unlike a termination, a retirement should shock neither a nonprofit nor any of its workers and should require no rapid adjustments in the nonprofit's daily operations or funding.

Since retirements involve no surprises they should bring no losses. The senior management of a well-run nonprofit should realize when an employee, volunteer, or other worker is scheduled to retire. They should be training other current workers to replace the retiring person or recruiting others from outside the organization as a replacement. Similarly, an employer or other worker for a nonprofit should be planning for his or her retirement. A retirement is not a loss; it is a natural transition in life.

Disability

In this discussion, the *permanent disability* of one of a nonprofit's employee, volunteer, or other workers is that person's loss of the ability to perform one or more of the essential functions of a job, with no reasonable expectation that the lost ability will return. A permanent disability should be contrasted with a temporary disability. A disability that lasts or is anticipated to last less than six months or sometimes a year is usually defined as temporary. A disability, whether permanent or temporary, can be either partial or total.

A partial disability involves loss of the ability to perform one or more of the essential functions of a particular job: A person who loses the ability to perform some of the functions of one job may still be fully able to perform all the functions of another job, either with his or her current organization or for another organization. A person who is totally disabled is not able to perform all the essential functions of any job for any organization.

Thus, there are four types of disabilities:

1. Temporary partial disability
2. Temporary total disability
3. Permanent partial disability
4. Permanent total disability

These four categories of disability, while conceptually distinct, actually fall into a continuous spectrum. For example, a chef who breaks his hand would probably suffer a temporary partial disability: partial because he can still use the other hand and arm to perform some duties and temporary because the hand should heal in less than six months. However, this same injury may leave the chef with a permanent partial disability if the broken hand will always be too weak to do some of a chef's normal work. Less dramatically, a cold or flu that confines a person to bed or home for a few days or a week generally would be classified as a temporary total disability because this illness prevents one from going to work. Finally, a pianist whose left hand has been amputated above the wrist typically would be considered permanently and totally disabled as a musician.

These examples, slightly altered, also illustrate why categories of disability can be arrayed in a spectrum, as well as separated into four separate categories. For instance, if the flu that confines a person to her house for a week develops into a severe chronic respiratory condition, a temporary total disability may turn into a permanent partial—or even a permanent total—disability. Similarly, the chef's hand injury may take longer than six months to heal, thereby making his temporary partial disability permanent. Conversely, if this chef restructures his career and becomes a food service manager, he may no longer have any occupational disability even though the condition of the injured hand remains unchanged.

These examples also illustrate that *disability* can be defined properly only in the context of a given job, and only from the perspective of the afflicted person and his or her employer. A person disabled for one job may be perfectly able to perform another. If this other job fully satisfies the emotional and financial needs of a person once unable to perform the essential functions of an earlier job, he or she is no longer disabled. Similarly, if a job environment and an employer's attitude allow or encourage the essential functions of a job to be redefined, a realignment of a seemingly disabled person's job duties or reassignment to completely different functions may again completely change the meaning of *disability*. Nonprofit organizations, especially those whose missions focus on human health, have long been particularly adept at finding employment opportunities within their own workforces for people whom other organizations might well consider disabled, and for encouraging other employers to stress each individual's abilities rather than disabilities.

Nonetheless, injuries and illnesses to employees, volunteers, board members, and other workers can bring unexpected losses to a nonprofit. Temporary total disabilities require that each disabled person's work either be assigned to others for a while or go undone. Temporary partial disabilities reduce or slow the output of the disabled person, perhaps requiring that he or she receive others' help. Permanent partial disabilities require a permanent change in a disabled person's work. Changes can include reassignment to another existing job for which the person can still perform all the essential functions, creation of a new job that the person can perform, or outplacement assistance to the disabled person in finding work elsewhere that he or she can perform, either as an employee or as a self-employed person. Total permanent disability, by the definitions used here, ends a person's working career. Nonetheless, many people once considered permanently and totally disabled have by themselves, or with the help of appropriate nonprofit organizations, fashioned highly productive lives.

Any disability that interrupts or otherwise detracts from the regular performance of any worker reduces a nonprofit's net income by increasing its costs or reducing its revenues. These adverse net income effects often include:

- Costs of changing others' work patterns, temporarily or permanently
- Costs of finding and training one or more replacement workers

- Costs of modifying a worksite for the newly disabled worker
- Medical costs of this disability that nonprofit must absorb or opts to absorb
- Reduction in contributions or other income that the newly disabled person normally would have generated

Beyond these net income effects, a nonprofit may face legal liability for the disability of a worker. For example, a nonprofit's employee who suffers a job-related injury or disease is entitled to state-mandated workers' compensation benefits. Under certain circumstances, an injured worker may sue his or her employer for negligence. Such harm to workers as well as to others is discussed in Chapter 5 in connection with a nonprofit's broader liability exposures.

Gradual Loss of Ability

Injuries and diseases that deprive a nonprofit of the services of an employee, volunteer, or other worker usually occur or clearly begin at a fairly definite point in time. Someone breaks a leg, is hospitalized for cancer, or enters a drug rehabilitation program at some identifiable date and either is or is not back working rather normally for a nonprofit by some future date. The same is true of injuries or diseases that strike a nonprofit's valued donor or public supporter, interfering with his or her contributions or other efforts on the nonprofit's behalf.

Quite different, often more difficult to recognize, and sometimes impossible to pinpoint in time are disabilities that advance slowly with age, unmarked by any specific incident of injury or disease. In households, in for-profit organizations, and in nonprofits, some people just grow too old, too weak, too tired, or too confused and absent-minded to perform their regular functions effectively. Such people are disabled, either partially or totally, and are likely to remain so, even though they have not recently broken any bones or received medication for any particular medical condition.

In any well-managed organization, the presence of workers who gradually lose their abilities must be addressed. In some cases, replacing the worker may be necessary to keep the organization functioning productively. In many other cases, however, reassignment of duties and other forms of accommodation may be effective in keeping the talented worker on board and contributing in a positive way to the organization. These workers should always be treated respectfully, with all the legal and human rights to which everyone is entitled. Managing these situations requires conducting regular performance appraisals based on specific goals, in conjunction with other enlightened human resource practices, and taking other steps to protect the rights of these workers.

In some community-serving nonprofits, the emphasis on charitably helping others who are in need can lead to retaining workers whom, for the sake of the organization and the well-being of its clients, should be replaced with other, more able people. This focus on kindness toward the respected veterans (perhaps founders of a nonprofit or pioneers of its cause) may cloud management's vision of their future mission and of the perhaps somewhat anonymous constituencies it is pledged to serve. As a result, some nonprofits do not release long-time workers whom other organizations would recognize as no longer effective. Such practices—though commendable from a humanitarian perspective and perhaps seemingly unavoidable for a nonprofit that has no policy for dealing objectively with gradually deteriorating workers—may not represent the best use of a nonprofit's resources. A better path, and one more in keeping with the fiduciary duties of a nonprofit's officers, may be to develop appropriate policies and procedures. Even though implementing these policies and procedures may take time, the time spent on this activity is likely to be a good investment in any nonprofit's future.

Catastrophe (Multiperson) Events

The death, retirement, disability, or gradual decline of one key person is not likely to doom a nonprofit that has achieved any size or a significant record of past accomplishments. Several deaths or disabilities in a single tragic event, or several essentially simultaneous retirements of a nonprofit's senior managers who are very close in age, can leave the organization unable to function adequately.

Good risk management, as well as common sense, calls for some preventative loss-control measures to reduce the likelihood or severity of multiperson losses. These include:

- Minimizing the number and length of occasions when a high percentage of a nonprofit's key people travel or appear together and taking reasonable precautions during such occasions (security experts picturesquely label this strategy as reducing the hand grenade problem; mountaineers call it the avalanche problem).
- Making and rehearsing contingency plans based on hypothetical situations in which combinations of a nonprofit's key people are not available for extended periods.
- Developing succession plans that reach throughout all levels of a nonprofit's management, and encouraging managers to share information that others would need if they had to replace a colleague following an emergency.

No general list of safeguards and alternatives for multiperson losses can be fully appropriate for any given nonprofit. The essential point is for the management of each nonprofit to discuss such possibilities frequently and frankly. Exploring this question thoroughly is good risk management in any uncertain threat to any of a nonprofit's property, income, reputation, and people resources. The key is to ask—and work to answer—this question. The general question may remain the same, but the correct specific answers to it usually change at least annually and sometimes weekly or even daily.

Loss of Dedication

All the perils discussed so far threaten all people who work for or otherwise support a nonprofit, governmental, or profit-seeking organization. The final two perils treated here—loss of dedication and loss of personal financial resources—also can adversely affect all people, but they are particularly crucial for people in the nonprofit sector. This is because dedication and personal resources affect everyone's enthusiasm and ability to work and serve as they wish, but these two factors usually are most essential for those dedicated to nonprofit activities. Many people in other sectors work more for money and other tangible rewards than for a cause; they seek satisfaction by gaining personal resources and personal time for leisure. For many in the nonprofit sector, satisfaction comes from giving their material resources and their personal time for a cause to which they are dedicated.

Frustrate that dedication or diminish those personal financial resources, and the people serving a nonprofit can dwindle or even disappear.

A nonprofit's workers, clients, and supporters lose their dedication to a nonprofit's mission because either (1) some other, outside cause becomes more important to them (perhaps the mission of another nonprofit, their children's education, or a new personal career) or (2) the nonprofit organization to which they have been dedicated somehow becomes less worthy in their eyes (maybe because of poor governance, a shift in mission, or some personal conflict or affront). To lessen the threat that outside causes or personal interests may lessen others' allegiance to it, a nonprofit must continue to remind its paid and volunteer staff, service recipients, and supporters about the importance of that nonprofit and its mission in their lives. To remain worthy of its support among its present staff, service recipients, funders, and others, a nonprofit must not only continue the activities that first generated this support, but it must also take care that any changes it is considering making in order to attract new groups of people do not drive away significant numbers of its current constituents. Both these tasks—remaining a sufficiently strong positive force in the lives of those now dedicated to it and attracting new workers, clients, and supporters—can be daunting and risky. Because no organization in history has yet succeeded in being all things to all people, a nonprofit's leadership may sometimes have to face difficult, risky, mission-critical choices and to make decisions it wishes it could leave to others.

Loss of Personal Resources

A nonprofit's staff and supporters, occasionally even its service recipients, may sometimes no longer have the resources—principally money and time—to continue their relationships with the nonprofits to which they have been committed. During recessions, for example, individual donors may reduce their contributions. Volunteers may have to seek paying jobs to make up for another family member's unexpected unemployment. In times of actual or threatened war, those who might otherwise be volunteers may enlist or be drafted into the armed forces. There can be stressful economic, political, or even personal circumstances when one does not have the time to enjoy or to support the better times nonprofits offer. In these times, for these people, each nonprofit must again stress the importance of its mission and of each worker's personal efforts to achieve it.

Consequences of These Perils

The perils that threaten the lives, health, productivity, and generosity of a nonprofit's people—its staff, clients, and supporters—have many adverse consequences for the nonprofit itself. These negative effects can endanger both a nonprofit's financial condition and its ability to fulfill its community-serving mission.

Financial Consequences

Having good people produces income for nonprofits; losing good people, for any reason, imposes costs on nonprofits. On the positive side, a nonprofit's people provide the energy that generates its revenues by providing client services, seeking public donations, presenting grant proposals to foundations and governmental agencies, and producing goods and services sold to the public. On the negative side, losing people to death, retirement, termination, disability, loss of dedication, or loss of personal resources not only diminishes these revenues but also increases the costs incurred trying to adjust for the absence of key personnel. With less income and additional expense, a nonprofit that loses its people to any of these perils faces greater challenges in fulfilling its mission.

Mission-Critical Consequences

When a nonprofit begins to lose its people at an unusual rate, it is likely to lose even more people. Such losses can take the form of long-standing staff vacancies, shrinking ranks of volunteers, needs for outside contractors that go unfilled, a diminishing client base, defecting financial supporters, or (perhaps worst) a reputation as being an unsafe place to work, volunteer, or seek community service. If it is public knowledge that others are leaving, potential new workers, clients, and supporters must question why they should sign aboard an organization reputed to be a sinking ship. The best solution is for a nonprofit to avoid such a reputation, to nourish and safeguard its people—its most valuable resource.

Chapter 7

Reputation and Mission Risks

The soul of any nonprofit is its mission. The fundamental nature of the organization, particularly as it is perceived by the community, is shown in how the mission is displayed and reinforced through its actions and decisions. The blending of the mission and public perception can be thought of as reputation. The mission of every nonprofit is as unique as that organization's reputation in the community. Some nonprofits enjoy a high profile in the community and with it a corresponding level of respect and prestige.

A nonprofit's mission is distinct from its reputation. The mission is the helm that guides the nonprofit to its overarching goal. The focus of the mission is intended to establish the operational parameters of the organization. Its *reputation* is the community's collection of beliefs, perceptions, and experiences that either support or refute the values, principles, and worth of the organization in the eyes of the community. A nonprofit's mission and its reputation are each subject to separate sets of threats.

Unique Characteristics of Nonprofits That Highlight Mission and Reputation Risk Areas

Nonprofits do not earn profits; they accumulate surplus. Although they do not provide equity to shareholders, nonprofits are expected to operate in a manner that may accumulate surplus, income exceeding revenues, in a given year. The term *nonprofit* does not mean that these organizations operate at a deficit. Any excess of income over expense is expected to be put into the operation of the organization to support its mission. Although the range of services provided through nonprofit organizations is extensive, they all operate in a competitive environment, particularly as they seek to obtain human resources, grants, contracts, and other resources.

Human resources within nonprofits generally comprise paid and non-paid staff, or volunteers. As with any organization, the conduct of the people affiliated with the organization can pose risks to its reputation. Nonprofits being somewhat public entities, however, are often subjected to more rigorous scrutiny, particularly by the media. Another unique characteristic of nonprofit organizations is that their governance entities, or boards, are generally not compensated. Board member service is voluntary in the independent, or nonprofit, sector. As such, nonprofit board members are expected to make business decisions that promote the mission of the organization, and are free from any potential benefits to themselves or family members.

In recent years, nonprofits have begun to work collaboratively and contractually with other nonprofits, public-sector agencies, and even private-sector firms. Contractual arrangements for provision of services can be uncharted territory for many nonprofits, who are accustomed to receiving revenue from donors, grants, and other private funding on a gift basis. Entering into contractual agreements for provision of services is not unique to the public and private sectors but can be problematic for a nonprofit organization if the contract is not consistent with the mission of the organization. As attractive as collaboration opportunities with the private sector might be, they contain potential risks to both the organization's mission and reputation. As with any other collaborative partner, each opportunity needs to be carefully examined with due diligence to ensure that the organization's business focus, advertising, past history, and other elements of its identity do not pose potential problems for its mission and reputation. Often sufficient care is not extended in vetting out potential partners. The allure of relatively easy income has a way of obscuring the realities of questionable business practices, previous controversies, or a conflicting perspective.

Mission Risk: What Does a Mission Statement Reflect?

The focus of the mission is intended to establish the operational parameters of the organization. The mission summarizes why the nonprofit exists, what services it provides, who it serves, and possibly the nonprofit's overarching values. The legal standard of obedience reflects on the obligation of board members to make decisions and take actions that are consistent with the nonprofit's mission statement. Assets are acquired and preserved to support the nonprofit's mission. Paid and volunteer staff and donors are recruited because the nonprofit's mission inspires them to give service or funding or both. Clients seek assistance from the nonprofit because they believe that their needs are consistent with the service area(s) described in the organization's mission. The nonprofit's mission tells the world who they are and what they do and describes the ethical substance of the organization.

If the nonprofit, its board, or its paid and volunteer staff act in a way that either appears or is in fact contradictory to the mission, then the organization is vulnerable to risk. Some of the ways in which the mission of the organization can be compromised include but are not limited to:

- Accepting a donation in exchange for doing something that is at odds with the mission, or from a source that contradicts the nonprofit's values
- Entering into a contract to do something that is contradictory to the mission
- Discriminating against people who might qualify for services
- Making decisions that are openly discriminatory regarding eligibility for services dispensed or clients accepted, or making other arbitrary and capricious decisions
- Failing to publish and update eligibility requirements for services and failing to ensure that all who are eligible receive services in a consistent manner
- Entering into a collaborative relationship with another organization—public, private, or independent—whose mission or business practices are contrary to or inconsistent with those of the nonprofit.

The nonprofit's actions are always subject to public scrutiny, particularly via the media. In order to maintain public trust, the nonprofit needs to ensure that the focus, structure, and semantics in the mission statement accurately reflect the organization's overarching goal.

Strategies for Dealing with Risks to a Nonprofit's Mission

Funding and Revenue Issues

Sources of funding and income can pose risks to a nonprofit's mission. In a nonprofit board's zeal to maximize revenue opportunities, decisions can be made to accept funding from individuals, foundations, and private-sector firms whose reputation, political agenda, or other characteristics make the funder a questionable partner. The quest for funding can also cause a nonprofit to seek contracts to perform services that are either inconsistent with or outside of the organization's mission.

Clarity and focus are key elements in preventing these missteps. The nonprofit's board must clarify how the mission of the nonprofit is demonstrated through its services. The focus of the mission should provide the framework for decision-making in terms of seeking grants and contracts or deciding to accept private or corporate donations. As difficult as it may seem, the board must be prepared to decline financial partnership with funders who are not a fit with the nonprofit's mission.

Client Base and Eligibility for Services

The nonprofit's mission should provide an overview of the targeted client base that the organization seeks to serve. The eligibility requirements need to further elaborate the types of services that will be provided to the intended client base. Eligibility requirements are intended to assist clients in presenting any necessary documentation to the intake worker, understanding the extent of the services provided, the timeline for services, and the conditions under which eligibility either runs out or can be revoked. Risk areas in determining a client base and presentation of eligibility requirements center around the perception or reality of discrimination. If a client base is limited to a particular gender, age, or other attribute, these need to be clearly articulated.

Allegations of bias can also emerge from poorly communicated eligibility requirements. To prevent misunderstandings, the nonprofit's board needs to ensure that senior management has the eligibility requirements available for distribution to clients and translations of the requirements available in the primary languages that clients speak. Eligibility requirements should also be clearly posted and available in the nonprofit's offices. If eligibility for services is means-tested (i.e., the potential client needs to demonstrate a particular income level), there must also be a listing of the types of documents that could be presented to satisfy this requirement.

Programmatic Focus

Introducing a new program is always an exciting part of nonprofit life. However, before the program is introduced, discussion needs to take place at the governance (board) level to ascertain the new program's relevance to the nonprofit's mission and to determine the degree to which the new program is consistent with the organization's values and focus.

Board review is particularly important if the new funding is being sought to support the program or if the program is emerging from a contractual relationship with either the public or private sector. If the program is the outcome of a contractual relationship, the board also needs to determine the nature of contractual requirements, which could include specifications on reports, the professional credentials of staff, and other deliverables.

The keys to establishing strategies for dealing with risks to the nonprofit's mission are board oversight and management's clear understanding of the nonprofit's mission and its function in policy-making and programmatic structure.

Reputation Risk

Farmingdale Center, River Day Care, Knoll Elementary School, and the Blue Chip Animal Shelter all provide case studies of reputation risks. The Farmingdale Center was one of the oldest providers of services to people living with HIV/AIDS when it was almost decimated by a scandal. No one took the money and went to Tahiti. No one was killed or injured. All the clients were served, and the paid and volunteer staff who stayed on received the level of support that they expected. So what was the problem?

Why did the reputation of this premier nonprofit suffer an almost terminal hit? Why did the county government terminate its contract with the center and force it to hand over its major program to another agency?

Farmingdale could not adequately account for the money it had received in conjunction with the contract it had with the county. The money came in, services were rendered, but there was no detailed accounting for the related expenditures, no statistics gathered, seemingly no accountability. The board rubber-stamped the decisions of a series of charismatic, yet dysfunctional executive directors. Management "teams" generally consisted of sycophants who always ensured that the current executive director's wishes were carried out. No one recognized that in addition to deficient management and governance entities, the organization also had an inadequate IT infrastructure. The accounting software was of such low quality that it could not generate the types of reports that were required by the terms of the contract the organization had with the county. The software also could not track and record the categories of expenses that were necessary to provide documentation of expenditures. In short, the organization was ill equipped to meet the reporting requirements of the contract, and it failed to recognize that their managerial and infrastructure dysfunction combined to create an almost lethal blow to the services their clients had come to expect. The saga of the nonprofit's managerial dysfunction and lurid tales of board and senior management interaction filled the newspapers for months. The donations fell from million-dollar levels to barely in the thousands. Volunteers left in droves because they were ashamed to be associated with the organization.

The organization did not die, but it was reduced to approximately one-third of its earlier size. Its most valued program was given to another organization. Almost 10 years, three executive directors, and many board members later, the organization finally recouped its good name in the city. It took nearly a decade to repair the damage to its reputation.

Risk Issues—Reputation

Because a nonprofit's reputation can be made vulnerable for seemingly minor infractions, it is important to recognize the value of a proactive approach to managing relations with the public. Even allegations or appearances of wrongdoing can have damaging effects. Examples of the types of risks that might damage the nonprofit's reputation include:

- *Failing to handle low-level crises in an effective and sensitive manner.* What sometimes begins as a small disruption or complaint can grow into a crisis due to mismanagement or a lack of sensitivity on the part of the nonprofit's management or staff.
- *Injuries due to lax maintenance of vehicles or physical plant, particularly if the person injured is a client or a member of the public.* Safety and security are implicit values in any nonprofit organization's culture. However, budgetary shortfalls or management shortsightedness can result in a physical plant that has poor outside lighting, faulty sidewalks or stairwells, and the like. Chronic safety issues can raise larger issues regarding the quality of service provided by the nonprofit.
- *Adverse publicity resulting from allegations of mismanagement or criminal behavior.* The two key terms in this risk area are *adverse publicity* and *allegations*. When accusations of mismanagement or criminal behavior occur, these claims are generally front-page news. However, the exoneration of the parties involved is rarely headline news.
- *Allegations of fiscal mismanagement.* When adverse publicity suggests that donor monies, or taxpayer monies if the nonprofit has a contract with the public sector, are being mismanaged, that creates a long-term cloud of mistrust over the organization.
- *Allegations of the nonprofit's staff injuring clients or the public.* Clients and the public need to feel that they can trust anyone associated with the nonprofit.
- *Allegations of discriminatory behavior toward clients, paid and volunteer staff, or others.* Anyone associated with the nonprofit, whether clients, employees, volunteers, donors, vendors, or other stakeholders, need to feel secure that they will not be subjected to discriminatory behavior.
- *Board decisions or behaviors that are in conflict with mission.* Board actions can either serve to reinforce or contradict the mission of the organization. In particular, board decisions to accept funding from or collaborate with sources whose values are in conflict with the mission of the organization put the nonprofit's reputation at risk.

- *Staff behavior that reflects poorly on the organization.* Staff, particularly volunteers, often are unaware that when they are working on behalf of an organization, they *become* the organization in the eyes of clients or the public. These observers have expectations of the organization that could easily be at odds with the behavior of the employee or volunteer.

These risks can not only damage the nonprofit's reputation, but they can also jeopardize its ability to fulfill its mission. Although adverse publicity and unfounded allegations may not completely destroy a nonprofit, the Farmingdale example illustrates that it can take several years for a nonprofit to regain public trust.

Implications of Damage to the Nonprofit's Reputation

Once a nonprofit's reputation is damaged, the initial adverse publicity may subside, but the damage remains. Why did it take the Farmingdale Center several years to regain its good name and reputation in the community, particularly when funds were not misappropriated, as was first claimed? This case illustrates the impact that damage to the nonprofit's reputation has on three organizational dimensions.

Economic

Damage to an organization's reputation can result in an immediate drop in donations from private and institutional donors. Even institutions, foundations, and corporations with long-standing ties to the organization would be reluctant to have their names associated with a nonprofit whose reputation has been called into question. Another aspect of revenue generation in the independent sector has been in the area of providing services to the public and private sectors on a contractual basis. As was shown in the Farmingdale example, the county rescinded the contract because Farmingdale could not produce the reports that were stipulated in the contract. The initial scandal highlighted Farmingdale's administrative and management deficiencies, but the more damaging long-term results came from the termination of the county contract and the persistent public belief that criminal activity had taken place.

Intellectual Capital

An organization's intellectual capital is the collective creativity, vision, and intellectual functioning of all its human resources. For a nonprofit organization, intellectual capital is represented in the composition and skill sets of its board, senior management, employees, and volunteers. In the wake of a scandal, a nonprofit could lose valuable intellectual capital through resignations from board members, staff, and volunteers. The individuals involved in the allegations may be suspended or terminated. Even if these individuals are guilty of wrongdoing, they possess knowledge about the institution's history, systems, and other critical functions, and their absence leaves a gap in the management of their departments and in the institutional history that they possess.

Additionally, the organization's damaged reputation could act as an obstacle to recruiting talented management and staff, gifted board members, and volunteers. Professionals who might offer *pro bono* services would be reluctant to have their names and professional reputations associated with the nonprofit. A major scandal, or even a series of minor but public crises, can have a chilling effect on the ability of the people left in the organization to be creative or to be proactive in their community outreach. They may be constantly subjected to questions or negative comments about the organization and the nature of the crisis.

Public Confidence

A nationally known, well-respected nonprofit recently declined a six-figure donation from a private donor. The donor was not a criminal or a person of ill repute. The donor was a lottery winner. One of the nonprofit's primary focus areas is helping people who are addicted to gambling to stop gambling and restore their lives. The nonprofit's leaders felt that by accepting a donation that was part of the proceeds of a lottery payoff, they would be compromising their mission. Their decision to stay true to their mission even by declining a large donation made national headlines and affirmed their commitment to their cause. The same might not have been true if they had made national headlines by accepting the donation.

Damage to a nonprofit's reputation can shake public confidence, and the damage can be further reinforced by the actions of the board, staff, and volunteers. The fallout can take many forms, some subtler than others. Economic pressures and community focus now emphasize a greater need for collaboration within the independent sector. Institutional funders, such as foundations, seek to have nonprofits partner with other nonprofits to achieve a greater economy of scale in service delivery. A nonprofit suffering from the effects of a reputation crisis generally makes for a poor choice in collaborative partnering. The subsequent isolation further reinforces the negative image of the nonprofit and calls into question other managerial and governance aspects of the nonprofit.

Collaboration, however, is not always an optimal—or voluntary—choice for survival. In the Farmingdale case, the county government forced a collaborative arrangement between Farmingdale and two other service providers to the HIV/AIDS community. The purpose of the arrangement was to ensure that the lead agency provided additional oversight to Farmingdale's board and senior management. Continued public funding from the county was contingent on Farmingdale's acceptance of this collaboration. It took Farmingdale eight years, three executive directors, and an award of damages against their previous auditors to wrest itself from this arrangement.

The private sector has demonstrated interest in collaborating with nonprofits. Corporations have begun to choose nonprofits as community partners. The corporations can enhance their reputation within their community by its support of a worthy nonprofit in the form of financial contribution and corporate volunteers. Again, image is everything. Corporations want to be associated with nonprofits of solid reputation, ensuring that their employees are offering their corporate volunteer time in a safe, supportive environment.

Strategies for Dealing with Risks to the Nonprofit's Reputation

A crisis need not escalate into a disaster for the nonprofit. In particular, a low-level crisis need not ever escalate into a major crisis. When a complaint or problem is brought to the attention of management, it is important to treat the person raising the issue with respect and sensitivity. Often complaints are taken to public authorities because the individual believed that his or her complaints were arbitrarily dismissed without sufficient investigation. If a customer service paradigm informs the nonprofit's culture, low-level crises have a better chance of being resolved without additional commotion. A highly developed customer service paradigm pays additional dividends in maintaining the organization's positive public image.

A prudent board and senior staff recognize that crises can arise from a fire at the organization's offices, the death of a key person, an allegation of inappropriate conduct, or a host of other reasons. The way in which the nonprofit initially responds and conducts itself throughout the duration of the crisis can be a key factor in maintaining public trust. For this reason, it is important to institute a crisis-management plan that includes the following components:

- *Designated spokesperson.* Determine who will act as spokesperson(s) for the organization and ensure that everyone in the organization understands that only the spokesperson is to speak on behalf of the nonprofit. Staff should also know that unauthorized contact with the media will be grounds for dismissal or other sanctions. All media requests are to be directed to the spokesperson.
- *Prepared Statement.* Develop generic prepared statements that can be tailored to address the nature of specific crises and supplied to the media (Exhibit 7.1). The statement itself need not be long but should include all necessary information.
- *Written procedures.* Develop written procedures for steps to be taken if an accident or other adverse occurrence takes place. Ensure that all staff, paid and volunteer, understand what is expected of them and receive appropriate training to practice these actions. These procedures should be readily accessible and placed in various locations in the offices and in electronic format.

The manner in which an organization responds to crisis can either instill public confidence or diminish current confidence levels. As an illustration of the critical nature of crisis *planning* and its role in the quality of the nonprofit's response, compare the organizational reaction in these three cases.

EXHIBIT 7.1 Sample Statements Issued in a Crisis

Here is a sample statement that would be issued in the event of a scenario that disrupted operations.

To: Media Contacts
From: Name of the Nonprofit
Re: [nature of the crisis]

On [give the date] the [name of the nonprofit] [state what has transpired]. We immediately activated the business resumption plan that we had in place in the event of such an occurrence. We expect to have key operations in place by ________________________ and to be fully operational for all functions by ____________________________________. Our telephone number 555-5555 is fully operational and callers can leave messages for staff members. We will be in touch with you via fax or e-mail frequently to update you on our progress. We also have information available on our web site [provide web address].

The following statement would apply to other crisis scenarios, such as allegations of misconduct.

To: Media Contacts
From: Name of the Nonprofit
Re: [nature of the crisis]

On [give the date] the [name of the nonprofit] [state what has transpired]. We are treating all information regarding this allegation as confidential at this time, and we will not discuss the case further. [Name of nonprofit]'s primary concern is for the welfare of our clients and we are cooperating with authorities to resolve the questions raised by these allegations.

Case 1: River Daycare Center

The assistant director of the River Daycare Center was arrested for child molestation. The parents of a child in the daycare center called police to report that their child had told them that Mr. Smith, a member of the daycare's staff for nine years, had touched him inappropriately. Mr. Smith was arrested and held without bail. The story made headlines throughout the region. There was no comment from anyone at the daycare center. No interviews were given, no statements released. Three months later, Mr. Smith was released for lack of evidence. The daycare center still had not made a public statement.

Case 2: The Knoll Elementary School

An elementary school teacher was arrested in a hotel room 50 miles from his school. The FBI had tracked him there as he had arranged to sell drugs to an undercover agent. The teacher was arrested after a struggle with law enforcement. Parents of the children in his class were horrified to learn about the incident and were concerned that he might have been selling drugs in the school. The assistant superintendent of schools in the town met with the media, provided a copy of the letter that the school district had sent to the parents of all the children at the Knoll School, and assured the public that the school district and the school principals monitor the activity of all teachers during the school day and while the teachers are on school property. He also advised the media that this teacher had been subject to the same rigorous background check, including fingerprinting, that all teachers in the school district must have. This teacher's background check showed no indication of any criminal behavior. In conclusion, the assistant superintendent stated that the teacher would be put on unpaid administrative leave pending the outcome of the criminal case against him.

Clearly, the Knoll School and its school district had plans in place to deal with the crisis that resulted in the arrest of a member of their teaching staff. The parents and the public knew that the school district had written letters to the parents of all the students, had done a background check on the person before hiring that had not indicated any criminal history, and had placed the person on unpaid administrative leave. That amount of information was sufficient for that point in the events. In contrast, the River Daycare Center did nothing to allay the fears of parents or the public about a member of their staff who had been accused of molesting a child. The reputation of Mr. Smith, despite his subsequent exoneration, was damaged to some extent. The public also observed that his employer did nothing to support him or express confidence in him as a valued employee.

If the cause of the adverse publicity reveals the actions of the board or a disgruntled board member, the challenge of recouping the organization's good name is even more difficult. Even if crisis management activities are set in motion immediately, the crisis itself causes disruption and can result in an unwelcome interruption to the normal board and nonprofit operations, as is the situation with case 3, Blue Chip Animal Shelter.

Case 3: Blue Chip Animal Shelter

Susan Smith, an employee of the Blue Chip Animal Shelter, anticipated a relaxing Sunday morning with coffee and the papers. Her expectations were dashed as she read the headline in Phil Mather's column. Mather, the premier muckraking columnist for the *Polk River Gazette*, had investigated the Blue Chip Animal Shelter's choice for a new executive director, Bob Green. Green had been recruited from another state, where his expertise contributed to the phenomenal growth of the Desert Animal Shelter. Blue Chip's board needed to make a generous offer to attract Green, but the details were supposed to be confidential. One or more board members were clearly irate about the offer and had contacted Mather with the astounding details. Green's executive package was to exceed the compensation of the CEO of the city's largest employer! As Blue Chip's biggest fundraising event was scheduled to take place in two weeks, Susan was in shock.

Even more disheartening, the intraboard battle at Blue Chip raged on for weeks in Mather's column, thanks to information supplied by the disgruntled board members. The municipality's city council even became embroiled in the controversy, demanding that either the compensation package had to be modified or they would terminate their contract with Blue Chip for animal rescue services.

In this case, the board leadership did not engage in effective crisis management, nor did they attempt to present a united front to the media. The crisis continued and became very public and political as the city council joined the debate. The board ultimately restructured the offer and attempted to conceal the enormous housing allowance that appeared to be what was fueling the initial debate. Several months later, Mather did a column on the resolution of the crisis and exposed the restructured package, which served to fuel the debate once again.

- *Maintenance of vehicles and physical plant.* Maintenance issues may appear to be in the realm of operations, but the overall appearance of the nonprofit facilities and their safety is essential in maintaining public confidence. The presence of common hazards, such as trash, peeling paint, and broken stairs, presents a poor image and suggests disregard for visitors, clients, and the public.

Staff Behavior and the Nonprofit's Public Image

Paid and volunteer staff are the nonprofit's fundamental resources in the delivery of services to the community. Often the employees and volunteers who deliver services and deal with clients and the public do not realize that, to the observer, they not only represent the nonprofit, they "are" the nonprofit. Consciousness raising regarding public image, particularly in service delivery and at special events, is an important step in maintaining a positive public image.

Although there are many ways to raise staff awareness, two effective methods are training and using public observers to help critique service delivery. Training for employees and volunteers should emphasize why maintaining public trust is essential and how staff behavior can either enhance or detract from the nonprofit's current good image. Modern culture has embraced the Top 10 List as a means by which essential points can be conveyed, including important dos and don'ts. If the list is printed on brightly colored paper and widely distributed, it will serve as a reminder to all.

Public relations training and consciousness raising can also be achieved through the use of role-play. As part of their training, employees and volunteers might be asked to work through typical scenarios, with other members of the group offering insight and recommendations. Consciousness raising is intended to increase the overall awareness of public image and help all staff to understand how they can be better representatives of the nonprofit to the community.

Another means of increasing employee sensitivity about image issues is the use of public observers. These individuals are recruited by management to observe service delivery techniques, customer service methods, and the quality of interaction with the public. The findings of the public observers, who are never identified, are conveyed to staff and volunteers at regularly scheduled in-service sessions. The sessions give management an opportunity to debrief the staff on the observer's comments and recommendations. The observations and recommendations need to be general in focus, and can serve as a springboard for recommendations on improving service. If specific counseling needs to be done with a staff member, it must be done in private. As the staff becomes used to the public observers' input, they can become more attuned to the correlation between their actions and public perceptions.

Mission and reputation risks highlight the need for the nonprofit's board and management actions to be in harmony with the mission of the organization. Although a nonprofit can never avoid a frivolous claim or litigation, the reputation that the organization has built and maintained over the years can be a crucial factor in helping it to defend itself and remain a valued member of its community.

Chapter 8

Managing Volunteer Risks

Volunteers in today's independent sector represent a new cultural paradigm, particularly in terms of age, diversity, education, skill set, and time commitment. More volunteers are seeking very short-term assignments, such as special events or done-in-a-day (DIAD) projects. Some have full time jobs in the corporate world and are volunteering as part of a larger corporate team. Community service programs for students are sometimes prerequisites for graduation. Across the country, community service programs have become part of mainstream academic programs at the elementary, high school, and collegiate levels.

Managing volunteer programs and the risks associated with these programs has also changed, particularly as the varieties of projects have grown, along with the number of single-event volunteers. This chapter focuses on how volunteer management risks can be addressed for short-term volunteer assignments, and also for the more traditional, longer-term volunteer programs. The factors of time and project duration have an impact on the design of orientation, training, and record-keeping. Shorter-term projects are particularly challenging in determining how to convey important information to volunteers without belaboring the process. Record-keeping is also a challenge with one-time projects or with collaborative projects involving the nonprofit and volunteers from a corporation, civic group, or church group. One way to begin to understand more about the new volunteer workforce is to compare cultural norms and workplace profiles that are separated by many years.

Exhibit 8.1 presents an abridged view of the changes in cultural norms and paradigms that have affected the workforce. These changes range from

EXHIBIT 8.1 Changes in Cultural Norms and Paradigms

	Cultural Dimensions	Mid-twentieth Century	Twenty-first Century
Social	**Gender roles**	Fewer women in the workforce; more women are full-time homemakers.	More women in the work-force; household and child-rearing duties are divided between partners.
	Family participation	Volunteers assignments were segmented according to age.	Families participate in volunteer projects together.
Workplace	**Skill set**	Professionals and highly skilled workers were predominantly men.	Diverse workforce: wide variety of skill sets, including technology, general contracting skills, fundraising, finance, legal, and other specialty areas.
	Corporate participation	Volunteers were generally individuals providing service outside the workplace.	Corporations partner with nonprofits by providing volunteer teams for special events.
	Technology	Typewriters, televisions, radios.	Wide array of electronic devices readily available and used by general population, such as computers, cell phones, pagers, PDAs, and laptops.
Volunteer service	**Expected duration of assignment**	Long-term relationship with a nonprofit.	Short-term assignments; minimal administrative bureaucracy; sign up on site the day of the event.
	Intrinsic rewards	Affiliation with nonprofit; volunteer awards.	Successful completion of project; popularity of done-in-a-day projects.

the composition and education of the workforce, to gender roles, to the types of technology adopted and accepted by the general population. The changes also bring about new expectations regarding volunteer assignments, duration of affiliation with an organization, and the current configuration of work groups.

Current volunteer programs have become more diverse in terms of volunteer staffing and the skill sets that volunteers bring to the organization. Because volunteers now reflect society's growing level of diversity, volunteer programs have also become more diverse in their agendas, which now embrace environmental causes, disease-related causes (e.g., AIDS and breast cancer), and DIAD projects, such as Christmas in April and other forms of community activism.

In addition to their volunteer assignments, many volunteers are either employed or are between jobs, having been recently laid off or retired. Volunteers in the twenty-first century are better educated and more conversant with current technology, which makes them more open to new and different assignments. The more sophisticated skill sets that they bring to the organization can be utilized in assignments that 50 years ago would have been offered only on a contractual or *pro bono* basis. Many nonprofits use volunteers to play important fundraising roles, design marketing materials, develop databases, upgrade computer systems, or design and host web sites.

Short-Term Assignments

Many volunteer opportunities are now being configured and offered to individuals and groups in the form of DIAD projects. This abbreviated format makes the opportunity more attractive because (1) the project is generally offered on a weekend, or outside of normal business hours, (2) the project can be completed in one day, and (3) the need for volunteer administration is minimized. The DIAD concept also has appeal to civic groups, church groups, and corporate volunteer programs. Although the nonprofit can benefit from an intensive approach to a project, the abbreviated nature of the event raises some unique risk issues.

Risk Issues in Short-Term Assignments

- *Screening.* The condensed timeframe of short-term assignments leaves little time for a nonprofit to screen the volunteers involved. This can be particularly problematic if the volunteers are working with children or vulnerable clients.

- *Providing an assignment that keeps volunteers active and engaged.* Even though a day sounds like a long time, the DIAD concept presumes the assignment will last at least six to eight hours. The volunteers need to be as actively engaged at hour 6 as they were at hour 2. Idle volunteers, particularly young and inexperienced ones, can derail a project by inappropriate activities.
- *Providing meaningful orientation.* Volunteers for DIAD projects need information about the nonprofit and the project in a condensed, user-friendly format. The relevance and usefulness of the information is crucial in helping the volunteers to stay on task.
- *Supervision.* Often DIAD projects involve collaborative ventures with civic, church, or corporate groups. Decisions must be made about who provides supervision: the nonprofit or, in the case of a collaborative venture, the civic or corporate group. The parameters of supervision also must be established to provide the appropriate level of monitoring.
- *Safety.* Volunteers in DIAD projects are sometimes expected to use gardening or construction equipment to complete their assignments. Risk increases if there are questions about volunteer familiarity and competence in the use of the equipment and the appropriate safety devices, such as goggles or gloves.
- *Public relations and the nonprofit's reputation.* In short-term projects that involve working with clients or the public, the nonprofit must ensure that customer service standards are conveyed in a truthful manner. At a walkathon fundraiser, a nonprofit collaborated with a civic group to provide volunteers. The civic group's volunteers were provided with only a minimal description of tasks and expectations. Several members of the civic group's volunteers were assigned to the entrance of the VIP tent. The volunteers were told that only individuals with identifying VIP badges were to be allowed in—no exceptions. Supervisors from the nonprofit's walkathon were not close enough to be summoned if the volunteers needed assistance. One couple attempted to enter the VIP tent; the husband had a badge, but the wife did not. Both the husband and wife were wearing T-shirts with the logo of one of the walkathon's major corporate sponsors. The volunteer apologized about

the situation and explained that only individuals with badges were permitted to enter. The wife became furious and loudly exclaimed that she would never attend this event again. Her husband was also very angry and the couple stomped off. The volunteer was horrified and sent another volunteer off to find the supervisor. When the supervisor arrived, she told the volunteer that the "no exceptions" rule was flexible and that couples could be let in if one of them had a badge. The volunteer felt terrible about the incident because he knew that by following what was presented as a hard and fast rule, he might have alienated a major donor. This nonprofit did not understand that the way it treats and instructs its volunteers is a part of public relations.

- *Protecting the nonprofit in a collaborative venture.* A major risk issue centers around who is responsible for short-term volunteers, the nonprofit, the sponsoring organization, or the individual volunteer. Particularly in collaborative ventures, it is important for the nonprofit to establish which organization is responsible for supervision, insurance, and other risk areas.

The brevity of the assignment and the interaction with volunteers establishes unique risks for the nonprofit, but short-term projects are an attractive way to introduce volunteers to the nonprofit. If the volunteers have a good experience, they are likely to return for short-term projects routinely.

Strategies for Dealing with Risk Issues in Short-Term Assignments

SCREENING

The very nature of short-term assignments leaves little time for a nonprofit to screen volunteers. If possible, obtain the necessary data on each volunteer, before the event, such as name, address, and contact information, including e-mail address. *Do not ask for personal information such as Social Security number or date of birth*. Basic information is particularly important if the volunteer is from a corporate, civic, or church group. The list of volunteers must be shared with the organization, and only those volunteers on the list should be permitted to work that day.

If the volunteers are going to be driving either their personal vehicles or the nonprofit's vehicles for the assignment, each volunteer driver must submit a photocopy of a valid driver's license, proof of insurance (if driving a personal vehicle), and a clean driving record *in advance* of the workday.

PROVIDING AN ASSIGNMENT THAT KEEPS VOLUNTEERS ACTIVE AND ENGAGED

Volunteers should be provided with an active agenda for the day. They need to know where they should be and what they should be doing for the duration of the project. They also need to know how to get additional assignments (and that they are expected to look for additional assignments) should their initial assignment be completed early.

PROVIDING MEANINGFUL ORIENTATION

The briefing materials prepared for DIAD project volunteers should contain all the information that is necessary and sufficient to complete their assignments, along with a description of the deliverables for the day. The nonprofit should strive to include a brief description of the organization's mission, vision, and values. Of particular importance is the identity of their supervisors and volunteer job description. Volunteers need to know that their supervisor will be in the immediate vicinity if they need assistance, and that they can ask for interpretation of rules and guidelines.

SUPERVISION

When working with civic, church, or corporate groups, the issue of supervision can be challenging. The individual members of the group recognize an affiliation to their group rather than to the nonprofit. For this reason, it is particularly important to determine in advance who will supervise the volunteers and then communicate this clearly to the volunteers. Every volunteer should be able to name two individuals he or she can call on for supervision during the project.

SAFETY

Before the start of a DIAD project, all volunteers who will be using equipment that has dangerous components, such as a staple gun, lawnmower, clipper, or hedge trimmer, should be required to pass a practical test. The volunteer should be able to demonstrate that he or she can (1) start the implement if it is has an ignition; (2) lift the implement and complete a typical task, such as trimming a hedge; and (3) use all necessary safety equipment, such as goggles and gloves. If the volunteer is unable to pass the practical test, he or she should receive another assignment.

PUBLIC RELATIONS AND THE NONPROFIT'S REPUTATION

Before the event, the nonprofit needs to review the nature of the project and determine the potential public relations risk issues that volunteers may pose in their assignments. Adequate supervision must be available for volunteers. No volunteer should be placed in the awkward and embarrassing position that the volunteer at the VIP tent experienced. In that situation, the nonprofit failed its volunteer and its corporate donor. If the rules can be waived by a supervisor, this needs to be conveyed to the volunteers, and a supervisor must be available at all times for consultation.

If additional clarity would help volunteers to do their jobs well, the nonprofit should prepare briefing materials that are user-friendly. Volunteers must be able to get information quickly. Materials should be printed on brightly colored paper using large type, presenting important telephone numbers or other data in prominent places.

PROTECTING THE NONPROFIT IN A COLLABORATIVE VENTURE

The use of a memorandum of understanding (MOU) is a means by which nonprofits can establish responsibilities in advance of the date of the project. The MOU should address supervision, insurance, identities of volunteers, the length of time that the volunteers will be working, provision of food and beverages, and other important issues. An MOU contains the following categories of information:

- Names of the organizations involved (the nonprofit and the collaborating organization)
- Contacts, or the project leaders representing the nonprofit and the collaborating organization
- Date(s) and time of the project – (the starting and ending times must be specified)
- Location of the project, including street address, city, and state
- Supervision, including which organization is responsible and accountable for supervising volunteers, with quality standards for adequate supervision specified

- Recommendations for attire (e.g., whether volunteers are going to be working outside, the need for comfortable work clothes)
- Safety equipment that volunteers need to bring, such as goggles and gloves
- Types of equipment that may be part of the project; the volunteers and collaborating organization need to know if volunteers might be using large equipment and to specify that volunteers will be required to pass a practical test before they are allowed to use the equipment
- Lunch breaks, coffee breaks, and who is responsible for providing food and beverages
- Insurance—whose insurance covers the volunteers
- Transportation—which organization is responsible for transporting volunteers to and from the project
- Other areas that might require clarification and responsibility delineation

Special Risk Issues in Volunteer Management for Short-Term Projects

WORKING WITH LARGE NUMBERS OF VOLUNTEERS AT SPECIAL EVENTS

Special events often require large cadres of volunteers. Planning is essential to ensuring that volunteers working at special events are safe, engaged in their assigned duties, and have adequate supervision. The planning process begins with the scope of the event. Consideration should be given to how long the event is scheduled to last, how tickets are to be sold, how other forms of revenue will be collected (e.g., proceeds from an auction), and how the proceeds of the event will be secured.

If the event has a designated volunteer coordinator, that individual should consult with the heads of each of the functional areas to determine the number of volunteers needed, what shifts have been established (e.g., more volunteers needed during the 12 noon to 3 PM shift), and what skills, if any, the volunteers should have. Before the event, volunteers will need to supply contact information and any other credentialing materials, such as driver's license, if necessary. Volunteers assigned to collect money, such as an admission fee to the event, or cashiers at a charity auction should receive a specialized briefing on procedures and protocols on handling money well in advance of the event. During the event, volunteers working with money or other valuable resources should be carefully supervised and safeguards put in place to protect volunteers.

The sheer numbers of people at large events can often be overwhelming. Before the special event, planners should examine the layout of the facilities and separate the space into zones. This will facilitate assignment of volunteers and the assignment of zone captains in charge of each zone. Within the zone teams of volunteers will be supervised by team captains.

WORKING WITH LARGE NUMBERS OF VOLUNTEERS IN EMERGENCY RESPONSE SCENARIOS

Emergency response scenarios also require much advance planning. Even though an emergency cannot be scheduled as a special event can, advance planning is still the key element. Many volunteers arrive spontaneously in the event of an emergency. These are people who just want to help. The identity and contact information for these spontaneous volunteers still needs to be recorded, as well as where the individual is to be assigned and the name of the supervisor. A sample form is shown in Exhibit 8.2.

EXHIBIT 8.2 Volunteer Emergency Contact Form

North Shore Neighborhood Center
Volunteer Data
Emergency Services

Name: ______________________________ Date: ____________________

Address: ____________________________ City/State/Zip: __________________

Telephone number: ____________________ Cell phone: ____________________

Pager: ______________________ E-mail: ________________________

Photo ID or Driver's License Number: ______________________________

Experience in emergency services? ______________________________________

____

____

Where placed: ______________________ Work shift: ____________________

Supervisor: ____

Although emergency scenarios are stressful, volunteer placement should always strive to achieve clarity in assignment and in articulating behavioral norms, such as staying until the end of your assigned shift. The planning process should include preparing relevant briefing material to ensure that the volunteer knows what is expected of him or her.

Long-Term Assignment Volunteers

Not all volunteer projects are DIAD. Some projects, such as mentoring, coaching a youth sports team, or working with seniors, can be long-term assignments. Selection and screening should correspond to the level of risk in the assignment. Volunteers who are working with children, senior citizens, or disabled children or adults should be subject to background checks. Volunteers should not be subject to background checks if their assignments are considered low risk or if they are not working with vulnerable client populations.

As part of the selection and screening process, prospective volunteers provide written permission to conduct a background check. A sample form is shown in Exhibit 8.3.

The prospective volunteer should be advised about the process, how long the background check should take, and when they should expect no-

EXHIBIT 8.3 Background Check Permission Form

Cold Lake Senior Center
Permission to Conduct Background Check

Name: ________________________________ Date: ____________________

Address: ______________________________ City/State/Zip: __________________

Telephone number: _____________________

I agree that prior to my assignment as a volunteer with the Cold Lake Senior Center, I will submit a sample of my fingerprints and permit the executive director of Cold Lake Senior Center to conduct a background check using fingerprinting and law enforcement databases.

Signed: ____

tification of the results. Nonprofits should also have information available for prospective volunteers that addresses erroneous results.

Effective Design for Orientation of Long-Term Volunteer Staff

In the past, the volunteer orientation was really a brief course in the history of the organization; the mission, vision, values, and programs of the nonprofit; and where and how the volunteer fits in. In the current volunteer environment, the length and depth of a volunteer orientation directly corresponds to the nature and complexity of the assignment. If the assignment calls for the volunteer to work with vulnerable populations or in a highly visible public-relations assignment, an in-depth orientation is a prudent investment of time. If the assignment is fairly routine, such as stuffing gift bags before a fashion show, the orientation can be streamlined. Because everyone—volunteer and nonprofit staff alike—are subject to intense time constraints, orientations should focus on information that is necessary and sufficient.

Volunteer Orientation Curriculum Components

Whether the orientation for new volunteers is to be abbreviated or extended, its design should fit the informational needs of the volunteers and communicate the organization's expectations and the parameters for service.

The following topic areas are a menu from which an orientation can be designed:

- Welcome and introductions
- Background: history and mission of the organization
- Program specifications—briefing on the program in which the volunteers will be assigned
    - Expectations of volunteer performance
    - Safety standards and training for the program
    - Behavioral norms and prohibited behaviors
    - Supervision and how volunteers can obtain assistance
    - Important information for the assignment
    - Interacting with clients, donors, and the public

Management and Supervision of Volunteers

In the orientation, the nonprofit briefs volunteers on how supervision is to be provided and how to obtain assistance when needed. Volunteers can become frustrated by a lack of clarity in providing directives or by difficulty in contacting a supervisor for guidance. Failure to provide adequate supervision can result in lapses in safety, errors, violations of nonprofit policies, and other undesired consequences. Lack of adequate supervision can also lead to clients' perceptions that they are being treated in a discriminatory manner, primarily because services are being provided in a nonstandardized manner. Clients may erroneously conclude that the volunteer is being arbitrary and capricious. Providing services in a standardized fashion is essential to ensure that clients are treated fairly and that they believe they are being treated fairly. Effective supervision needs to be fair, clear, psychologically valid, and rooted in appropriate organizational goals and objectives.

Administration and Record-Keeping

Document management is a challenge in any type of organization. For volunteer management, the challenge is determining which information to capture, how to store it, how long to store it, and how to keep it secure. Depending on the level of risk associated with the volunteer assignment, keeping a minimal amount of information on volunteers is generally a good practice. If the volunteer has specialized credentials or has had a background check, these records must be secured in a locked file cabinet.

If the nonprofit has both DIAD projects and long-term volunteer assignments, the volunteer files should reflect the relevant data collected for each category of assignment. For the purpose of this discussion, it is assumed that most administrative information is stored in an electronic database rather than in paper files.

SHORT-TERM VOLUNTEERS

Short-term assignments generally require only minimal contact information for the volunteer. If the volunteer has specialized training, such as operating a forklift or other complicated equipment, that information might be stored as part of the database entry.

Only data that is essential to the volunteer's work in the nonprofit's program should be gathered and stored. The only personal data gathered should be the volunteer's contact information, emergency contact information, and possibly the month and day of the volunteer's birthday for celebratory reasons. Avoid asking for data such as Social Security or driver's license numbers unless there is a compelling reason.

If the volunteer assignment requires specialized credentials, such as a health care provider license, specialized driver's license, other professional practice licenses, or a background check, these should be verified, up to date, and relevant to placement. If volunteers work in the nonprofit's offices on a long-term basis, they will need to be kept apprised of all workplace policies, such as those covering the use of computers, nondiscrimination, prohibition of sexual harassment, and compliance with the Americans with Disabilities Act. The nonprofit must have a written policy on computer use and to distribute it to all staff, paid and volunteer. If, in the course of their assignments, volunteers are expected to work with the nonprofit's computers, Internet access, or e-mail, they should be required to sign a memo stating that they have read and understood the computer policy. Use of the organization's e-mail accounts and Internet access can be a key part of a volunteer's assignment. It is important to ensure that volunteers understand that the e-mail and web access belong to the organization and that they should have no presumption of privacy. Misuse of the nonprofit's e-mail and Internet access could cause damage to the organization's reputation and create legal problems for volunteers and staff.

Volunteer Handbook

Volunteers working on long-term projects might benefit from the materials contained in a volunteer handbook. Relevance is key in determining what should be included in a volunteer handbook. Volunteers appreciate having a document that is user-friendly and contains the topics of information they might need. Following is a sample table of contents for a handbook.

- Brief background: Mission and history of the organization (relevant statistics, description of awards and recognition bestowed by the organization)
- Organizational policies
  - Use of computer
  - Prohibition of drug and alcohol use
  - Prohibition of sexual harassment
  - Prohibition of fraternization with clients
  - Other significant organizational policies
- Program description and parameters volunteers need (information about the program to which they are assigned, including program objectives and performance standards)
- Performance expectations and behavioral norms
  - Interaction with the public
  - Prohibited behavior and consequences
  - Grievance policy and due process
  - Required documentation for assignments, including fingerprinting
- Staff directory
- Calendar of events and activities for the upcoming fiscal or calendar year, including dates, locations, and times of volunteer recognition events
- Awards for volunteers
  - Types of awards and qualifications for them
  - The process by which individuals are considered or chosen for the awards

The manual should be organized so that volunteers can locate information quickly and individual sections can be changed as needed, since that may be the most efficient means of updating the manual. The emphasis should be on substantive content—less is more. If a volunteer has to plow through seemingly endless narrative—or worse yet—confusing and complex rules and requirements, they will be less inclined to see the document as a resource. Besides being issued to all volunteers, copies of the manual also must be placed in convenient locations on the premises so that volunteers can refer to it while they are at work.

Strategies for Managing Risk in a Volunteer Program

- *Consider using volunteer focus groups to design training and programs.* Volunteers want to do a good job, stay safe, and have their efforts reflect well on the organization. Their input into the type of training that is useful and relevant can help to develop ways to introduce risk management practices into every aspect of volunteer service.
- *Maintain an organizational culture that affirms and rewards risk management practices.* Volunteers learn about the nonprofit's values as they observe what is rewarded and what is punished. Risk management practices should be introduced into all aspects of the organization's life, including DIAD projects and long-term volunteer assignments. Helping volunteers to understand the connection between risk and potential loss is important, but even more significant is helping volunteers to understand how they can be part of the risk management team.
- *MOUs are important documents.* Collaborative partnerships are important in achieving outreach to the community and ensuring that the risk issues are addressed. A draft MOU should be developed as soon as discussion begins with a potential collaborative partner. The partner organization should work with the nonprofit to negotiate the terms of the MOU. Parties representing each organization should be appointed to see that the terms and conditions are carried through.
- *Obtain agreement to abide by the organization's computer policy.* The proliferation of technology makes using the Internet an everyday occurrence. The nonprofit's computer policy should outline appropriate and prohibited uses of technology and make it clear that any individual using its computers has no expectation of privacy. Volunteers who have access to the nonprofit's e-mail and Internet accounts must be fully briefed on their responsibility in its use and required to sign the organization's computer policy.
- *Supervision and guidance are key.* All volunteer projects need adequate supervision. The scope of the project should be presented in a manner

that allows volunteers to practice tasks if necessary and to ask for clarity or guidance. No volunteer should ever feel as though he or she is alone or will not be supported. Fostering a high level of trust between volunteers and supervisors is a key responsibility of all supervisors.

- *Tailor the requirements and training to the project task.* If the project is a DIAD, the briefing materials and the data needed from volunteers is more abbreviated than it would be if the program involved mentoring at-risk youth.

Chapter 9

Governance and Fiduciary Risks

The governing board of a nonprofit organization imparts the oversight and policy-making necessary to keep the nonprofit viable and in compliance with relevant laws and regulations. This entity can be called the board, trustees, governors, or by other nomenclature intended to indicate its role within the organization. The primary functions of the board are governance and fiduciary management. The board plays a key role in supporting the development of good risk management practices for the entire organization, but its efforts in addressing risk need to begin within the board itself.

The Nature of the Governance Role

The board of directors is the central governance entity of an organization. The nonprofit's bylaws or articles of incorporation present the regulatory context in which the board is expected to operate. Because of its critical role in the management of the nonprofit, the board's actions directly affect the operational viability of the nonprofit. To fulfill this responsibility, a board has a legal duty to conserve and protect the assets of the organization. These assets include not only money, property, and human resources, but also the integrity and reputation of the nonprofit.

Because governance involves both policy-making and oversight, board members should be fully prepared for discussion and decision-making at board meetings and should be prepared to engage in meaningful analysis of business opportunities and revenue generation. The essence of governance is providing vision and guidance to the nonprofit. The quality of the board's vision and its crafting of policies are directly correlated with the board's collective governance capability.

Volunteer Protection Laws

One of the most common misinterpretations of, or assumptions about, the state and volunteer protection laws is that these laws immunize *nonprofits* as well as volunteers. They do not. The clear legislative intent of many of these laws, including the federal law, was to ensure that a nonprofit that retains a volunteer, and not the volunteer, will be required to foot the bill for any harm resulting from the volunteer's service.

In response to the erosion of the charitable immunity defense in the courts and the concern by volunteers about their personal liability for volunteer service, all 50 states have enacted legislation to provide varying degrees of immunity to volunteers. Some states protect only volunteers in service delivery capacities, while others protect only directors and officers. A federal law, the Volunteer Protection Act (VPA) of 1997, was adopted to provide a more uniform measure of protection to volunteers. Neither the state laws nor the federal law provide protection to volunteers who violate federal laws, such as Title VII of the Civil Rights Act. In addition, the state and federal laws exclude protection for volunteers who are negligent while operating a motor vehicle. Due to these and other exceptions and exclusions under the laws, the protection they afford is incomplete, and volunteers continue to be exposed to claims related to their service.

The VPA provides immunity for volunteers serving nonprofit organizations or governmental entities for harm caused by their acts or omissions if:

- *The volunteer was acting within the scope of his or her responsibilities at the time of the alleged act or omission.* Unfortunately, in many cases the scope of a volunteer's responsibility is not defined. In some cases a volunteer will take it upon him or herself to undertake service for the organization.
- *The volunteer was properly licensed, certified, or authorized to act under the applicable law.* Whether it was appropriate for a volunteer to be authorized to act is not readily apparent in all instances.
- *The harm was not caused by willful, criminal, or reckless misconduct; gross negligence; or a conscious, flagrant indifference to the rights or safety of the individid-*

ual harm. This condition provides guidance to plaintiff's counsel in terms of wording a complaint so that it will avoid the protection of the VPA. A plaintiff need only state that a volunteer's action was willful or in flagrant indifference to the rights and safety of the individual harm for the matter to require a factual determination by a court. Therefore, the volunteer is unable to avoid being sued and must defend him or herself.

- *The harm was not caused by the volunteer operating a motor vehicle, vessel, or aircraft where the state requires an operator's license and insurance.*

Nevertheless, despite the VPA, many volunteers remain *fully liable* for any harm they cause, and all volunteers remain liable for some actions. The VPA applies only to nonprofit organizations and governmental entities. In addition, the VPA does not prevent a nonprofit from bringing an action against a volunteer.

Nonprofit Boards: Standards of Care, Loyalty, and Obedience

Board members are tasked with governing the nonprofit and establishing policies that will keep the nonprofit viable. Actions of boards of directors, whether for-profit or nonprofit, are evaluated by the legal standard of the reasonably prudent person. This doctrine does not place specific standards on the actions of boards as collectives, or members as individuals, but sets the expectation that the decisions made and actions taken would be consistent with those exhibited by a reasonably prudent person. This doctrine sets the tone for three standards of care that are attributed to all boards of directors, namely, the duties of care, loyalty, and obedience. Because board members are held to these standards, they need to be particularly attuned to the implication of board behavior and decision-making on the nonprofit's mission and reputation.

The Duty of Care

The duty of care refers to the responsibility of conducting the affairs of an organization with competence. The quality of deliberations and decisions is directly correlated to the board members' collective preparation for the meeting and to the individual member's intellectual capacity and ability to engage in critical thinking. Raising the board's awareness of the relevant concepts and issues in risk management is essential to incorporating risk management as an essential element in the organizational culture.

Board member accountabilities and responsibilities need to be addressed in written procedures and standards of expected performance. Board members should be briefed on what is expected of them in terms of performance and normative behavior. For example, the following categories of information should be addressed:

- How many meetings a year must they attend?
- What are their obligations in terms of committee work?
- What is the governance model of their organization?
- What are the consequences of failing to live up to the board member responsibilities outlined?

Board members should also be expected to review of materials in advance of a board meeting and be prepared to participate fully in discussions. Board members should also expect that materials provided by staff are of high quality, completeness, and relevance to the operational or financial topics they represent. Many nonprofit board members are reluctant to demand quality in these materials because of the flawed rationale that nonprofits cannot attract quality staff or that because salaries are low, quality standards cannot be imposed. Both beliefs are irrational. Board members have every right to demand and receive high-quality materials. The gravity of their decisions requires that board members rely on only top-quality data presented in a professional manner. Failure to receive materials of this quality should not ever be tolerated. Because nonprofit board members can be held responsible for inappropriate and illegal activity within the organization, decisions need to be discussed carefully, and all factors regarding the implications of the decisions must be disclosed.

The Duty of Loyalty

The duty of loyalty requires that board members put the interests of the organization they are serving above their personal interests while rendering decisions and taking actions on the nonprofit's behalf. In some cases a board member's private business or activities outside the boundaries of the nonprofit will come into conflict with the duties of board service. For example, a board member of an animal shelter may also be the president of an animal feed company. Should the nonprofit seek bids to provide feed for the shelter's residents, the board member could face a conflict of interest. Signing a conflict of interest disclosure form on an annual basis is one way board members can affirm that their business and financial dealings do not establish a conflict of interest for their board work. Copies of the signed conflict of interest statements must be kept on record in the board member's personnel file. All board members should be asked to disclose potential conflicts of interest and indicate their understanding of the nonprofit's policy, even if they cannot imagine any circumstance in which a conflict might arise. If the information disclosed indicates a possible conflict of interest, this conflict must be noted, and the board member must recuse himself or herself from discussion or voting on any topic related to this potential conflict. The minutes of the meeting must also indicate that the board member did not participate in the discussion and voting on the topic because of a possible conflict of interest.

The Duty of Obedience

The duty of obedience requires board members to conduct themselves in accordance with the nonprofit's mission. Decision-making and the crafting of policy needs to be consistent with the mission and values of the organization. This standard also carries the responsibility of remaining informed about all the organization's programs, new initiatives, and collaboration with other nonprofits or with public- or private-sector organizations.

These standards of behavior provide a framework in which the nonprofit's board can conduct business and reduce the potential for behavior that would damage public trust. Board members need to take their position of trust and authority seriously. It is particularly important to have the executive committee of the board committed to ensuring that all board members adhere to these standards of behavior—and committed to removing any board member whose performance does not meet these standards.

Primary Risk Areas

Inappropriate procedures for board deliberations and decision-making can create or exacerbate risks for nonprofit boards if they have failed to identify general risk areas and take steps to develop and implement strategies to deal with these risks. The types of risks related to the board vary depending on the size and programmatic focus of a nonprofit. Generally, the primary risk areas related to a nonprofit board include, but are not limited to:

- Failing to exercise due diligence in the recruitment and selection of board members
- Failing to enforce term limits to board membership
- Failing to adequately record the actions and decisions made at board meetings in the structure and detail of the board minutes
- Failing to offer a comprehensive board orientation for new members
- Failing to require and enforce performance expectations such as attending a specified number of board meetings and working on a specified number of committees
- Failing to provide board members with the necessary and sufficient data and background materials that are required to make informed decisions

Strategies for Dealing with Risk Areas

In addition to providing policy-making and governance to a nonprofit, boards are expected to conduct meetings, record decisions in the minutes, and conduct financial matters in compliance with Internal Revenue Service regulations governing the organization's 501 status. Boards of directors need to develop and enforce standards of procedure for the collective board unit and individual members.

As with any effective work group, the selection of the members, their training, and the enforcement of performance and behavioral norms will contribute to better board decisions and subsequently reduce risk related to governance activities.

Membership: Structure and Composition of the Board

Board members should be carefully recruited. Depending on the nature of the organization, board members can serve to represent the greater community, particular needed skill sets, or a working mix of client representatives, links to major donors or corporate sponsors, and other important links to the community. As individuals are recruited to be potential board members, it is particularly important to brief them on the organization's expectations of board member performance and normative behavior. If financial or in-kind support at a specific level is required, this must be disclosed to individuals being recruited to serve. Expectations related to work load and other obligations should be conveyed in a forthright manner. Other expectations, such as disclosure of potential conflict of interest via a conflict of interest disclosure form, must be articulated. No one benefits when potential board members are told that they are simply giving their name to the organization and very little is expected in terms of work.

A potential board member should meet with members of the nominating committee before his or her name is presented formally to the board. The potential board member should provide the nominating committee with a resume, curriculum vitae, or any other relevant documentation of experience. The board candidate should be asked to describe his or her expectations of board membership, any areas of interest, and how he or she could provide value as a board member. Conversely, the candidate should also receive useful and complete information on the organization's expectations. The candidate should be given accurate information on the subsequent steps in the process of being elected to the board, including how he or she should expect to be formally notified of the election results.

Each board member should have a personnel file containing the following types of information:

- Current contact information, including cell phone and fax numbers and e-mail address
- Resume or curriculum vitae
- Record of attendance at board meetings
- Committee assignments and other board responsibilities

- Date that the member is due to rotate off the board
- Signed statement(s) regarding conflict of interest and the like

Board Meetings and Committee Meetings

Board meetings should be scheduled at regular times and board members should be required to attend a stated number of meetings per year. At least one week before each meeting, board members should receive a packet of materials to be discussed at the meetings. The packet should include minutes of the previous meeting, financial statements, and other documents relevant to the deliberations. Members need to understand that they have an obligation to review the materials in advance of the meeting and come to the meeting fully prepared to discuss the items on the agenda.

Many boards rely on a committee structure to do much of the groundwork for bringing decisions to the larger board membership. Membership on a committee brings additional obligations for board members. Performance and behavioral norms also must be explicit for these smaller work groups. Decision such as whether to accept a budget need to be grounded in the analysis and recommendations of the finance committee. The standards of care, loyalty, and obedience apply to committee work as much as to larger board meetings. Each committee should have a specific assigned interest area and develop an annual agenda of objectives from which deliverables are assigned to the membership.

Orientation Session for New Board Members

Board orientations serve several purposes. The first is to orient new board members on the nonprofit's mission, objectives, and expectations of its board members. Additionally, it is an opportunity for current board members to meet and become acquainted with new board members. Each new board member should receive an orientation packet, which might include the following types of materials:

- *Brief description of the organization's mission/activities.* This information can be structured in executive summary form.

- *Requirements for membership on the board.* These requirements should be framed in terms of attendance at board meetings, attendance at and performance expectation of committee assignments, minimum financial donation, fundraising requirements, and other conditions of board membership.
- *Policies for board members in areas that include:*
  - Term limits. Board members must know how many consecutive terms they are permitted to serve and the length of each term.
  - Standards of care, loyalty, and obedience and the way in which the nonprofit expects board members to live up to these standards.
  - Indemnification, or information on the nonprofit's directors and officers coverage.
  - Responsibilities and accountability. Specific board obligations should be clearly articulated.

All members of the board, even incumbent members, should have up-to-date board packets containing procedural manuals, material that describes current operations of the organization, and historic documents, such as minutes of previous meetings.

One of the most important areas for board policy and decisions is that of financial operations. As is true of many boards, few, if any, members have a finance or accounting background. Only a select number of nonprofit organizations require professional credentials for a board member to qualify to serve as the organization's treasurer. Regardless of their background, all board members need to know how to read, interpret, and analyze financial statements. The next section of this chapter provides a brief primer on the board members' fiduciary role.

The Nature of the Fiduciary Role

Members of the board have a fiduciary duty to the nonprofit organization that includes the responsibility of oversight of financial activities and the preservation of organizational assets. Although all members of the board bear these responsibilities, the members of the finance committee have a particular interest in carrying out these duties. The goals of financial oversight and asset preservation include:

- Establishment and maintenance of the organization's financial viability
- Generation of profits sufficient to permit the organization to continue its service to the community
- Provision of goods and services to the community as inexpensively as possible, which requires the organization to make efficient use of its resources and assets

In order to meet their fiduciary duty, board members can make use of the organization's financial statements. At a minimum, the members should be able to interpret and evaluate the four basic financial statements common to all organizations:

1. Balance sheet
2. Statement of revenues and expenses
3. Statement of changes in net assets
4. Statement of cash flows

Being able to interpret and evaluate the basic financial statements will help board members contribute to the overall financial management of the organization. The four basic elements of financial management are planning, decision making, directing, and controlling, all of which occur in parallel with one another. As part of the planning and decision-making aspects of financial management, board members help to choose among a variety of alternatives and identify the actions that should be taken in order to achieve the organization's mission and objectives. Identifying which of the organization's resources will be used, and how they will be used, to carry out the planning is part of the directing aspect of financial management. As part of the controlling element of financial management, board members monitor the actions of the organization to help ensure that the plans are being followed and that resources are being used appropriately. Having board members who are actively involved in the financial oversight of the organization helps to reduce or control the risk of financial mismanagement.

Before the accounting scandals at organizations such as Enron and WorldCom, many board members erroneously believed that having the accounting auditors give the financial statements a "clean bill of health" was all that was necessary to oversee the financial activities and safeguard assets. Now, however, many realize that putting absolute trust in the auditor's report is imprudent and may put the organization at financial risk. In the best-case scenario, the auditor's opinion of the financial statements is an independent opinion only to the degree to which the financial statements fairly present the organization's financial position for the defined time period. *Fairness* in this case means that the auditor found no evidence that there was any substantial inaccuracy in the financial statements and that the statements are in compliance with generally accepted accounting principles (GAAP). If the statements are fair, a reasonable person reading the financial statements would not draw incorrect conclusions about the financial position of the organization. Having a clean audit does not mean that the organization is in a *good* financial position; it only means that the financial statements fairly present the position, whatever that position may be.

In the worst-case scenario, the auditor's opinion may be biased, not objective, and not independent of the organization being audited. The auditor may have an incentive to misrepresent the fairness of the financial statements. For example, if the firm performing the audit also receives substantial compensation for providing consulting, tax work, or other services, the audit may be biased to reflect an unrealistically positive financial position. In recent years several major accounting firms have been involved in lawsuits that alleged biased auditors' reports. Although some legislation has resulted from congressional scrutiny, conflicts of interest involving auditing firms will probably not be completely eliminated.

What should a responsible board member do? Being able to evaluate and interpret the four basic financial statements can go a long way toward reducing the risk of financial mismanagement. What should an informed board member know about the financial statements? Knowing the basic components of each statement and knowing how to analyze the financial statements through horizontal, vertical, and ratio analysis will give each board member the ability to evaluate and interpret the financial statements. Being able to evaluate and interpret the financial statements allows the board member to judge the competency of analyses performed by others, including the staff and management members of the organization, the auditors, and any outside financial consultants.

Balance Sheet

The balance sheet presents the assets, liabilities, and net assets of the organization. In other words, the balance sheet presents what the organization owns, the debt it must pay, and its net worth. The balance sheet provides a snapshot of the organization, because it captures what the organization looks like at a particular point in time, generally the last day of the accounting period. Typical accounting periods are monthly, quarterly, half-yearly, and yearly. The basis of the balance sheet is the basic accounting equation:

$$\text{Assets} = \text{Liabilities} + \text{Net Assets}$$

Since the total of what the organization owns equals the combined total of its debt and its worth (net assets), there must be a balance between the total assets and the total liabilities plus the net assets.

Assets of the organization are the resources it owns, both current and noncurrent. Examples of current assets include cash and cash equivalents, accounts receivables, and investments that have a life of one year or less. Noncurrent assets include investments with a life greater than one year, such as property and equipment. A term that is used interchangeably with *noncurrent* is *long-term*. Similarly, *short-term* can be used instead of *current*.

Liabilities are the obligations of the organization to pay its creditors. As with assets, liabilities are divided into two categories: current and noncurrent. Examples of current liabilities include accounts payable, the current portion of long-term debt, and accrued expenses. Examples of accrued expenses include salaries, wages, and interest. As in the case of current assets, current liabilities are those that should be paid in one year or less; conversely, noncurrent liabilities have a payment life of more than one year. Examples of noncurrent liabilities are mortgages payable and bonds payable.

In a nonprofit organization, net assets are the community's interest, or ownership, of the assets of the organization. In a for-profit organization, this portion of the organization is referred to as owners' equity or shareholders' equity. In the past, the term *fund balance* was used in nonprofit organizations to indicate the net assets, but that term is rarely used now.

In a nonprofit organization, the community "owns" the assets of the organization, and net assets are the quantifiable reflection of that ownership. Net assets are equal to the value of all assets minus any liabilities:

Net Assets = Assets – Liabilities

This equation is simply a restatement of the basic accounting equation. The net assets are generally categorized into three classifications:

1. Unrestricted net assets
2. Temporarily restricted net assets
3. Permanently restricted net assets

Temporarily restricted net assets reflect the dollar value of donations for which the donor has specified their use for a specific time period. For example, a donor may give land to the organization with the stipulation, or restriction, that the land cannot be sold for five years. Permanently restricted net assets are donations for which the donor has specified how they should be used in perpetuity. An example of a permanently restricted net asset is an endowment that allows the organization to spend the interest, but never the principal. Unrestricted net assets do not have any stipulations or restrictions for their use, other than legal or ethical considerations.

Statement of Revenues and Expenses

The statement of revenues and expenses is primarily a summary of the organization's expenses and revenues over a period of time. It is analogous to an income statement for a for-profit organization, but instead of net income (revenues minus expenses), the statement of operations for a nonprofit reflects any profit in terms of excess of revenues, gains, and other support over expenses. *Revenues* refer to any amounts earned by the organization by selling a product or providing a service. *Gains* occur when assets are sold for more than their book value. For example, if the organization owns property and sells that property for an amount greater than the property's original purchase or donation value, the organization has incurred a gain. Other support includes unrestricted donations, donations released from restriction, and appropriations from governmental organizations or other grant-making organizations. The basic formula for the statement of revenues and expenses is:

Revenues – Expenses = Excess of Revenues, Gains, and Other Support Over Expenses

Unlike the situation in an income statement, a positive difference between revenues and expenses is not considered profit, but rather increases in unrestricted net assets. In a for-profit organization, profits are distributed to the owners of the organization; in a nonprofit, excess of revenues, gains, and other support over expenses should be used to generate more services for the community. If they are not used to generate more services, they become a part of the unrestricted net assets of the organization, thereby increasing the organization's net worth.

The statement of revenues and expenses also contains information on what are known as below-the-line items. For example, donations that are made specifically to acquire capital assets are not considered a part of revenues, gains, and other support. Another example of a below-the-line item is a transfer to the parent organization (assuming there is one). The effect of below-the-line items appears on the statement of revenues and expenses, below the value of excess of revenues, gains, and other support (hence the name). Below-the-line items directly affect the value of unrestricted net assets, either positively or negatively. The effect is positive if the below-the-line item reflects an inflow of value to the organization and, conversely, the effect on the net unrestricted net assets is negative if the below-the-line item reflects an outflow of value.

Statement of Changes in Net Assets

The purpose of the statement of changes in net assets is to account for any changes in the net asset of the balance sheet from one accounting period to the next. There are two reasons why the value of net assets would change:

1. Changes in unrestricted net assets
2. Changes in restricted net assets

Changes in unrestricted net assets flow directly from the statement of revenues and expenses. If the excess of revenues, gains, and other support is positive, unrestricted net assets are increased. A positive change reflects that the organization's revenues, gains, and other support are greater than its expenses, and the amount of the unrestricted net assets is increased by that amount. Conversely, if the organization's expenses are greater than its revenues, gains, and other support, the amount of the unrestricted net assets is decreased by that amount.

As discussed previously, the statement of revenues and expenses contains information in addition to the value of the excess of revenues, gains, and other support over expenses. These below-the-line items directly affect the value of the unrestricted net assets, either by increasing or decreasing them.

Changes in restricted net assets, either through a temporarily restricted or permanently restricted donation, directly affect the value of the net assets. However, not all changes in restricted net assets change the value of net assets. For example, temporarily restricted assets are only restricted for a specific period of time. If the restriction period for any of the temporarily restricted net assets expires, the value of that net asset "moves" to unrestricted net assets. Although the value of restricted net assets is reduced, the value of net assets is not changed, since the reduction is offset by the increase in unrestricted net assets.

Statement of Cash Flows

The fourth basic financial statement is the statement of cash flows. This statement answers the following questions:

- Where did the cash come from?
- Where did the cash go?

The statement of cash flows tracks cash flows from operating activities, cash flows from investing activities, and cash flows from financing activities. Operating activities are the normal business activities in which the organization engages to generate revenues. Examples of operating activities are the selling of products or the provision of services. Investing activities include activities such as the purchasing and selling of investments, transfers to the parent organization (if there is one), and making capital expenditures. The statement of cash flows tracks the cash inflows and outflows from these activities and reports the net increase (or decrease) in cash and cash equivalents as the result of these activities.

Financial Statement Analysis

Now that the components of each of the financial statements have been discussed, learning how to analyze the information contained in the statements is the next step. The real value of financial statements lies in the fact that they can be used to help predict the organization's future financial condition, as well as providing a view of the organization's current condition. Analyzing the financial statements can help to answer the following questions:

- Is the organization profitable? Why or why not? Compared to other similar organizations, how well is this organization faring in profitability?
- How effective is the organization in collecting what is owed to it? How does the organization compare to other similar organizations?
- Will the organization be able to meet its debts in a timely manner? Compared to other similar organizations, is this organization doing better or worse?
- How efficiently is the organization using its assets? Compared to other similar organizations, is improvement needed?
- Are the organization's facilities and equipment in need of replacement? Does the organization meet the standard for facility and equipment replacement?
- Is the organization in a good position to take on additional debt, or is it overextended? Compared to other similar organizations, does the organization have too much or too little debt?

Financial Ratios

Financial ratios express the relationship between two numbers and basically pull together two elements of the financial statements: one expressed as the numerator and one as the denominator. There are almost an unlimited number of financial ratios that can be calculated, and we will not, of course, be able to cover each possible ratio here. However, if a board member is able to calculate and interpret some ratios from each of the four common classifications of ratios, the job of analyzing the financial statements can be accomplished. There are four general classifications of financial ratios: liquidity, profitability, asset management or activity, and capital structure.

- *Liquidity ratios* measure an organization's ability to meet short-term obligations, collect receivables, and maintain sufficient cash on hand. Liquidity ratios help to answer the question, "How able is the organization to meet its short-term obligations and debt?"
- *Profitability ratios* help to answer the question, "Is the organization profitable?"
- *Asset management or activity ratios* help to answer two questions: "How efficiently is the organization using its assets to produce revenues?" and "In view of current and projected revenues, is the amount of each type of asset reasonable, too high, or too low?"
- *Debt management or capital structure ratios* help to answer the questions, "How are the organization's assets financed?" and "How able is the organization to take on new debt?"

Ratio analysis can best be interpreted relative to a standard, therefore, ratio analysis should be a comparative analysis. The standard may be the organization's past performance, a goal set by the organization, or the average performance level in the industry or a group of equivalent organizations. Trade associations frequently publish the financial ratio standards, or benchmarks, for the industry.

Liquidity Ratios

Liquidity ratios reflect the ability of the organization to meet its current obligations, or pay bills that are due. If the organization does not have enough cash on hand to pay its obligations when they come due, its credit rating may be adversely affected, which could result in a loss of credit, loss of vendor relationships, and loss of trade discounts. Frequently used liquidity ratios include:

- Current ratio
- Quick ratio
- Days' receivables ratio
- Days' cash on hand ratio
- Average payment period

CURRENT RATIO

The current ratio reflects the short-term solvency of the organization. The current ratio equals current assets divided by current liabilities. Both of these values can be found on the balance sheet. If the current ratio is 1 or more, the organization has enough current assets to meet its current liability. If the current ratio is less than 1, the organization may experience difficulty in meeting its short-term obligations. For example, if the current ration is 0.45, for every $1 owed in short-term obligations, the organization only has 45 cents to cover those obligations.

$$\frac{\text{Current Assets}}{\text{Current Liabilities}} = \text{Current Ratio}$$

In general, an organization would like to be equal to or above the current ratio standard. If the current ratio is substantially greater than the standard, however, the organization may be holding too much cash on hand and should look into longer-term investments. If the organization finds itself in a nonliquid position, it should develop and implement plans to either improve the flow of cash into the organization or reduce its short-term obligations.

QUICK RATIO

The quick ratio is a more stringent indicator of liquidity than the current ratio, as it uses only the most liquid current assets in its formula. Assets that are current but are immediately liquid are excluded. Current assets that are excluded include accounts receivables and the value of product inventory. The quick ratio equals cash plus short-term investments (also known as cash equivalents) plus net accounts receivables divided by current liabilities. The values of these four accounts can be found on the balance sheet.

$$\frac{\begin{array}{c}\text{Cash + Cash Equivalents +}\\ \text{Net Accounts Receivables}\end{array}}{\text{Current Liabilities}} = \text{Quick Ratio}$$

As with the current ratio, in general an organization would like to be equal to or above the quick ratio standard, but not substantially above the standard.

DAYS' RECEIVABLES RATIO

The days' receivables ratio is a measure of how long the average client or customer takes to pay the invoice for services or products sold. The quicker clients or customers pay their invoices, the quicker the organization is converting its receivables into cash. The days' receivables equals net accounts receivables divided by net revenues divided by 365. The value of net accounts receivables can be found on the balance sheet and the value for net revenues can be found on the statement of revenues and expenses.

$$\frac{\text{Net Accounts Receivables}}{\text{Net Revenues / 365}} = \text{Days' Receivables}$$

The days' receivables ratio should be equal to or below the standard. If the organization is not at least meeting the standard, it may be experiencing some liquidity problems. Developing and implementing a plan to improve the collections of receivables may improve the organization's liquidity position by bringing cash into the organization more quickly.

DAYS' CASH ON HAND RATIO

Days' cash on hand is a measure of how long the organization could meet its obligations if cash receipts were discontinued. Days' cash on hand equals unrestricted cash and cash equivalents divided by expenses minus depreciation expense divided by 365. The values of these two accounts can be found on the balance sheet.

$$\frac{\text{Unrestricted Cash + Cash Equivalents}}{\text{Expenses – Depreciation Expense / 365}} = \text{Days' Cash on Hand Ratio}$$

In general, an organization would like to be equal to or above the days' cash on hand ratio, but not substantially above the standard. The days' cash on hand ratio can be improved by either increasing the inflow of cash or decreasing the expenses.

AVERAGE PAYMENT PERIOD

The average payment period equals current liabilities divided by expenses minus depreciation expense divided by 365. The value of current liabilities can be found on the balance sheet and the values of expenses and depreciation expense can be found on the statement of revenues and expenses.

$$\frac{\text{Current Liabilities}}{\text{Expenses} - \text{Depreciation Expense} / 365} = \text{Average Payment Period}$$

The average payment period is a measure of how long it takes the organization to pay its bills. Developing and keeping a credit-worthy relationship with vendors and suppliers is critical to the financial well-being of the organization, and the organization should thus attempt to pay its bills on time. In general, the average payment period should be equal to or less than the standard. If, however, the average payment period is substantially below the standard or is substantially less than 30 days (the typical number of days allowed to pay an invoice), the organization may be paying its bills too quickly and thus missing opportunities for short-term investment. It may also be that the organization is paying its bills in less than 30 days in order to earn trade discounts, or reductions in the amount paid in exchange for early payment. One has to investigate the cause of the ratio value before one can decide what action, if any, should be taken.

Profitability Ratios

Nonprofits do not generate profits. Nonetheless "profitability ratios" measure a nonprofit's ability to generate revenues that exceed it expenses. These profitability ratios are all measures of the ability of the organization to produce a surplus, that is, to generate excess revenues, gains, and other support over expenses. An organization that is only breaking even or, worse, suffering a loss, will not be able to expand its delivery of services. If the organization experiences continued losses, it may not even be able to survive. Frequently used profitability ratios include:

- Operating margin
- Return on total assets

OPERATING MARGIN

The operating margin measures the proportion of excess revenues, gains, and other support over expenses earned for each dollar of revenues, gains, and other support. Both of these account values can be found on the statement of revenues and expenses.

$$\frac{\text{Excess of Revenues, Gains, and Other Support Over Expenses}}{\text{Revenues, Gains, and Other Support}} = \text{Operating Margin}$$

In general, an organization would like to have an operating margin at or above the standard. Although the mission of the nonprofit is not to generate a profit (excess revenues, gains, and other support over expenses), having a good operating margin gives the organization the financial ability to expand its delivery of services. If the operating margin is substantially higher than the standard, however, the organization may be charging too much for its services and products and not meeting the needs of the community.

RETURN ON TOTAL ASSETS

The return on total assets is a measure of how much profit is earned for each dollar invested in assets. The return on total assets equals the excess of revenues, gains, and other support over expenses divided by total assets. The value of revenues, gains, and other support can be found on the statement of revenues and expenses, and the value of total assets can be found on the balance sheet.

$$\frac{\text{Excess of Revenues, Gains, and Other Support Over Expenses}}{\text{Total Assets}} = \text{Return on Total Assets}$$

In general, an organization would like to have a return on assets at or above the standard.

Asset Management Ratios

The asset management ratios provide a measure of how much in revenues, gain, and other support is generated for each dollar invested in assets.

Asset management ratios include:

- Total asset turnover ratio
- Fixed asset turnover ratio
- Age of facility ratio

TOTAL ASSET TURNOVER RATIO

The total asset turnover ratio measures the overall efficiency of the organization's assets to produce revenues, gains, and other support. The total asset turnover ratio equals revenues, gains, and other support divided by total assets. The value of the revenues, gains, and other support can be found on the statement of revenues and expenses, and the value of total assets can be found on the balance sheet.

$$\frac{\text{Revenues, Gains, and Other Support}}{\text{Total Assets}} = \text{Total Asset Turnover Ratio}$$

In general, an organization would like to have a total asset turnover ratio equal to or greater than the standard. The higher the ratio, the more efficient the organization is in its use of assets.

FIXED ASSET TURNOVER RATIO

The fixed asset turnover ratio is a measure of the organization's efficiency in using its fixed assets to produce revenues, gains, and other support. The fixed asset turnover ratio equals revenues, gains, and other support divided by fixed assets minus accumulated depreciation. The value of the revenues, gains, and other support can be found on the statement of revenues and expenses, and the values of facility, equipment, and accumulated depreciation appear on the balance sheet.

$$\frac{\text{Revenues, Gains, and Other Support}}{\text{Fixed Assets} - \text{Accumulated Depreciation}} = \text{Fixed Asset Turnover Ratio}$$

In general, an organization would like to have a fixed assets turnover ratio equal to or higher than the standard. If the ratio is substantially higher than the standard, however, it may be an indication that the organization has not invested enough in fixed assets and will need to upgrade its facility or equipment in the near future.

AGE OF FACILITY RATIO

The age of facility ratio provides a measure of the average age of an organization's facilities and equipment. The age of facility ratio equals accumulated depreciation divided by depreciation expense. The value of accumulated depreciation can be found on the balance sheet and the value of depreciation expense appears on the statement of revenues and expenses.

$$\frac{\text{Accumulated Depreciation}}{\text{Depreciation Expense}} = \text{Age of Facility Ratio}$$

In general, an organization would like to be equal to or below the standard. If the ratio is substantially higher than the standard, it may indicate that the organization needs to replace its equipment or facilities soon.

Debt Management Ratios

Debt management ratios reflect the organization's long-term liquidity by quantifying the relationship between the organization's assets and its long-term debt. Debt management ratios also give an indication of an organization's ability to cover its long-term debt and its ability to take on more long-term debt. Debt management ratios include:

- Long-term debt to net assets ratio
- Times interest earned ratio
- Debt service coverage ratio

LONG-TERM DEBT TO NET ASSETS RATIO

The long-term debt to net assets ratio is a measure of the relationship between long-term debt and the assets owned by the organization. It is a reflection of the proportion of net assets that were financed through long-term debt. The long-term debt to net assets ratio equals the long-term debt divided by the net assets. The values of both long-term debt and net assets are shown on the balance sheet.

$$\frac{\text{Long-Term Debt}}{\text{Net Assets}} = \text{Long-Term Debt to Net Assets Ratio}$$

In general, an organization would like to have a long-term debt to net assets ratio equal to or lower than the standard. Although all organizations should take advantage of the leveraging power of long-term debt, taking on too much debt may place the organization in the risky position of not being able to easily repay the debt. In addition, having too much debt may put the organization in the position of not being able to take on additional debt when it is needed.

TIMES INTEREST EARNED RATIO

The times interest earned ratio is a measure of the organization's ability to meet its interest payment for long-term debt. The times interest earned ratio equals the excess of revenues, gains, and other support over expenses plus interest expense divided by the interest expense. The values of excess of revenues, gains, and other support over expenses and the interest expense can be found on the statement of revenues and expenses.

$$\frac{\text{Excess of Revenues, Gains, and Other Support Over Expenses} + \text{Interest Expense}}{\text{Interest Expense}} = \text{Times Interest Earned Ratio}$$

In general, an organization should have a times interest earned ratio equal to or greater than the standard. The value of the times interest earned ratio is especially important if the organization wishes to take on more long-term debt in the near future. Creditors and lenders use the times interest earned ratio to evaluate an organization's ability to repay debt.

DEBT SERVICE COVERAGE RATIO

The debt service coverage ratio is a more stringent measure of an organization's ability to repay its long-term debt. Unlike the times interest earned ratio, the debt service coverage ratio does not measure only the organization's ability to cover its interest expense. Instead, this ratio measures an organization's ability to meet its entire loan requirements: principal plus interest. The debt service coverage ratio equals the excess of revenues, gains, and other support over expenses plus interest expense plus depreciation expense divided by the interest expense plus the principal payment. The value of the interest expense, depreciation expense, and the excess of revenues, gains, and other support over expenses can be found on the statement of revenues and expenses.

$$\frac{\text{Excess of Revenues, Gains, and Other Support Over Expenses} + \text{Interest Expense} + \text{Depreciation Expense}}{\text{Interest Expense} + \text{Principal Payment}} = \text{Debt Service Coverage Ratio}$$

In general, an organization would like to have a debt service coverage ratio equal to or greater than the standard. The greater the debt service coverage ratio, the better able the organization is to handle additional long-term debt.

Chapter 10

Managing Risks Related to Serving Vulnerable Populations

The fictitious William Lennahan, executive director of the Safe Biking for Children Program, could not believe his eyes when he found the following article about the arrest of one of his volunteers in the *Central City Chronicle*.

> **Bike Safety Teacher a Suspect in Child Molesting Case**
>
> *by Mary Sims, Staff Writer*
>
> *Central City*—A Central State University student who was arrested when he allegedly tried to meet with a 10-year-old girl for a sexual encounter will be arraigned Monday afternoon in Central City, police said yesterday. Central County sheriff's detectives arrested 26-year-old Joe Green at about 4 p.m. on Thursday as he arrived at a hotel in Central City. He went there for a purported meeting with the girl that had been arranged via e-mail, said Detective Sgt. Fred Smith. Green, an undergraduate student majoring in biology at Central State University, volunteered at several elementary schools in surrounding counties, teaching bicycle and personal safety, Smith said.
>
> "We do not want to give the names of the schools because we do not want to identify the little girl in any way," Smith said. "Even though the girl never sent any e-mail back to him, she is his intended victim in his mind." The girl's parents alerted detectives last month to inappropriate

e-mails Green allegedly sent to her. Investigators then took over the girl's e-mail account and began corresponding with the suspect, setting up the sting operation that resulted in Green's arrest. Smith said a total of 17 e-mails were sent each way during a one-month period. Police said Green obtained the girl's e-mail address after meeting her in one of the classes he taught. Not long afterward, he began e-mailing her, police said. The investigation was conducted by Detective Henry Gomes, who posed as the 10-year-old girl in correspondence with Green. Over the course of a month, Green allegedly became increasingly explicit in describing his sexual desires and eventually arranged for the Thursday afternoon meeting at the hotel, investigators said. He allegedly stated in one e-mail that he intended to drive the girl to a remote location and engage in several sexual acts.

The detectives took Green into custody without incident. He was booked into the Central County Jail on suspicion of attempted lewd and lascivious acts with a child under 14 years of age. He is being held on $250,000 bail. Smith said the high bail is warranted because Green, who is originally from Tulsa, Oklahoma, is considered a flight risk.

Defining "Vulnerable Populations"

The Center for Vulnerable Populations Research at the UCLA School of Nursing defines vulnerable populations as:

> . . . social groups who have an increased susceptibility or higher than the national average risk for health-related problems. This vulnerability or risk is evidenced in increased comparative morbidity and mortality rates, decreased life expectancy, and decreased access to care. For a variety of reasons, a number of populations and groups in society are vulnerable to health disparities.

Organizations offering services to vulnerable clients must be concerned about the safety of the individuals they serve, especially:

- Children
- Dependent adults, particularly those who are frail elderly or developmentally disabled
- Individuals with disabilities, including those with chronic or life-threatening illnesses

Organizations serving such individuals are expected to have specific knowledge about the conditions that contribute to an individual being considered vulnerable. Understanding these conditions is the basis for identifying the risk of serving vulnerable populations.

What makes one person vulnerable when another individual with analogous characteristics might not be considered vulnerable? The aspect of vulnerability tends to emerge around one or more of these characteristics:

- *Age*—either very young or very old
- *Health*—individuals with disabilities, chronic illnesses, or terminal illnesses
- *Power*—individuals who believe that they are at a disadvantage in terms of social, personal, or positional power
- *Socioeconomic status*—individuals who rely on people or institutions to provide resources to satisfy basic or security-level needs

These factors can make it difficult, or even impossible, for vulnerable people to discern the motives of others or to tell whether they are in danger. Clients who are members of vulnerable populations often are socially marginalized and isolated. They are in particular need of supportive interaction. The combined effect of a client's isolation and his or her need for supportive interaction can provide the opportunity for unscrupulous people to take advantage of them. Exhibit 10.1 summarizes the primary vul-

EXHIBIT 10.1 Primary Vulnerability Characteristics

Characteristic	Nature of the Vulnerability
Age	
Preschool children	■ Sees all adults as authority figures ■ Intellectual development in early stages, such as reasoning ■ Virtually no life experience
Elementary school children	■ Trusts select group of adults, such as teachers, coaches, classmates' parents ■ Intellectual development still in formative stages ■ Few life experiences ■ Beginning to be involved in after-school activities, including sports

(*continues*)

EXHIBIT 10.1 *(Continued)*

Characteristic	Nature of the Vulnerability
Middle school children	■ Peer pressure to conform ■ Beginning to try new experiences, some risky ■ Reasoning and judgment maturing, but still in developmental stage ■ Can be expected to participate in after-school activities and interact with adults other than their teachers and own parents
High school; adolescence	■ Sometimes rebellious; wanting to experiment with new roles and activities ■ Under pressure to perform academically to enter college, the military, or vocational institution ■ Pressure to conform and join peer groups, such as gangs
Dependent elderly	■ Loneliness, as children have moved away, spouse has died ■ Limited skills in managing money (spouse may have managed money while he or she was alive) or using technology such as phones, answering machines, and e-mail ■ Socially marginalized by a youth-oriented society ■ Denial of deteriorating quality of life issues due to behavioral norms introduced early in life
Health	■ Can affect individuals of any age ■ Impairment can be mobility, vision, hearing, or others ■ Alzheimer’s disease or dementia ■ Chronic or terminal illnesses such as cancer or AIDS ■ Can result in individuals becoming dependent on others to complete routine tasks ■ Fear or anxiety associated with illness; diminished cognitive functioning and reasoning caused by drug therapy
Power	■ Providers of service can cause clients to become dependent, particularly if the client group has already been abused by others, such as battered women
Socioeconomic status	■ Service providers have the power to provide or withhold necessary resources to clients

nerability characteristics and the corresponding factors which contribute to the vulnerability.

The circumstances of vulnerability can emerge from a combination of the low level of a person's reasoning and logic skills, life experience, coping skills, overall health, and belief about the power that the person he or she is interacting with has over him or her. In the tragic cases of children being molested by clergy, the victims' nascent reasoning skills, limited life experience, and the belief that the clergy person's demands are endorsed by the deity are contributing factors leading to molestation. Children are socialized to conform to the requirements of trusted adults such as teachers, clergy, coaches and other professional service providers, including health care professionals. This socialization makes them more vulnerable to violations of that trust.

Similarly, elderly people are often vulnerable due to diminished cognitive capacity that is related to health or age or that reflects an educational background that, by current standards, is deficient. Seniors often live far from their families and may be widowed after many years of marriage. Often they do not know how to use cell phones, answering machines, the Internet, or e-mail. Failing vision can make using equipment such as cell phones difficult. Sometimes vulnerability in these populations can be positively correlated with socioeconomic status or general state of health. Another aspect that can make seniors a target of unscrupulous people is their perceived financial profile.

Programs Serving Vulnerable Populations

There is a wide range of programs serving vulnerable populations. Services can range from skilled nursing facilities to daycare for children or Alzheimer's patients, to sports and mentoring programs. Exhibit 10.2 summarizes the types of programs that might be available to serve the general categories of vulnerable populations.

EXHIBIT 10.2 Programs for Vulnerable Populations

Characteristic	Programs
Age	
All ages	■ Child protective services ■ Adult protective services ■ Family services, including family therapy, supervised visitation, family support
Preschool children	■ Daycare centers
Elementary school and middle school children	■ Tutoring programs ■ Sports ■ Scouting or other civic or social groups ■ Recreation programs, including camps, parks, and wildlife programs
High school—adolescence	■ Tutoring ■ Sports ■ Community service projects ■ Recreation programs, including camps, parks, and wildlife programs
Senior citizens	■ Community centers ■ Meals on Wheels or other nutrition-based programs ■ Independent living programs ■ Skilled nursing facilities
Health	■ Centers for handicapped youth and adults ■ Daycare centers for Alzheimer's patients ■ Programs for individuals living with AIDS or HIV ■ Mental health centers, residential programs ■ Home health and hospice: visiting nurses, respite workers, personal care attendants
Socioeconomic status	■ Food banks

Primary Risk Areas in Serving Vulnerable Populations

Programs and services designed for vulnerable populations provide educational opportunities, training, and often enhancement of clients' quality of life. Nevertheless, the integrity and reputation of the program can be compromised by injuries, accidents, and claims of abuse. In order to devise effective risk management strategies, it is important to examine some of the primary risk areas in programs serving vulnerable populations. These include, but are not limited to:

- *Hiring people who constitute a threat to the clients being served.* Programs serving vulnerable populations may be targeted by criminals who pose as either trained staff or eager volunteers.
- *Harm or injury to a client due to unqualified employees or volunteers.* This issue is particularly important if the program has a volunteer contingent. Many nonprofits believe that volunteers cannot be closely supervised or terminated.
- *Physical and emotional abuse.* Vulnerable populations are susceptible to abuse by staff and volunteers.
- *Sexual abuse.* The factors that contribute to a client's vulnerability can also contribute to the person's becoming victimized by a sexual predator or assault.
- *Theft or extortion.* In residential or daycare facilities, theft of valuables or misappropriation of resources is not uncommon.
- *Intimidation or undue influence.* Vulnerability often makes a client a target for staff or volunteer intimidation or undue influence, which may lead to abuse.
- *Security and safety issues in facilities that serve vulnerable populations.* Facilities serving vulnerable populations can have several buildings, multiple floors, and many pieces of equipment that all require monitoring.
- *Release of clients to unauthorized caregivers.* This risk area is particularly acute for children and for adults whose cognitive functioning is impaired.
- *Family members' or caregivers' ignorance of contact information or programmatic information to clarify authorized activities.* Family members and other caregivers may not be well informed about an organization's programmatic parameters and what the organization considers appropriate and inappropriate staff behavior.
- *Failure to encourage feedback from clients, families, and caregivers regarding abuse or inappropriate behavior.* Clients, families, and caregivers may fail to report abuse or inappropriate behavior, thereby exposing the organization to potential liability for failing to report.

- *Unsafe facilities and faulty emergency equipment.* Facilities housing programs for vulnerable clients can sometimes be neglected due to insufficient funding or lack of managerial awareness.

Families and other caregivers of the clients must be actively involved in efforts to prevent abuse. Nonprofits should be vigilant in dealing with risk issues relating to vulnerable populations and work with families and caregivers to identify signs of abuse. Organizations should ensure that the relationship between clients and staff is productive and beneficial to the client.

Strategies for Dealing with Primary Risk Areas

Because the topic of working with vulnerable populations is so large, the range of discussion categories has been collapsed into the following:

- Human resource management
- Training and job orientation
- Supervision
- Combating abuse through consciousness raising and zero tolerance
- Clarity in articulating the parameters of the nonprofit's programs
- Providing avenues for feedback from clients, families, caregivers, and staff
- Ensuring safe facilities

Human Resource Management

The method used for recruiting, screening, and placing paid and volunteer staff is a primary risk management tool. The advertisements for recruiting paid and volunteer staff must be clear about the nature of the work assignments and the required qualifying documentation. If criminal history record checks are required, the recruitment material should clearly state that background checks will be conducted. This may discourage individuals who do not wish to be subjected to background checks.

The quality of an organization's staff is a key determinant of the safety of vulnerable service recipients. Every organization has a responsibility to carefully select, train, and supervise the employees and volunteers deployed to serve children, dependent adults, and elderly and disabled individuals.

SCREENING NEW EMPLOYEES AND VOLUNTEERS

Because of the vulnerability of a nonprofit's client base, care should be taken in establishing a process whereby paid and volunteer staff are screened. As part of the recruitment and application steps, individuals applying for paid and volunteer staff positions must be advised of the screening process. Every state has specific guidelines on screening and background checks for certain positions, especially those in programs licensed by the state. Up-to-date information on these guidelines can be obtained from state and local agencies' web sites.

A basic screening process includes a written application form, face-to-face interviews, and reference checks. The process is necessary for all employees and volunteers who work in any capacity with vulnerable populations. The application form should include a signature block that, when signed by the applicant, certifies the truthfulness of the information and informs the applicant that any falsification or significant omission of information will result in denial of the position for which the application is being made, or in the case of individuals already placed, termination. The signature block should also include a statement of consent to verification of the information on the application and a waiver of any rights to confidentiality.

If the background check indicates that the applicant has been convicted of a crime, it is important to advise the applicant of the results of the background check. If the applicant disputes the results, the nonprofit should provide him or her with information on the steps to be taken to correct erroneous results. It is important to bring in the nonprofit's legal counsel for these discussions and to advise the applicant that he or she cannot be considered for the position until the issues raised by the background check are resolved.

CURRENT STAFF: EMPLOYEES AND VOLUNTEERS

Nonprofit organizations should consider establishing periodic reviews of current employees and volunteers to ensure that they continue to meet the standards set by the organization. Some organizations have strengthened their screening processes to include criminal history record checks. Most of these have decided that current employees and volunteers should undergo the same record checks as new applicants.

To inaugurate such a program, senior management must be willing to set the example and be the first staff to be screened, using the opportunity as a means of educating the staff on the process. One national youth-development organization's board of directors became the first volunteers in that organization to undergo criminal history record checks when they instituted a policy requiring such screening of all volunteers. If the organization establishes a screening policy, any staff member, paid or volunteer, who balks at being screened should be counseled that the screening is mandatory and is a condition of continued employment or volunteer service. If he or she continues to refuse to be screened, the person can be given the opportunity to resign.

Before implementing a new screening policy, a nonprofit should establish clear criteria for disqualifying applicants. When establishing screening criteria, organizations must consider state and local laws and regulations. Some jurisdictions have instituted screening or licensing requirements for individuals who have substantial contact with children or other vulnerable individuals, such as dependent elderly people or people with disabilities. Nonprofits that receive private or government grants should determine whether these funders impose screening requirements for personnel who will be working under the terms of a grant.

The National Child Protection Act of 1993 envisioned a process in which an organization would not receive a copy of an individual's "rap sheet" but would instead be given a summary of the record made by a state agency. The agency would tell the organization only if the individual's record included offenses that make the applicant unfit for working with children or other vulnerable clientele.

For positions that require substantial direct contact with vulnerable populations, personal safety concerns are paramount. Therefore, the focal points of criminal history record checks for these individuals are crimes against people.

Youth-serving organizations generally agree that individuals should be permanently disqualified from holding positions that require substantial contact with children if their criminal records include any of the following:

- Past history of sexual abuse of children
- Conviction for any crime in which children were involved
- History of any violent or sexually exploitive behavior

Offenses become relevant based on the nature of the position. For example, assisting with in-home health care could give staff access to prescription medications that may tempt people with a history of drug abuse or those who recognize the potential street value of the drugs if they were to steal them. A recent record (within the past few years) of substance abuse or drug distribution would be very relevant, given the characteristics of the position in which the applicant would serve.

If the staff structure includes bargaining units, negotiations must be initiated to ensure that all staff are screened.

Training and Job Orientation

A comprehensive staff orientation program is an important tool for reducing the risk that staff members will behave inappropriately toward clients or otherwise violate the organization's rules and procedures. An effective orientation provides a clear explanation of the organization's mission, policies, procedures, and expectations. The orientation should also address topics such as identifying and reporting abuse, working with clients who have physical impairments, and the organization's definitions of appropriate and inappropriate behavior. Working with families and caregivers is another important area in which new staff should be carefully briefed. The organization's expectations for staff interaction with families and caregivers should be clearly articulated and specific guidelines made available in writing.

New paid and volunteer staff should also be trained, if necessary, in first aid and cardiopulmonary resuscitation (CPR) and briefed on emergency exit procedures for a variety of emergency scenarios. These procedures should be practiced routinely not only to assist the staff in becoming accustomed to locating the nearest exit, but also to make them familiar with assisting clients to exit the building. Depending on the nature of the facility and client base, these exercises may have to be done in small groups at regular intervals. Staff may have to practice with other staff who play the roles of clients.

The orientation for new staff and volunteers should include a detailed presentation and accompanying written materials on the organization's policies on:

- Depth of staffing—ensuring that paid and volunteer staff understand that they are required to work in pairs or groups with clients
- Prohibition against fraternization with clients
- Drug and alcohol policy
- Other practices and behaviors that are not acceptable and the consequences for engaging in prohibited behaviors

Each staff member, paid and volunteer, must have a written job description that specifies assignment, duties, obligations of care, and prohibited actions. Manuals for paid and volunteer staff should include explicit "Do's and Don'ts" for working with clients.

Supervision

In any organization that serves vulnerable populations, staff as well as clients must be supervised. Supervision also includes providing support and guidance to families and caregivers.

Special attention should be paid to releasing clients, particularly children, to authorized caregivers. Because many divorced parents have joint custody of children or are part of large extended families, it is important for staff to know who will be picking up the child and for parents to know that any changes must be communicated to the head of the facility. Staff should never release a child to a parent or any other adult without a specific directive naming that individual. If the staff member is in doubt, the child should be kept in another area until the identity of the person authorized to pick up the child is confirmed. It is well worth the time to ensure that the child is released to the correct person.

Parents and caregivers should have a written copy of the nonprofit's policy on release of children to authorized caregivers. All individuals authorized to pick up a child should be required to sign a statement that they understand and will abide by the policy. Copies of photo identification for all individuals authorized to pick up a child should be on file. In the event of an emergency in which the authorized caregiver cannot pick up a child and someone who is not on the list will be picking up the child, the executive director, principal, or other member of senior management must (1) be contacted by the parent making the request and (2) ensure that the person picking up the child is at least 18 years of age and will be bringing photo identification (the child should not be released to anyone who has not presented photo identification). Before the child can be released, the person picking up the child must, to the extent feasible under the circumstances, meet with someone in the nonprofit's senior management who will copy the person's photo identification for the nonprofit's files and look at the vehicle's registration if the child will be transported in a private vehicle.

In the orientation for new staff members, the nonprofit should provide guidelines for appropriate interaction with clients and specify what behaviors and activities are not acceptable. These guidelines and prohibitions must be provided in writing to new staff and volunteers, along with clearly articulated consequences. All staff need to understand that they will be carefully supervised and that their colleagues, the clients, and the clients' families are also tasked with reporting any indications of abuse or inappropriate behavior. By indicating that all members of the staff will be monitored, the nonprofit can make its policies applicable across the board.

Helping Families and Staff Deal with Abuse

Vulnerable service recipients, both children and adults, may be targets for abuse. Staff members must know what abuse is, how to detect abuse, what actions to take when abuse of a service recipient is suspected, and the staff member's legal responsibilities. Regular in-service sessions are necessary to introduce new information about the nature of abuse, detecting abuse, and preventing abuse. As staff awareness is raised concerning these issues, the nonprofit's policies and values will be reinforced. Clearly instituting a zero-tolerance policy on abuse is not enough. Staff, clients, and their families need a high level of understanding about sources of abuse, abusive situations, and the impact that abuse has not only on the person abused, but also on other clients and the institution.

IDENTIFYING ABUSE

The definitions of physical and emotional abuse vary by state and can often be found on the state government's web site. The state of Arizona has posted these definitions of abuse, physical injury, emotional abuse, and emotional maltreatment from the Arizona Revised Statutes (ARS) on its Child Protective Services Department web site:

> ARS §8-801(2) "Abuse" means the infliction or allowing of physical injury, impairment of bodily function or disfigurement or the infliction of or allowing another person to cause serious emotional damage as evidenced by severe anxiety, depression, withdrawal or untoward aggressive behavior and which emotional damage is diagnosed by a medical doctor or psychologist pursuant to section 8-223 and which is caused by the acts or omissions of an individual having care, custody and control of a child. Abuse shall include inflicting or allowing sexual abuse pursuant to section 13-1404, sexual conduct with a minor . . .
>
> ARS §13.3623(A)(4)—"Physical injury" means the impairment of physical condition that includes but shall not be limited to any skin bruising, pressure sores, bleeding, failure to thrive, malnutrition, dehydration, burns, fracture of any bone, subdural hematoma, soft tissue swelling, injury to any internal organ or any physical condition which imperils health or welfare.
>
> Emotional abuse is evidenced by severe anxiety, depression, withdrawal, or improper aggressive behavior as diagnosed by a medical doctor or psychologist and caused by the acts or omissions of the parent or caretaker (ARS §8-201).
>
> Emotional maltreatment includes blaming, belittling or rejecting a child, constantly treating siblings unequally, and persistent lack of concern by the caretaker for the child's welfare. Emotional maltreatment is rarely manifest in physical signs, particularly in the normal school setting; speech disorders, lags in physical development, and failure to thrive syndrome are physical indicators of emotional maltreatment. More often it is observed through behavioral indicators, and even these indicators may not be immediately apparent.

In helping staff, family, and caregivers identify abuse and physical injury, the organization might consider posting definitions from relevant state law and providing written materials on identifying abuse and reporting abuse. If the nonprofit does not have a clearly articulated zero-tolerance policy on abuse, a policy should be developed and material on the policy promulgated. Most importantly, the policy needs to be consistently enforced.

The organization should have a mandatory reporting policy for any suspected abuse, even when such a policy exceeds the requirements of law. Every state protects individuals who report suspected abuse from liability when the reports are made in good faith. A mandatory reporting policy is a powerful deterrent for individuals who seek access to vulnerable individuals through your organization.

Clarity in Articulating the Parameters of the Nonprofit's Programs

Families and caregivers and clients (if able to comprehend) need to receive an initial orientation regarding the scope of the program, how staff and volunteers are screened and supervised, and what the nonprofit's policies are on interaction between staff and clients.

Family members in particular should understand that staff have strict guidelines about interaction, such as giving gifts to clients. The more family members and caregivers know about the program, the guidelines on interaction, and the nonprofit's commitment to safety, the better the program will be.

Family members should also understand that a staff member's job description expressly prohibits him or her from engaging in certain activities. These prohibited activities may include:

- Calling clients at home
- Transporting clients to or from home except as directed by the program in the organization's vehicle under the auspices of a transportation program
- Having social events for clients at the staff member's home or outside of a nonprofit-sponsored event
- Giving or receiving gifts
- Offering services such as private caregiving to individuals served by the organization

Family members and caregivers should also know how to contact the nonprofit in the event that they wish to provide feedback or file a complaint. Programs should also encourage active participation and feedback from the client (if able) and from his or her family members. The information or feedback supplied by these sources should be carefully monitored and any complaints should be followed up immediately.

Providing Avenues for Feedback from Clients, Families, Caregivers, and Staff

Families, caregivers, staff, and clients should know how to report activities or behavior that they believe, or suspect, to be inappropriate. Simply stating that management is committed to being open to receive feedback is not enough. The nonprofit must routinely solicit feedback from clients (if they are able), families, caregivers, and staff. Additionally, senior management must provide families, caregivers, staff, and clients (if they are able) with information in advance of any emergency on how to access senior management to report abuse, neglect, or any other matter that requires immediate attention. This information needs to be updated and reissued on at least an annual or semiannual basis. Hotline numbers should be posted prominently around the facility, and staff members should be trained to assist family members in reporting problems.

Fostering an organizational culture that invites feedback from family, staff, and clients can be facilitated by the use of:

- *Surveys.* "Customer satisfaction" surveys should be disseminated to family members on at least an annual basis. Staff should also be given an opportunity on an annual basis to offer feedback by means of a general survey.
- *Open door policy.* Senior management should establish a visible track record in welcoming and supporting those who bring problems or issues to them. An open door policy can be seen as false if staff or families perceive that their concerns are not addressed.
- *Hotlines and other mechanisms for whistle-blowing.* Occasionally, families, staff, or clients want to report what they believe to be a situation so egregious that they require anonymity. Hotlines and other mechanisms should be made available to employees, volunteers, families, and caregivers with the guarantee of anonymity.
- *Incentives for families, caregivers, clients, employees, and volunteers to offer recommendations for improving the quality of programs or service.* These incentives can be as small as a ticket to a ball game. If the suggestion saves the

nonprofit significant sums of money, the reward should correlate to the significance of the savings.

Ensuring Safe Facilities

In working with vulnerable populations, the safety of the facility becomes one of the nonprofit's paramount issues. With any program serving vulnerable populations, there are professional practitioner organizations and industry standards to guide the overall layout of the facility. Routine inspections and evaluations to ensure the safety of the facility are essential. To simplify the process, the nonprofit might consider two tiers of evaluation for the facility: initial safety inspection to ensure compliance with relevant codes and regulations and a second tier of routine evaluations to ensure that safety standards are met.

INITIAL SAFETY EVALUATION FOR A FACILITY

In the initial safety evaluation, there are three main categories for examination:

1. Americans with Disabilities Act (ADA) Compliance. Key areas in these compliance standards include:
   - Access for mobility impaired clients, visitors, and staff, including elevator access if there are multiple floors
   - Alarm systems for visually-impaired and hearing-impaired clients, visitors, and staff
   - Bathroom facilities that provide access for disabled users and bathrooms with multiple facilities if client base presents this need
   - Accessibility and safety railings
   - Other accommodation features such as nonskid flooring, ramps, sufficiently wide hallways, and other features that provide additional safety to clients, visitors, and staff
2. State and local regulations, such as building codes. The nonprofit should consult with a facilities engineer or local building or fire inspector to ensure that the building has:
   - The proper number of fire alarms and smoke detectors
   - Fire suppression equipment

- Eyewash stations
- Appropriate hazardous or medical waste disposal
- First aid kits—the size of each kit being tailored to the population numbers of each unit
- Fire retardant or nonflammable building materials

The initial inspection should also identify immediate and potential hazards, such as asbestos and seismic issues. Addressing these hazards should be a priority in the nonprofit's overall risk management program.

3. Industry standards and best practices on facilities layout. Professional organization rules on the facility safety features that apply to the use of the facility, such as school and nursing home codes. For example, if the facility is used as a daycare center, the professional standards for the layout of a daycare center should be followed.

ONGOING SAFETY EVALUATIONS

Safety is an ongoing task. The time invested in a weekly walkabout is time well spent. A member of senior management, such as the facilities manager, should be assigned responsibility for conducting a regular weekly inspection to ensure that:

- Halls are clear and passable.
- Safety equipment is not being improperly used or hidden due to clutter.
- Emergency access doors work and alarms sound if the emergency access doors have alarms attached.
- No trash has accumulated outside of designated refuse areas.
- Items that can fall are secured.
- Hazardous materials are secured, and only authorized staff have access to them.

In addition, the organization should conduct regular quarterly inspections of safety equipment such as fire extinguishers, smoke detectors, and fire alarms. The responsible staff member should use checklists for all equipment to ensure that all safety features and equipment are in working order.

EMERGENCY DRILLS AND EXERCISES

Fire and other emergency drills are essential to ensure that staff and clients are familiar with the locations of emergency exits and understand important emergency egress protocols, such as not using the elevators. The frequency of these drills or other emergency scenario drills is critical to ensuring that staff and clients can safely use the facilities. The value of emergency exercises was illustrated by one firm in the World Trade Center on September 11, 2001: All but 6 people of the 5,000+ employees exited safely. That company had been conducting fire drills every month for the previous eight years. All staff knew instinctively how to exit the building in the event of an emergency.

Chapter 11

Managing the Risks of Transporting Clients

Transportation is an important program component for many nonprofit organizations. Some nonprofits transport seniors and people with disabilities, others take children to after-school or sports activities, and some deliver food and meals. The transportation of clients involves risk, and this chapter discusses those risks and strategies for building a transportation program that will reduce the potential for claims, injuries, accidents, and inappropriate behavior.

A transportation program is more than simply loading passengers and providing rides. The nature of the program must be carefully crafted, and the board needs to ensure that the program is in harmony with the nonprofit's mission. Once the central focus of the program is established, its parameters must be set up, and the types of vehicles, driver qualifications, and eligibility guidelines for use of the service need to be established. Central components of any transportation program are the parameters of the service, the clients, staff, vehicles, and the administration of the program.

Range of Service in Transporting Clients

There are myriad programs that focus on the transportation of clients. Some programs offer short-distance transportation, such as a school bus taking children to after-school programs. Social service programs can provide clients with transportation to medical appointments, shopping, or to events in locations away from their hometown. Other programs feature transportation of many clients at one time in multiple vehicles on long trips, usually in a caravan fashion from one destination to the next.

Clients can be able-bodied adults who simply lack transportation. Other client groups are children, senior citizens, disabled people, or other vulnerable population categories. The common expectation among these programs is that the clients will be transported to and from their destination safely, on time, and without incident.

To achieve these goals, nonprofits must be proactive in the design, implementation, and administration of transportation programs. Although many things can go wrong in any program, transportation programs can be particularly exposed to accidents, claims, and injuries because the majority of the transportation takes place on public thoroughfares. The following list of risk areas in transporting clients highlights the need for extensive prior planning before a program is offered and the high level of attention to detail needed in the administration and monitoring of the program.

Risk Areas in Transporting Clients

Any programmatic offering involves risk, but the nature of a transportation program incurs additional risk because the services are not offered exclusively in the nonprofit's offices. Transportation involves driving on public roads and highways using vehicles owned, leased to, or contracted with the nonprofit. Risk levels may increase if the client base consists of young, old, disabled, or otherwise vulnerable clients. Regardless of the specific focus of the transportation program, some common risk areas should be examined. These areas include, but are not limited to:

- *Emergency procedures.* A vehicle with driver and clients is involved in an accident. Clients might be injured or traumatized. The driver does not know what to do or how to help clients.
- *Failure to comply with state laws and regulations regarding driver credentials, training, physical examinations, and drug testing.* Drivers and staff attendants may not have the correct credentials for placement in a transportation program. Inadequate or sporadic procedures might be in place for training, background checks, and random drug testing. If vol-

unteers are utilized, these procedures might not be applied to nonpaid staff. Drivers could also have physical impairments or conditions, such as color blindness, that preclude their ability to drive.

- *Failure to conduct vehicle maintenance and safety inspections.* If the nonprofit has one vehicle or a fleet of vehicles, regular maintenance and daily safety inspections are essential.
- *Failure to comply with state laws and regulations regarding safety equipment.* If the transportation program features transportation services for disabled adults or children or for other special-needs groups, vehicles must be equipped with all features required by state regulations.
- *Drivers taking unauthorized passengers.* Screening, training, and supervision of staff is essential.
- *Due to driver negligence, client missing an appointment with a professional service provider and being assessed a penalty fee.* Nonprofits must have policies to address any penalties a client may incur if he or she is late for an appointment due to conditions either beyond or within the driver's control.
- *Drivers asking for tips or other compensation.* The nonprofit must maintain an environment in which staff members are carefully supervised and clients feel safe in reporting what they believe to be improper actions on the part of the staff.
- *Drivers stealing money or other valuables from clients or using coercion to have clients hand over the valuables voluntarily.* Screening and background checks for transportation staff are essential.
- *Drivers using the client transportation as a cover for other unauthorized activity, such as personal business, dealing drugs, or selling merchandise.* Transportation staff should be closely monitored in their rounds and remain in constant contact with the nonprofit's office.
- *Clients being denied service because of an arbitrary or discriminatory application and screening process.* Eligibility requirements must be widely disseminated and applications reviewed and approved or denied in accordance with written guidelines. These guidelines should be readily available to clients if they have questions or concerns.
- *Clients observing inappropriate behavior on the part of drivers, staff, or other clients and being rebuffed by the nonprofit when the behavior is reported.* As

part of the information about the program, the nonprofit needs to provide the names and numbers of individuals who are available to receive complaints or feedback on the service. Clients should also know the process for resolving complaints.

- *Clients expecting drivers to provide additional transportation services beyond the scope of the program.* The program information should be specific about the parameters of service and what types of requests are appropriate and inappropriate.

Elements of the Transportation Program

Core Values

Like all aspects of the nonprofit's program agenda, the rationale for and the values associated with a transportation program should be clearly articulated. The basic values and mission of the program need not be complex, but they should give clients and potential funders alike the program's underlying principles. Sometimes, a simple statement affirming the program's commitment to safety can highlight these principles. For example, the web site of the Minnesota Department of Safety presented the following core values for a school transportation program in the form of "The School Bus Driver's Commandments of Safety" (2002).

1. A school bus driver's paramount responsibility is the safety of their transported students.
2. Know and obey the Minnesota motor vehicle laws.
3. Utilize correct and safe procedures when crossing railroad tracks.
4. Be positive the vehicle is mechanically safe before going onto a route.
5. Drive defensively and always expect other drivers or pedestrians to do the unexpected.
6. Know where all emergency equipment is located and how to use said equipment.
7. Never take undue risks.
8. Know and obey the pupil transportation rules and regulations set forth by the Minnesota Department of Public Safety and your local school district.

Design of the Program: Establishing Parameters of Service

As a nonprofit board deliberates about offering a program that transports clients, several factors must be considered. How will the program be funded? If funding has been secured, the size of the funding and any limiting factors or caveats should be built into the overarching program goals and objectives. The funding source may also have stipulated that the funding was to provide a transportation program to meet a particular need. Whatever the stipulated need, the program must be crafted and delivered to meet the funding limitations. If the transportation services are limited to clients' meeting certain eligibility requirements, these should be clearly articulated and available in writing or on the nonprofit's web site. If there is a limitation on the number of clients that can be served, there have to be clearly stated methods for determining who will receive priority for service. If there is a waiting list for service, the waiting list can be offered as an alternative to immediate service. Potential clients who are put on a waiting list should be told how long they could expect to be on the waiting list before service is available. The availability of transportation should be considered a resource. As such, the emphasis in the development of any transportation program should be on clarity of eligibility requirements and easy access to this information, offering access to the transportation program in a fair and open manner, and the availability of an appeals process for potential clients if service is denied.

Progam design should also take into consideration the variety of profiles that potential clients may present. Depending on the focus of the program, transportation services could be offered exclusively to at-risk or vulnerable populations. If that is the case, the nature of the clients' vulnerability must be conveyed in the written materials on the program. If the clients have impaired mobility, hearing, or vision, special training or documentation for the staff assigned to the transportation program might be needed. If the clients have service animals, the transportation of these animals should be included in the plan.

If the clients are vulnerable because of age (i.e., children or elderly), the program documentation should be specific in these areas. As with clients having visual, hearing, or mobility impairments, children and elderly clients will require assistance in boarding and exiting the vehicle.

The program may not initially focus on special-needs clients because the overarching goal focuses on transportation related to other services. It is entirely possible that the target audience would be individuals who require transportation and do not present physical or age-related limitations. A carefully structured transportation program can act as a road map to address not only the needs of the clients, but also the ways in which the nonprofit can reduce the potential risk.

Clients

Client needs are the primary reason for offering a transportation program. In offering the program to clients, it is important that they understand the nature of the program, the limits of the service, the eligibility requirements, and the conditions under which they can utilize the services. To that end, it is important that clients either attend a program orientation or receive materials that provide an orientation in a user-friendly format with the necessary level of information.

Introducing the Program to Potential Clients

Whether the program is new or ongoing, the nonprofit needs to publicize the program to continue to recruit clients. The material outlining the program should include a description of the eligibility requirements, as these are essential in ensuring that all eligible clients are admitted to the program. If the program is currently filled, the nonprofit can either expand the program, compile a waiting list, or seek another nonprofit with which to collaborate in ensuring that clients are not turned away. If the client base consists of vulnerable or underserved clients, it is particularly important to work to meet the needs of this community.

HOW TO APPLY FOR SERVICE

Clients need to know how they apply for service, what verifying documentation they will need (if any), and how long the process will take before they receive notification that they are eligible.

SCOPE OF THE SERVICES

The scope of services for a transportation program includes what service clients can expect, and when, where, and how often it is offered. Clients should receive ample information on the specifics of the program, including routes, timetables, how to request service, and any other information that will ensure their comfort and safety.

HOW TO OBTAIN SERVICES

Clients may not have participated in a transportation program before. They need to know what is expected from them in terms of arriving on time, safety procedures, and what behavior and requests are considered appropriate. Although information such as when to arrive, what documentation to bring, and what constitutes appropriate or inappropriate behavior may appear to be intuitive, in many cases it is not.

To assist clients in understanding what appropriate behavior is, provide some examples of *inappropriate* requests or behavior. These examples can include a client asking drivers for transportation to places that are not covered by the nonprofit's program, which then renders the vehicle a taxi and incurs liability for the nonprofit. Clients generally cannot bring guests, but caregivers and service animals are allowable under the terms of the Americans with Disabilities Act. It is important to differentiate to ensure clarity. Clients need to comply with all safety procedures, such as wearing seatbelts and shoulder harnesses.

Clients need to know how to go about providing feedback. Information on how to contact the nonprofit's senior management in the event of a problem with the driver or the quality of service should be widely disseminated to clients and clearly posted in the vehicles and in the nonprofit's offices.

GRIEVANCE POLICY

Clients should be advised of what the nonprofit's grievance policy is and how to go about filing a grievance. Having a grievance policy is particularly important in the event that a client is denied service or has had his or her eligibility discontinued.

Licensing of Drivers

CREDENTIALS AND COMPETENCE OF THE DRIVERS

For the purposes of discussion and comparison, we present the requirements for school bus driver credentials. State government web sites are particularly useful for obtaining specific information on the criteria for the state in which the nonprofit is located.

LICENSING REQUIREMENTS

Each state has its own set of requirements for licensing drivers of buses and large vans. These often take the form of minimum age requirements; ensuring that the driver does not have a disqualifying offense, such as a driving under the influence (DUI) conviction; passing written and practical examinations; and, in some states, successful completion of driver training seminars. Some states require background checks to determine if the applicant has a criminal history and if so, what types of convictions are on the person's record.

Some commonalities in the requirements for obtaining a school bus license include, but are not limited to:

- Holding a valid driver's license for a personal vehicle.
- Completing a prescribed education program for the purpose of learning how to operate a school bus, large van, or commercial-grade vehicle.
- Attending a specified number of hours of a new school bus driver certification class taught over a period of days. Normally, a portion of one of the days is required for performance testing.
- Scoring a specified minimum grade on a written test given at the conclusion of the class.
- Passing a performance test, including:
  - Pretrip inspection of a school bus with at least the specified minimum grade of mastery.
  - Basic control skills tests, including tests on backing up the bus.
  - On-the-road driving skills test with at least the specified minimum score.
- Having an acceptable Department of Motor Vehicles record, including but not limited to:
  - No more than one conviction for a moving violation within the last 12 months.
  - No more than three such convictions within the last five years.
  - No conviction of driving while impaired within the last five years and no more than one at any time.

  - No suspension or revocation of license within the last five years.
- For recent (up to five years) out-of-state residents, a copy of the driving record from the former state of residence, to be obtained by the applicant, will be required to ascertain whether the applicant has an acceptable driving history.
- Physical health standards, including, but not limited to:
  - School bus drivers should be able-bodied and free of physical handicaps. They should not suffer from chronic diseases such as heart trouble, seizure disorders, high or low blood pressure, fainting or dizzy spells, diabetes, or any physical or mental disability or disease that could reduce a driver's control.
  - Passing an initial drug screening and being subject to random drug testing during the course of employment as a school bus driver.
  - Visual acuity, generally at least 20/40 vision with or without corrective lenses. The field of vision should be at least 150 degrees.
  - Depth perception, or a demonstrated ability to distinguish relative distance of objects from the bus.
  - Color vision, or a demonstrated ability to identify colors that pertain to traffic safety.
- Be at least 18 years of age with at least six months' driving experience as a licensed operator of a motor vehicle; hold a valid commercial license and a valid school bus driver certificate.
- Have the approval of the principal, transportation director, superintendent, and local board of education.

Vehicles

The safety and integrity of the vehicles used in a transportation program are a critical element in managing risk in the program. Although vehicles vary in size and capacity, conducting a safety check on each vehicle every day is time well spent. A sample daily safety check for a school bus might include, but is not limited to:

- *Rear-vision and crossover mirrors, including their proper adjustment.* The driver must be able to monitor traffic on both sides of the bus and behind the bus, as well as monitoring what is going on inside the bus. The inspection should check adjustment, cleanliness, and condition.

- *Eight-lamp system and stop arm.* This is the system that warns others drivers to stop when the doors of the bus are opened. The lamp system includes the flashing red lights on the bus, front and back, and the stop arm is the mechanism that controls the stop sign to halt traffic. To check on this, the driver needs to open the door and then walk around the bus to check that all the lights are working and that the stop arm deploys correctly.
- *Service brakes, including trailer brake connections.* The driver should engage the brakes and then visually check to see that all the lights come on. If the bus is towing a trailer, make sure that when the brakes of the main bus are pressed, the lights on the trailer engage. Electric brakes make an audible sound when engaging and disengaging.
- *Parking (hand) brakes.* The driver should start the ignition, set the hand brake, and then check to ensure that the dashboard light indicating that the hand brake is engaged is working.
- *Steering mechanism.* The driver should start the bus, then turn the wheel to the right to the full extent, and have a colleague confirm that the steering wheel has fully turned. The driver then should turn the wheel to the left to ensure that it has fully turned in that direction.
- *Lighting devices and reflectors.* The driver should check the cleanliness and condition of all external lights and reflectors. The driver should then turn on the headlights and parking lights and put the vehicle in reverse to check the back-up lights and audible indicator.
- *Tires.* All tires should be checked for proper inflation, the sidewalls checked for cuts or damage, and as much tread as can be seen for cuts or damage.
- *Fluid levels.* The oil level, transmission fluid level, power steering fluid level, brake fluid level, and radiator level should be at normal levels.
- *Horn.* The horn should be tested to ensure it is working.
- *Windshield wiper or wipers.* The wipers should be visually inspected to ensure that they are not damaged, covered with leaves or other debris, or are stuck.

A copy of the current daily pretrip inspection report must be carried in the bus and should be placed in the vehicle file at the end of the workday.

Document Management

Any transportation program requires good document management. Several essential categories of files, documents, and other important documents are highlighted in this section. For all these categories of files and documents, an important risk management consideration is establishing a means of backing up the files, both paper and electronic. In the event of a fire, flood, or other scenario that might destroy current records, these documents must be accessible.

FILES AND RECORDS FOR PROGRAM OPERATIONS

The documents in program operation files can include materials on eligibility requirements, a description of the program, and other marketing materials. Some essential information that needs to be easily accessible includes:

- *Files to track client usage and indicate where clients are transported, as well as other important data.* Depending on the scope and configuration of the transportation program, clients may be picked up at their homes, or at a designated location. For each day's transportation, the program manager needs to know the identity of clients using the service that day, their destinations, which vehicle they are scheduled to travel in (if the nonprofit has more than one vehicle), and any other relevant data, such as a client's signature on a sign-in sheet.
- *Schedule of vehicle usage.* For any given day, week, or month, the program manager must be able to track which vehicles were in use, their routes, the time they departed the nonprofit, and the time they returned. The schedule also must take into consideration the downtime needed for maintenance or repairs.
- *Schedule for upcoming week/month of client transportation.* The program manager should develop schedules on a weekly basis and a monthly basis. The monthly schedule should be developed first, and the weekly schedules reflect any necessary adjustments in the scheduling. Primary and back-up driver assignments should be made when compiling the monthly schedule, and adjusted when doing the weekly schedule.
- *Files to capture comments or feedback from clients regarding quality of transportation service or driver performance (cross-referenced with the file in the client folder).* This is a particularly important file. As part of the transportation

program, client feedback and complaints must be handled promptly and in a manner sensitive to client needs. This file should capture the feedback or complaints and indicate the actions taken to resolve any complaints.

- *Insurance and registration documents*
  - *Insurance documents.* Insurance policies should be readily accessible. Coverage levels should be in compliance with state minimum levels for liability, property damage, and other required coverage. The nonprofit should consult with its insurance advisor to determine appropriate levels of coverage and to secure special coverage or endorsements, if necessary.
  - *Accident and claims records.* All claims that have been filed should be documented, and a separate file should exist to hold documentation for all pending claims.
  - *Vehicle registration and Department of Motor Vehicles documents.* All licensing and registration documentation for each vehicle can be kept together.

PERSONNEL FILES AND RECORDS

The personnel records and files on all drivers and attendants should be part of the nonprofit's human resource department. Regardless of the pay status of the driver, each driver needs to have comparable materials in his or her file. Even if a driver is a volunteer, he or she must be subject to the same qualification criteria and the same standards to maintain driver qualification, such as random drug testing, as a paid employee. Because of the credentialing and licensing requirements each state places on specialized vehicle drivers, the personnel files for these individuals also need to contain the following types of materials:

- *Driver qualifying documentation.* These documents indicate that the individual has met the qualifying standards required by the state.
- *Comprehensive schedule for driver requalification.* This file provides a schedule over the next six months to one year identifying drivers who need to update their qualifying documentation.
- *Random drug testing.* In compliance with many state laws, nonprofits need to establish a random drug testing program. The results of the

drug testing must be placed in the driver's personnel file. The drug testing should take place at least once a quarter on an unannounced basis. Files related to the drug testing and results are highly confidential and should be secured and maintained by the most senior level of management.

CLIENT FILES AND RECORDS

As clients apply for transportation services, it is important to establish a file for each client to store the client's intake document, application, and any other qualifying documentation. Client files should also contain contact information for the client, including cell phone number and e-mail address, if the client consents, and emergency contact information. The client's file should also indicate the location to which the client wants transportation and the general nature of the services the client will be receiving at that site, such as medical or legal assistance. The client's file should also indicate the client's usage of the transportation services. For example, if the client has requested transportation once a week on Thursdays to a health care provider, the usage history would show the dates the client used the service and where the client was picked up and dropped off. This file can easily be cross-checked with the vehicle usage records.

The client's file should also include any documents providing feedback on quality of service and staff performance, as well as the resolution of any complaints.

VEHICLE FILES AND RECORDS

Whether the nonprofit has one vehicle or a fleet of vehicles, a file should be maintained on each vehicle. This file must contain a comprehensive maintenance schedule. The schedule should be set up on a monthly basis and indicate what has to be done for each vehicle. Drivers and other staff working with vehicles should be encouraged to provide feedback, and their supervisors should respond promptly to problems reported. Each vehicle file contains documents and reports relevant to that vehicle. The vehicle file should also store daily inspection reports and feedback from drivers on maintenance or servicing for individual vehicles. At a minimum, the following documents need to be on file for each vehicle:

- Maintenance schedule.
- Maintenance and regular inspections of any special equipment, such as ramps and wheel chair lifts/restraints.
- State vehicle registration requirements for vehicles transporting disabled passengers, particularly if special inspections are required at specified intervals or special equipment must be installed or inspected.
- Inventory of safety equipment and the last date it was tested or scheduled for inspection.
- Other documents related to upkeep of vehicles.

Maintaining documents and reports on vehicles in individual vehicle files affords easy access and an efficient means of tracking problems and routine maintenance.

Emergency Procedures

One of the most important skills that drivers and attendants need to have is the ability to handle an emergency. The emergency may be a traffic accident or a medical emergency involving a client or fellow staff member. In addition to driving and safety skills, the nonprofit must ensure that all drivers and attendants are skilled in dealing with emergencies and have had regular opportunities to engage in emergency procedure training scenarios.

All staff working in the transportation program should understand how to use the safety equipment in the vehicles, including fire extinguishers, first aid kits, emergency exit features, and the like. Staff should also be certified in first aid and CPR on an annual basis.

State government web sites have helpful information on emergency scenario procedures for larger vehicles such as school buses. As a starting point in developing emergency scenario training for a nonprofit's transportation program, the program manager might review the relevant materials on the state government's web site. The Minnesota Department of Public Safety web site (2002) offers these procedures to be used in the event of a school bus accident:

1. Stop and remain at or near the accident.
2. Evacuate students from the bus if:
   a. There is a fire or danger of fire.

b. The bus is in an unsafe position.

c. There is danger of drowning.

3. Try to prevent other accidents. Set out emergency warning devices. Use hazard warning lights.
4. Aid the injured.
5. If possible, send two responsible students for help. The driver must remain with the bus.
6. Give and collect information. You are required by law to give your name, address, date of birth, driver's license information, vehicle information, and insurance information. Get the same information from the other driver. Get names and other information from witnesses.
7. Report to the proper authorities.
8. If the accident results in death or serious personal injury on the school bus, or property damage to the school bus of an apparent extent or a specified dollar amount, do not use the school bus to transport students unless the vehicle has been determined by the authorities to be safe to operate.

Driver qualification documents should include a completed evaluation in emergency preparedness. At least once a year, there should be a mock emergency simulation in which each driver demonstrates that he or she knows the proper procedure to follow in the event of an accident or other emergency. The evaluation document should include specific skill set standards and validation of skill in each of these areas.

Summary

Transportation programs provide otherwise homebound clients with a needed service to keep medical appointments, shop, or obtain professional assistance. Key elements to be built into the overall design of such programs focus on the areas of communication, staffing, and safety.

Clarity of communication about the program, eligibility requirements, and expectations of both the clients and the organization provides the necessary foundation to the program itself. Clients need to understand the scope of the program, how to apply, how to participate, and how to provide feedback to the nonprofit on service or staff issues.

Careful selection, training, and supervision of staff assigned to the transportation program are primary risk management concerns. In particular, drivers have to be credentialed in accordance with state regulations, subject to random drug testing, and be well versed in safety practices and emergency response. Background checks for driver staff may be required by the state for licensing to ensure that applicants have no DUI convictions or other crimes that would preclude them from obtaining a specialized license. Close supervision of staff ensures that drivers and attendants have picked up clients at their homes or designated locations and have completed their appointed rounds as specified in the daily schedule.

Chapter 12

Managing Collaboration Risk

Collaboration is any form of joint effort of two or more organizations. Nonprofit organizations are in the collaboration business. In fact, it would be difficult to find a nonprofit that is not involved in collaboration with another entity, whether the collaboration consists of joint purchasing and office-sharing arrangements with other nonprofits or product endorsements, community events, and event sponsorships with for-profit businesses. Nonprofits throughout the United States recognize that when two or more organizations come together for a common purpose, the organizations and the clients they serve stand to win.

Collaboration is something that may bring joy to the collaborators and new revenues to the nonprofit involved, while making everyone's lives more interesting and the mission of a nonprofit within closer reach. Yet collaborations can also spell disaster for a nonprofit. Failed collaborations can affect the ability of the nonprofit to operate effectively in the long run or exhaust the valuable resources of the nonprofit that are needed for mission-critical activities.

Collaborations are fraught with risk. Collaborations may be inherently risky; in fact, they are riskier than other activities undertaken by a nonprofit. This may be true because each collaborator exercises little control over the actions of the other collaborator. Unlike an activity in which the nonprofit exercises control and can direct its staff members to do and not to do certain things, collaboration requires a heightened level of trust in the other party to do what it has promised to do. Communication is not only important when collaborating, it is vital. When things do not go as expected, disciplining one's partner in a joint activity is unlikely to be as easy as disciplining a paid or volunteer staff member.

Another element that makes collaboration inherently risky is that most of them represent an attempt to do something new. Collaborations frequently involve a first-time effort to address a challenge. Many collaborating organizations do not know each other well and have not worked together before.

Collaboration: How and Why?

Collaboration can take many forms, from the most informal agreement to work together on a one-time project to multiyear joint ventures or full-blown mergers that involve substantial resource shifts and changes in organizational structure. Some collaborations result in the disappearance of one or more collaborators and the formation of an entirely new entity.

Described here are three broad categories on a continuum of collaboration that a nonprofit may consider as it looks for ways to expand services, improve service delivery, or further pursue its charitable mission. The continuum of collaboration begins at the informal end, with a catchall category titled informal collaboration. At the middle of the continuum are activities that involve strategic restructuring. The principal distinction between these forms of collaboration is that strategic restructuring requires organizational change in order to facilitate or accommodate the collaboration. At the opposite end of the spectrum from informal collaboration is the merger, whereby the legal status of the organizations involved changes as part of the collaboration. This chapter focuses principally on the risks associated with informal collaboration and strategic restructuring activities. Mergers are discussed briefly. Remember that risk management activities are important in all collaborative environments. Although risk management may be critical in a formal merger, the failure to pay attention to threats and opportunities in even an informal collaboration could spell disaster.

Informal Collaboration

For many nonprofits, informal collaborations provide immediate and important rewards, such as access to information and other valuable resources, recognition by important constituencies, and the ability to offer services and assistance beyond the immediate means or scope of the nonprofit. Examples of information collaborations include information sharing, joint purchasing, sharing staff, co-locating, and program coordination. Details follow.

- In an *information-sharing* arrangement, two organizations might agree to share information so that the resources of each can reach the constituents of the other. A legal aid program might collaborate with a homeless shelter and domestic abuse shelter so that it can share information on the resources available from these providers with clients who require services in addition to legal aid. The collaboration may be as simple as maintaining a list of other providers in the community and updating the list periodically. Or it may evolve into a program whereby clients of one service provider enjoy ready access to the others, and intake procedures are simplified to the benefit of the client.
- Two organizations might pursue a *joint purchasing* arrangement when each believes that its purchasing power will be greater when they work in partnership to solicit bids for products or services both need. For example, the social services providers in one community may collaborate to hire a public relations firm that will assist in developing a public service announcement to air on local radio stations. The announcement benefits each provider by raising awareness about the services available from the organizations, and the cost is shared amongst the providers, thereby making the campaign affordable to each.
- Another example of collaboration at the informal end of the spectrum is small and midsize organizations *sharing staff* or *co-locating* their offices. Under such an arrangement, the collaborating organizations might be able to afford shares of state-of-the-art equipment, as well as access to staff specialists that would be out of reach to the organizations if operating independently. Certain equipment, such as photocopiers and high-speed scanners, may be desirable but too expensive for one organization. Certain positions, such as graphic designer, management information systems (MIS) director, human resources manager, and risk manager, may be vital to an organization but needed only on a half-time basis. Staff sharing can be an effective solution to this dilemma. A nonprofit such as a youth program could enter into agreements with a local government that enable the nonprofit to operate out of government-

owned facilities, such as community centers. Without these collaborations, a nonprofit's services would be restricted to its headquarters. With them, a nonprofit can deliver services from several locations throughout the community, nearer to residents who want to use the nonprofit's services.

- *Program coordination* is collaboration that may take several forms, from two nonprofits working together to refer prospective clients to each other's services to the joint pursuit of funding and joint delivery of programs. For example, a domestic violence center may invite staff attorneys from the community legal aid or bar association's *pro bono* program to host an on-site legal clinic at the center one day per month.

Strategic Restructuring

Sometimes working with another entity involves more than simply sharing resources or information. From time to time a partnership may require that each organization make changes in the way it operates to accommodate the requirements of the collaboration. Following are two examples of strategic restructuring: joint ventures and confederations.

- *Joint venture.* The term *joint venture* most often refers to a one-time partnership whereby two entities assume shared responsibility for the success or failure of the undertaking. A joint venture may be limited to a project or to a certain timeframe.
- *Confederation.* When several organizations collaborate on a project without relinquishing their legal status or independence, they form a confederation.

Mergers

When two or more organizations discuss the possibility of combining, creating a new entity, or changing one entity to incorporate the other, they are contemplating a merger. The outcomes of merger negotiations include:

- The dissolution of two or more groups after these groups transfer their assets, liabilities, and programs to a new entity.
- The concurrent expansion of one organization and the dissolution of another. The dissolving organization transfers its assets and liabilities to the surviving entity.

- The failure to reach agreement and the decision to continue operating the groups as independent, unrelated organizations.

If a new entity derives from a merger, the new entity's name may incorporate the names of one or more predecessor groups, or it may represent an entirely new label. Mergers lie at the most extreme end of the collaboration continuum for obvious reasons: They involve significant legal and organizational changes and generally result in the creation of a new or substantially different organization.

Collaboration Risk: When Partnerships Fail to Meet Expectations

Collaborations and partnerships are becoming increasingly popular among nonprofits as organizations seek creative ways to undertake new initiatives, stretch limited resources, and build community-wide support for a charitable mission and services. The most common mistake in developing these initiatives is the failure to fully consider the risks of the project or program.

A nonprofit may enter into a contractual arrangement with a government agency to provide services that the agency no longer wants to deliver. There may be opportunities for a nonprofit to secure long-term reliable funding for projects within the scope of its mission. When a nonprofit provides services on behalf of a local government, it is typical for the government agency to request that the nonprofit add the government agency as an "additional insured" to the nonprofit's insurance policy. The insurance should be provided by the entity that is providing the service and has control over how the service is being provided. If the service is being provided by the nonprofit on behalf of the government, it is appropriate for insurance coverage to protect the government funder, as well as the nonprofit.

Another opportunity for constructive partnerships lies with other nonprofit organizations. It makes sense to collaborate with complementary organizations. In times of increased competition and shrinking budgets, collaborating with another organization can be a way of conserving resources and gaining access to an expanded market for products and services.

It is important to remember that even though a partner is another nonprofit organization, the same caveats for working with corporations and governments apply. It is wise to proceed carefully and diligently. When two organizations with different cultures, histories, and perspectives come together to accomplish something, a wide range of unexpected events can occur. Even groups that believe at the outset of the relationship that they are of one mind often find that each group's unique culture emerges during the delivery of a collaborative effort. Examples of such difficulties follow.

- The motivation of one partner changes over time, and eventually the partnership is no longer in that partner's best interest.

  A nonprofit enters into a collaboration with a municipal government whereby the government allows the nonprofit to use a small inner-city park for the nonprofit's annual day-camp. There is one small building on the park grounds, containing restrooms, office space, and a small community room. As awareness about the day-camp increases, the number of enrolled campers surpasses the nonprofit's original projections. The park is large enough to accommodate the program on sunny days, but when the weather fails to cooperate with the camp schedule, the small community room does not provide enough room for activities that will hold the interest of the young campers. Although it is hard to pass up the "free rent" the city has offered, the nonprofit recognizes that it must move the program to another location or limit enrollment. It decides to move, and finds another site owned by a different nonprofit and offered for a reasonable rental fee.

- One or both organizations realizes that it did not accurately project the amount of effort and resources the partnership would require. As a result, the partnership is consuming more resources than its benefits warrant.

  Two nonprofits that provide training agree to collaborate and hold joint conferences in select locations across the country. Attendance for the conferences falls short of the collaborators' expectations, but participants give high marks to the training. During a review of the collaboration, the staff agree that the amount of time required to coordinate training schedules, trainers, and logistics far exceeds the benefit of holding the joint conferences.

- One partner discovers something about the other that makes continued affiliation inappropriate or too risky.

  A nonprofit partners with a corporation to develop a campaign that encourages local residents to undergo a test for a treatable form of cancer.

The corporation's name will appear on all the printed campaign materials and the public service announcement. The nonprofit agrees to this publicity in exchange for the company's generous funding of the campaign. When the corporation is embroiled in a scandal alleging misrepresentation of income, the nonprofit decides that proceeding with the company as its partner will attract negative attention to the nonprofit and reduce the ultimate effectiveness of the public education campaign.

- One partner fails to live up to the promises made to the other, putting the results sought by both in jeopardy.

  Two nonprofits partner to sponsor a 5K run. The event is expected to raise $10,000 and attract 500 runners. The nonprofits agree to split the net proceeds to support their charitable activities. Nonprofit A agrees to design and print 1,000 promotional flyers. Nonprofit B agrees to send its volunteers to businesses throughout the community to post the flyers. Both nonprofits agree to provide 10 volunteers each on the day of the 5K run. One week before the event, only 25 runners have registered. Nonprofit A learns that instead of visiting local businesses to obtain permission to post the flyers, Nonprofit B left the stack of flyers at the town's visitor center. Rather than face embarrassment from low turnout, Nonprofit A decides to cancel the event.

- The organizations involved in a collaborative effort discover they are not compatible, perhaps due to a culture clash or personality conflict involving representatives from each group.

  A group of nonprofit performing arts organizations start a collaborative marketing effort. The immediate result of the collaboration is that all the groups spent less to market tickets and ticket sales grew. Unfortunately, a serious dispute begins about just who "owns" the patrons in the seats, who are now donor prospects. The dispute results in a dissolving of the collaborative marketing program.

- One or both partners feels that its "brand" has been lost or subsumed in the partnership.

  Two nonprofits collaborate on a statewide conference for social workers. One organization is quite large and has the resources to produce eye-catching conference materials, including banners and conference signs. The other nonprofit is comparatively small, and the organization's receptionist is responsible for graphic design and desktop publishing. At the conference the smaller nonprofit's materials and signs look amateurish next to the professional materials from the larger nonprofit. Several attendees ask whether the two organizations have merged, whether the smaller nonprofit has been acquired by the larger nonprofit, or whether the smaller organization is winding down its operations. The staff and board of the smaller nonprofit decide that although the joint conference provides a meaningful educational opportunity, it left attendees with the false impression that the smaller organization was declining.

- Assumptions made by one or both parties, such as attendance at an event or community support for the partnership, prove erroneous.

  A government social services agency contracts with a nonprofit to provide mentoring services to clients involved in the juvenile courts. When a mentor suffers an injury, the agency learns that the nonprofit has not purchased accident insurance and the organization does not have the funds needed to cover the participant's medical expenses.

Risk Management Checklist for Collaboration

Here are some general tips to keep in mind regardless of the type of organization a nonprofit partners with.

- *Confirm compatibility.* Is the organization compatible with its intended partner? Will any precedents or policy be violated by partnering with the organization? For example, is it appropriate for a youth-serving agency to engage an alcohol or tobacco producer (or the subsidiary of one) as a lead sponsor of an educational program?
- *Understand motivations.* The motivation for a nonprofit may be clear, for example, to raise additional money for a critical initiative. The prospective partner may be motivated by a number of factors, including some that may not be obvious, such as the desire to cleanse an image or to target a new consumer group, such as young adults or members of an ethnic minority group.
- *Conduct due diligence.* It pays to conduct a minimal level of due diligence before formalizing a partnership. For example, is a business partner a subsidiary of a company that engages in activities that a nonprofit's constituents may find objectionable? Does the company engage in unacceptable business practices, such as foreign labor, child labor, or inadequate environmental safeguards?

- *Interpret the message.* Carefully consider the message the nonprofit's constituents will receive when they learn of the partnership or collaboration. Will they be bombarded with advertising that contains the new partner's logo? Will it appear that the nonprofit has endorsed a company's or another nonprofit's products or services? Has the nonprofit done so?
- *Clarify expectations.* The most important ingredient in a successful partnership is clarity of expectations. The nonprofit must make certain it knows and acknowledges what the partner hopes to get out of the endeavor. If a business partner expects an increase in sales to a specific constituency, determine what it expects the nonprofit to do to accomplish that goal. If a government agency expects 100 percent enrollment, the partners must discuss what steps will be taken if some clients refuse to participate. The nonprofit should push for additional clarity beyond the simple altruistic or operational motives the agency may describe.
- *Put it in writing.* Any partnership or collaboration that spans a lengthy period of time, involves a substantial sum of money (from the nonprofit's perspective), or in which each partner has specific responsibilities should be put in writing. A brief memorandum of understanding (MOU) or memorandum of agreement (MOA) provides an opportunity to outline expectations and responsibilities and assign risk to those who will be responsible if something goes wrong.

Another common danger is that one or a few of the partners will end up doing most of the work, with some of the groups shirking their responsibilities or unable to meet their requirements. It is unlikely that all participating organizations will be able to make their respective efforts equal.

Risk Management Strategies for Successful Collaborations

With care, caution, and due diligence, collaborative efforts with other organizations can be an effective way to conserve resources and advance a nonprofit organization's mission. Another way to think about risk management for collaborative efforts is to consider the steps that should be taken during each phase of the relationship. The three phases of collaboration follow, along with practical tips for each phase.

Phase I: Before a Partnership Begins

Risk management and common sense go hand in hand when a nonprofit is preparing to enter into a partnership with another organization. Here are some tips for getting it right before the starting gate opens.

KEY QUESTIONS TO ASK AND ANSWER

Before working out the details of a partnership, a nonprofit should consider asking the following questions. These questions were adapted from "Quizzing for Quality Services and Strategic Partners," featured in *Association Management*, September 2002. *Association Management* is the monthly magazine of the American Society of Association Executives. For more information on the products and services available from ASAE, visit www.asaenet.org. The answers will be a guide to a decision to proceed or to look elsewhere for a partner.

- ☐ Why is this collaboration being considered?
- ☐ How did the idea to collaborate come about?
- ☐ Is management confident that there is an audience or demand for the outcome of the collaboration?
- ☐ Is the proposed collaboration consistent with the nonprofit's mission? Will the collaboration contribute to the mission or simply generate funds for low-priority or unnecessary activities or services? Are the anticipated outcomes (including products, events, or services) consistent with the mission?
- ☐ Does any other group currently provide the product or service that will be developed through the collaboration? If yes, how will the nonprofit compete?
- ☐ How will stakeholders (donors, service recipients, the public, and others) likely perceive the collaboration, particularly in terms of the nonprofit's reputation? Will the collaboration alienate any of the nonprofit's current partnering organizations or supporters?
- ☐ Will the collaboration cause an undue hardship on the organization, including the staff?
- ☐ How will the success or failure of the collaboration be measured?

- ☐ If the business partner goes out of business, could the program continue? If not, could it be disbanded without causing a serious negative impact on the nonprofit?
- ☐ What are the best and worst possible outcomes of the collaboration? Is the nonprofit prepared for both?
- ☐ Will the partnership enable the nonprofit to deliver additional services or reach a wider audience?
- ☐ Is the proposed collaboration cost effective? Will the outcomes of the collaboration be worth the investment of time and resources? Does the nonprofit have enough information about the strategy to evaluate whether it will be cost effective?
- ☐ Does the technique require a long-term investment of time or substantial investment of resources?
- ☐ What time and resource commitments is the nonprofit making to this collaboration?
- ☐ What "return on investment" is expected over what period of time? How will success be evaluated?
- ☐ Is the proposed collaboration ethical and above reproach?

WORKING OUT THE DETAILS

Before proceeding with a partnership, the nonprofit should work with the partner organization to hammer out the details of the collaboration. The discussions and negotiations should cover the following points.

- *A point person in each organization should be determined, including:*
  - who will do what, and by when.
  - who will pay for expenses incurred to support the partnership.
  - who will be responsible if someone gets hurt.
- *All commitments are put in writing.* Discuss the value of a written MOU that substantiates your commitments. Be wary of a partner who refuses to put partnership details in writing and insists that you proceed with a handshake.
- *Explorations and negotiations take time.* Time is required to work out the details of the partnership. Until all parties to the agreement have had a

chance to ask questions, pose concerns, and resolve differences of opinion, they should avoid rushing to move forward. The most important issue is a shared vision of the outcomes of the partnership (e.g., the number of people who will attend the event, the distribution of net proceeds). When partners have divergent expectations of the results, the chances are slim that both will be satisfied with the outcome.

- *Support must come from the top*. Partnerships with the best chances of success enjoy support from senior management at both organizations. To avoid a situation in which management priorities are out of sync with the goals of the partnership, high-ranking support for the partnership must be sought and written commitments concerning the partnership be executed by senior officials at both organizations.
- *The potential negatives should be considered before they materialize*. Although many nonprofits find it easy to discuss all the positive outcomes that will flow from a collaboration, it is difficult to discuss how the relationship could sour or what the partners will do if things go awry. Nonetheless, it is essential to discuss possible misfires, accidents, and harm before they occur. The parties in the collaboration should discuss the following possibilities and make certain that the organizations are in agreement about what will occur if a negative outcome occurs such as the following:
  - What if someone gets hurt?
  - What if the event/program is undersubscribed?
  - Under what circumstances will an event be canceled? Is there a deadline for doing so?
  - What if one partner decides not to continue with the partnership? May the other party "go it alone" and continue with the program, or must the effort be abandoned if one partner backs out?

Phase II: During a Partnership

- *The nonprofit must act promptly*. While the partnership is active, the nonprofit should act promptly if the key contact at the partner organization is unresponsive or appears unable to fulfill the requirements or duties identified in the written MOA.

- *Communication should take place often and openly.* A process should be established that encourages representatives of the partners to communicate as often as is necessary to keep information flowing between the partners. Partners should be encouraged to call on each other if problems or concerns arise or if one partner wants to make a change in the program or pursue a different course from the one that the parties agreed to at the outset of the collaboration.
- *The nonprofit must fulfill its side of the bargain.* The nonprofit's point person must supervise the activities the nonprofit agreed to provide. All agreed-on activities should be done to specification, on time, and within budget. The point person can work out any discrepancies with the point person for the other organization to avoid delaying the project.

Phase III: After the Partnership Concludes

- *Review of the partnership.* Before the dust settles on a collaborative effort, the nonprofit should take some time to review the processes used, expected and unintentional outcomes, and the ups and downs of working with this partner. In some cases, the lead representatives from both collaborators will get together for this review. If the collaboration was not successful or there was a disagreement or falling out, the nonprofit may want to undertake this review alone. As part of this review, each side could consider asking:
  - Was the principal goal of the collaboration achieved? To what degree (e.g., 100 percent, 50 percent)?
  - What went especially well with the collaboration, and why (e.g., partners were open with each other, representatives got along well)?
  - Did anything go wrong? If so, what could have been done, if anything, to prevent it?
- *Review of the written agreement.* When the partnership or activity in which the partners are involved has concluded, the MOA used for that collaboration should be reviewed:
  - Were there other things that should have been discussed and put in writing before the partnership began?

  - If so, would they be applicable to other partnerships?
  - What modifications to the template MOA would improve the value of this document in a future collaboration?
- *Review of the potential for future collaboration.* The nonprofit should consider whether it would entertain partnerships with this organization in the future. The following questions could apply:
  - Under what circumstances would the nonprofit partner with this group again?
  - What would the organization do differently if collaborating with this group again?
  - Are there similar groups that would be suitable partners for future collaborations? If yes, who are they? If not, why not?

Collaborating with Insiders

Nonprofits often collaborate with *insiders*, such as board members, friends, or relatives of the nonprofit. Doing so may be necessary for a small startup. Although they have more options and more developed networks of contacts, larger and more mature nonprofits may determine that collaborating with insiders is in the best interests of the nonprofit. For example, a board member or relative of a staff member may have special or unique skills the nonprofit requires and be willing to offer these skills at a reduced price to the nonprofit. Or a board member or donor may offer his or her home as a site for the nonprofit's upcoming fundraiser. The reasons to collaborate with insiders include:

- The comfort level of working with a known person or organization, particularly when the project is of great importance or special significance.
- Services, support, or assistance can be obtained for less than market price.
- There is no steep learning curve: The partner is familiar with the organization and does not need time to understand the culture, decision-making process, or mission of the organization.

Risk Management Strategies for Familiar Collaborations

When collaborating with insiders, it is important to consider the following risk management precautions.

- Key contacts are selected from each organization that pose the most limited conflict of interest. For example, if Nonprofits A and B are collaborating, and the president of Nonprofit A is the board chair of Nonprofit B, someone other than the president of Nonprofit A should be the key contact from that group. Otherwise, Nonprofit B may feel undue pressure to please Nonprofit A and may not forcefully advance the mission of Nonprofit B.
- A long-standing relationship and good feelings should not be relied on to the extent of forgoing a written agreement of the partnership. With a known potential partner, there is a tendency to want to skip the formal process and move straight into implementation. This is generally unwise. A written agreement helps both parties stay on course and live up to their commitments.
- Any differences should be settled promptly. If something goes awry, such as a missed deadline, everyone should stop and clear the air. Petty squabbles could ruin the relationship. With insider collaborations, there is more at stake than the one-time project or event. A long-term relationship can be impaired or ended if disagreements are not aired and a mutually agreeable conclusion found.
- Responsible staff must make sure the deal is in the best interest of the nonprofit, and approval must be obtained from parties independent of the key players.

Business–Nonprofit Collaborations

Business-nonprofit collaborations can yield valuable dividends for a nonprofit, but even the best-thought-out collaboration can encounter difficulties. Some of the potential negative consequences of entering into a partnership with a for-profit entity include:

- *Wasted resources.* Lots of money and time could be spent on an endeavor that does not produce the expected results.
- *Reduced donations.* Other funders may see a splashy corporate-funded educational or other program and believe that the nonprofit organization no longer needs additional financial support.
- *Loss of organizational flexibility.* A significant part of the nonprofit's operation and much energy may go into making a program work, which may leave the group with less time and fewer resources to focus on its mission.
- *Tainted partners.* Even with appropriate due diligence, there is always the risk that the affiliated company could experience a public relations nightmare. The nonprofit's name could also get dragged through the mud.
- *Antithetical marketing.* The company's marketing strategy, product line, or reputation could be inconsistent with the nonprofit's message and mission.
- *Overwhelming success.* The program could become so successful that it becomes the dog and everything else the nonprofit does is the tail. Is the nonprofit a charity providing mentors for inner-city kids or a sales force for an athletic apparel company?
- *Structural atrophy.* So much effort may be required to make this arrangement work that other departments, units, and programs are neglected.

In early 2002, the American Association of Museums (AAM), a nearly century-old association representing the entire scope of museums and paid or volunteer staff who work for museums, adopted *Guidelines for Museums on Developing and Managing Business Support.* This document outlines a suggested approach to developing a policy on business support. Some of the key elements in the guidelines include avoiding conflicts of interest, proper use of a museum's name and logo, and the appropriate promotion of business relationships. (The full guidelines can be found at www.aam-us.org, in the section titled Ethical Guidelines.)

AAM advocates that its members develop written policies covering business support and obtain board approval of these policies. The policy should define the museum's goals for developing and managing business support, as well as the relationship of such support to the museum's mission. Additional recommendations found in the document include:

- The importance of explaining how the organization will support its business relationships.
- A provision explaining how the organization will deal with conflicts of interest, such as when a business relationship is considered in which a member of the nonprofit's board has a personal interest.
- The need to determine whether an organization intends to exclude any business or category of business from consideration for collaboration because of the business's products and/or services.
- What restrictions apply to the use of the organization's name and marks.
- What restrictions or conditions apply to the manner in which the business may promote its relationship with the organization and whether the organization requires that its approval be obtained in advance.
- Thinking about the organization's standards for recognizing business supporters or partners.
- Whether the organization will entertain offers of exclusive partnerships or collaborations.
- The commitment of the organization to develop and maintain documents about the relationship.

Insurance Considerations and Checklist

As mentioned in a prior section, many collaborators assume things about their partner that turn out to be untrue. The topic of insurance is a common area for such mistakes, and one partner often assumes that the other partner's insurance coverage will protect everyone involved in the collaboration. First, a nonprofit that is entering into a collaboration must never assume that its partner has it covered. Second, it must never assume that its existing insurance program is adequate. The nonprofit must clarify, investigate, and put its expectations and requirements in writing. The following checklist is a start on identifying insurance considerations for a collaboration.

- Will the collaboration involve the rental or purchase of property? If yes, who will be responsible for insuring this property?
- Will automobiles be used in the delivery of services under the partnership? If yes, do the vehicle owners have insurance? "Insurance follows the car," and nonowned vehicles owned by employees and volunteers may be used. This means that the vehicle owner's coverage responds first and the organization's nonowned auto insurance applies only after the individual's insurance is exhausted.
- Does the collaboration agreement make the employment status of all persons working on the project clear? State law mandates that employees must be covered by workers' compensation coverage.
- Does the collaboration agreement contain a mutual indemnification clause? Does each party agree to be responsible for its own negligence and indemnify the other for legal expenses and claims based on its negligence?
- Does the collaboration create any special committees or governing groups? Are the management acts (decisions) of these groups covered under one or both partners' directors' and officers' liability insurance?
- Will the partners rent facilities as part of the collaboration, or use each other's facilities? Landlords often require that organizations that rent facilities provide proof of insurance coverage, so that the user pays for claims for liability or property damage.
- Will the collaboration involve the use of equipment? Property coverage should be in place to pay for damage to property caused by any person exercising control over the equipment.
- Does the collaboration involve the delivery of professional services (e.g., medical, counseling, legal services)? If so, do one or both partners have appropriate professional liability insurance to cover claims alleging errors in the delivery of professional services?
- Will the collaboration involve the collection and transportation of money? If so, these activities must be covered under the appropriate crime insurance policy. Crime policies cover theft only by employees of the insured.
- Does the collaboration involve service delivery to vulnerable clients? If so, will those services be provided on a one-to-one basis or be other-

EXHIBIT 12.1 Sample Insurance Requirements

- Commercial general liability policy in the amount of at least $1million combined single limit for each occurrence, written on an occurrence form;
- Auto liability policy including coverage for owned (if any), nonowned, and hired vehicles in an amount not less than $1 million;
- Workers' compensation coverage covering all employees working on the collaboration and having statutory limits for each jurisdiction where the work under the collaboration is performed, and an employers' liability policy with at least the following limits: $250,000 per accident and $500,000 per disease;
- Willingness to name [name of partner nonprofit] as an additional insured on all applicable policies and provide valid certificates of insurance indicating coverage.

wise unsupervised? Unsupervised or one-to-one service delivery to vulnerable clients, such as children, the elderly, or people with disabilities, heightens the risk associated with the staff or volunteer position. As a result, a more rigorous screening process is in order, and the organization retaining these personnel should make certain that its insurance program includes coverage for allegations of sexual misconduct and abuse.

- Does the written agreement indicate whether each partner has insurance coverage at a specified limit? Remember that promises to indemnify are hollow unless they are backed by the ability to pay another party's legal costs. For most nonprofits, insurance backs the promises to pay. Exhibit 12.1 is an example of insurance requirements for a party agreeing to indemnify another:

Drafting a Memorandum of Understanding

An effective MOU prevents misunderstandings and disputes by clarifying the expectations of the partners. The process of developing an MOU is an instructive and potentially invaluable experience in partnering. During this process the nonprofit will learn how responsive its partner will be. Are calls returned promptly? Does the partner give the partnership the attention and seriousness it requires? The organization may also learn how this partner reacts when the two partners disagree on an issue. In many cases, the nonprofit will learn vital information, such as:

- The partner's corporate structure.
- Whether it has liability and other types of insurance.
- What the partner is willing to promise (ambitious projections may fade as the partner commits to something realistic).
- What aspects of the project the partner is willing to be responsible for.
- How each organization will assess or evaluate the success of the project.
- The partner's overall commitment to the project.

The refusal to put anything in writing is a red flag and may be enough reason not to proceed with the arrangement.

A number of elements should be contained in a typical MOU. Since each project and its partners are unique, the following suggestions are provided as an example. As with any contract, it is critical to obtain legal counsel before a nonprofit obligates itself.

- *Overall intent.* Many MOUs begin with a brief description of the overall intent of the parties, such as:

  > Whereas the mission of We CARE is to provide after-school tutoring to elementary-age children, and the mission of We DELIVER is to transport children to after-school activities, the organizations hereby agree to collaborate in delivering an after-school tutoring program beginning September 1, 2004.

  The overall intent clause must accurately reflect what the parties are intending to do. Ulterior motives have no place in effective partnerships.
- *The parties.* The next clause in an MOU describes the parties to the agreement. It should generally be specific enough to indicate the types of organizations (e.g., "a nonprofit corporation headquartered in the District of Columbia").
- *The period.* A time period for the partnership must be specified.
- *Assignments and responsibilities.* This important section of the MOU describes the duties and responsibilities of each partner. It is generally more effective to describe each organization's responsibilities separately, beginning with the items that are an organization's sole responsibility. List each group's sole responsibilities, followed by a description of shared responsibilities, if any. In many cases, this section of the

agreement is the most detailed and lengthy. Clarifying responsibilities is the most important purpose of a written agreement.

- *Disclaimers.* Many MOUs contain one or more disclaimers, including one indicating that employees of Organization A are not to be considered employees, borrowed or otherwise, of Organization B and vice versa. It may also be worthwhile to disclaim what the partnership is not intended to do, guarantee, or create.
- *Financial arrangements.* A typical partnership has financial implications. These should be spelled out in detail, including which entity is to pay for each item and when payment is due.
- *Risk sharing.* Another critical element of an MOU is a description of who will bear the risk of a mishap. What if something goes wrong? What if the partnership's activities result in injury, death, or a financial loss? An important tenet of risk management is that an organization should never assume responsibility for something over which it does not have control. For example, a nonprofit renting a building to hold a dinner meeting should not assume responsibility for the damage caused by a leaky roof. A formal MOU may include an indemnification provision, promising that Organization A will pay for losses suffered by or caused by Organization B. Ideally, indemnification provisions should be mutual in that each party will be responsible for its own negligent acts or omissions. An organization's agreement to indemnify a nonprofit without the financial resources (including insurance) to meet this responsibility is a hollow promise. A nonprofit must make certain that its partner is not only willing but also able to pay for losses it causes. A section on insurance requirements is one way to do this.
- *Insurance requirements.* This section indicates the insurance requirements that each organization places on the other. In some cases, one organization will require that its partner have certain insurance in place. If the parties have agreed to a mutual indemnification provision (see the previous item, *risk sharing*), the insurance requirements should be bilateral. For example:
    - The parties to this agreement hereby agree that each will maintain insurance throughout the duration of the collaboration that meets or exceeds the following:

    - Commercial General Liability policy in the amount of at least $1 million combined single limit for each occurrence, written on an occurrence form.
    - Auto Liability policy including coverage for owned (if any), nonowned, and hired vehicles in an amount not less than $1 million.
    - Workers' Compensation Coverage covering all employees working on the Collaboration and having statutory limits for each jurisdiction where the work under the Collaboration is performed, and an Employers' Liability policy with at least the following limits: $250,000 per accident and $500,000 per disease.
  - In addition, each party to this agreement will name the other party as an Additional Insured on all applicable policies and provide valid Certificates of Insurance indicating coverage.
- *Signatures*. A representative from each partner with authority to bind their organizations contractually should sign the MOU. Each partner should retain a copy of the signed agreement.

Part III

Risk Financing for Nonprofits

Chapter 13

Fundamental Objectives and Alternatives for Risk Financing

Risk financing is a subset of an organization's financial management activities. The principal goal of risk financing activities is to maximize the value and use of an organization's resources. To maximize an organization's resources, it must strive to manage the sources and uses of funds with which it will finance its recovery from a loss. Therefore, risk financing involves planning and arranging for the sources of funds to be used for losses before the event occurs. The management process also extends to directing and controlling the expenditure of those funds when a loss happens. An effective risk financing program sets forth how an organization will pay for the losses that occur.

Financing Risk Management Activities

Risk management is just one of many management programs competing for a nonprofit's limited resources. Every organization is concerned about its operational costs and ensuring the maximum use of its scarce resources. Funds spent on risk management cannot be used for program expenses, revenue development, salaries, and other activities that a nonprofit must finance. However, the funds devoted to risk management also aid the effective and efficient operation of an organization and support its mission.

Risk management costs are divided between risk control and risk financing. Risk control expenses include the costs to establish methods and techniques for preventing losses and minimizing the adverse consequences of accidents that do occur. Examples of risk control expenditures are staff screening procedures, facility safety measures, computer backup systems, human resource policies, staff training, worker safety incentive programs, and a crisis management or disaster recovery plan.

Risk financing decisions identify the sources of funds the organization will use to pay for losses. Most risk financing strategies blend retention and transfer techniques. Retention is drawing on the organization's money to pay for losses. A nonprofit can plan to use operating income, establish a reserve fund, secure a letter of credit or other borrowing scheme, or have a captive insurance company pay for losses it chooses not to insure or cannot insure. In contrast, transfer techniques transfer or shift the financial responsibility for specified losses to another party, usually an insurance company. Through an insurance transfer an organization exchanges the uncertainty of potential loss expenses for the certainty of the premium payment. Each organization should consider adopting a risk financing policy statement to establish its guidelines for the use of the various retention and transfer techniques. The statement provides an overall framework that will guide subsequent retention and insurance purchasing decisions.

Establishing a Risk Financing Strategy

An organization's culture, goals, and mission influence its risk financing strategy. One factor to consider is the board's and senior management's appetite for risk. Organizations that are risk averse will seek a high level of certainty with regard to risk financing costs. Other factors to consider in establishing a risk financing strategy include determining the most efficient allocation of resources (availability of financial resources) and post-loss goals.

Appetite for Risk

A nonprofit's senior management and board should determine the level of uncertainty it can tolerate with respect to the potential financial consequences (costs) of risk. The greater the organization's need for certainty (knowing how much it will spend on risk financing to maintain a sense of security), the more insurance the organization will purchase. A comprehensive insurance program offers stability and certainty through fixed premium expense and the knowledge that insurance will pay for certain losses. In contrast, the more risk and uncertainty the board and senior managers are willing to accept, the less they will rely on insurance to fund losses. A nonprofit that chooses to accept a high level of risk may not purchase as much insurance.

Allocation of Resources

As mentioned earlier, risk management is just one of the demands placed on the organization's resources. Risk management costs should be evaluated like any other expense and allocations made based on the organization's needs and the potential benefits from the expenditure. Insurance is available for almost anything when the price is right. However, an organization does not have to purchase every insurance product available but should carefully assess the costs and potential benefits of various insurance policies.

Post-Loss Goals

The post-loss goals of risk management are survival, continuous operation, required financial results, stability of operations, and growth. Survival as a post-loss goal is important to every nonprofit even if the organization operates at a reduced capacity after the loss. If the organization wants to go beyond mere survival, it must determine the level of operational and financial results it wants to maintain after a loss. One alternative is to maintain continuous operation—keeping the doors open no matter what happens—while recovering from a loss. Each organization should review its operations to decide if there are any activities that must continue to operate despite the occurrence of a loss. Some activities or programs can withstand a temporary shutdown, but there may be some programs or events that cannot be discontinued even briefly. Depending on a nonprofit's needs, insurance can play a substantial role in providing the funds (especially extra expense insurance) needed to maintain its operations after an insured loss.

Another goal is to achieve certain financial results after a severe loss. A nonprofit's post-loss objectives vary in the degree of financial strength the organization wants to maintain in the event of a loss. First, a nonprofit may just want to maintain a positive cash balance despite the occurrence of a severe loss. Another organization may want to maintain a specific reserve level after a loss. Last, a nonprofit may want to ensure that a loss does not adversely affect its planned growth in revenues and services. The choice of maintaining a positive cash balance will tend to increase reliance on insurance to ensure that the financial results fall within the established boundaries. Insurance will also be the mainstay of the risk financing strategy for an organization that wants to maintain a selected reserve level. Immediately after a loss an organization may operate at a reduced capacity but strive to return to its pre-loss level of services as soon as practical. Another post-loss goal is to sustain the planned growth of an organization after a loss. However, an organization focused on growth can approach its risk financing strategy in two different ways. Organizations with a high tolerance for risk will spend less on insurance and risk management so its funds can be spent on expansion. If the organization has a lower appetite for risk, it will use insurance to ensure that the growth will continue in spite of a loss. Once an organization determines its tolerance for risk, it should consider the availability and allocation of resources and articulate its post-loss goals. These elements form the basis for a risk financing strategy.

Once an organization has established its post-loss objectives, it needs to balance these against its pre-loss objectives of economy of operations, its tolerance for uncertainty, and legality (operating within the law). *Economy of operations* refers to the need to balance the costs of various risk management activities with the benefits received, so that the organization can operate efficiently.

Risk Financing Techniques

Risk financing techniques are ways for an organization to generate the funds needed to pay for losses. There are two major categories of risk financing techniques: retention and transfer. *Retention* means that all the funds come from inside an organization; the nonprofit will pay for any retained losses. In contrast, *transfer* means that the funds for loss payments come from outside the organization. Risk transfer techniques include purchasing insurance and noninsurance transfers, such as a contractual agreement whereby another organization agrees to indemnify the nonprofit.

For large organizations, selecting the appropriate risk financing technique requires complex loss and statistical analyses. The organization must be able to predict the frequency and severity of different types of losses to determine the projected cost of future losses. Then the organization can determine the appropriate level of retention. For many nonprofits, risk financing decisions involve deciding which insurance policies to purchase and what limits it can afford. The retention decisions typically focus on what size deductible or retention an insurer will offer or what level the nonprofit can afford. However, it is valuable for every nonprofit to have a basic understanding of the available risk financing options.

Retention

Retention is the technique whereby an organization pays for certain types of losses or a specific portion of each loss. As mentioned earlier, an organization should consider how it will pay for any retained losses that occur. Various funding options are explained below.

CURRENT EXPENSING

Current expensing involves paying for any retained losses from current operating expenses. This option is used when an organization has not established any type of reserve or other funding strategy to pay for losses other than drawing from its operating funds. This technique is the least formal retention technique and does not ensure that money will be available to pay for losses. Most nonprofits use the current expensing technique to fund their retained losses.

UNFUNDED LOSS RESERVE

Unfunded loss reserve is an accounting technique that recognizes the likelihood of future losses. The organization does not allocate specific funds for the payment of losses but relies on its current funds to pay for retained losses. The advantage of this technique is that the organization has at least recognized the potential for future losses and placed a value on projected losses.

FUNDED LOSS RESERVES

A funded loss reserve is a more sophisticated retention technique. With a loss reserve, the organization sets aside funds or other assets from which it will pay retained losses. In order to fund the reserve properly, the organization needs to analyze its past loss experience and predict the amount of future losses.

BORROWING

With this technique the organization borrows funds or uses its credit to pay for the retained losses. Some organizations establish a line of credit prior to any losses to ensure this source of funding. Other organizations may try to secure a loan after a loss, for example, when an organization faces an unanticipated retained loss. Although the cash is from a source outside the organization, borrowing is still considered retention because the nonprofit must repay the debt from its own funds.

CAPTIVE INSURANCE

A captive insurer is a subsidiary of the parent organization and therefore considered a part of that organization. Therefore, any loss payments from a captive insurer have not transferred the financial risk to an entity outside the organization. Generally, only very large nonprofits and associations of nonprofits have the resources and expertise required to establish a captive.

Contractual Transfer

An organization can transfer the financial consequences of losses to another through insurance or noninsurance transfers, such as indemnification agreements and hold-harmless agreements. A *noninsurance transfer* means that the party accepting responsibility for the financial consequences of a loss is not acting as an insurer. A contractual transfer for risk financing does not shift the actual risk to another party, it just shifts the financial burden for certain losses to another party.

Although we are discussing the use of contracts to transfer the financial responsibility for a loss to another party, do not forget that this type of transfer can work two ways. Many contracts attempt to shift the financial burden to the nonprofit for losses both within and outside the nonprofit's control. Therefore it is critical for each organization to set up a procedure to review all contracts for potential risk financing transfers. One suggestion is to ask an insurance professional to review all contracts containing indemnification and hold-harmless agreements or insurance provisions.

CHARACTERISTICS

Any contractual transfer for risk financing (insurance and noninsurance) shares three common characteristics:

1. The other party promises to provide the funds without the nonprofit promising to repay the other party. The nonprofit will repay neither the insurance company for its loss payments nor a contractor with which it has an indemnification agreement.
2. The other party will only pay for the losses that fall within the scope of the contract. Every insurance policy contains exclusions and limitations so the insurer will not pay for all losses. Similarly, a noninsurance contract stipulates certain types of losses and expenses that will trigger the promise of indemnification or commitment to hold harmless.
3. The nonprofit's financial security depends first on the other party's willingness and ability to pay the incurred losses and, second, on whether the contract is legally enforceable. Therefore, an insurance policy is only as good as the financial strength of the insurance company. Also, if a nonprofit agrees to indemnify its board members for their alleged or actual wrongful acts, that pledge is only as good as the nonprofit's ability to fund future losses. The best course of action is to determine if the other party's promise to pay is supported by an insurance policy or other funding mechanism.

INDEMNITY AGREEMENT

An indemnity agreement is when one party to the contract agrees to pay the other party if the other party suffers a type of loss covered by the contract. The agreement is for any type of loss specified in the contract.

HOLD-HARMLESS AGREEMENT

A hold-harmless agreement is a form of indemnity agreement in which one party agrees to hold another party harmless from specified types of legal claims that may be brought against the second party because of the activities covered by the contract. Therefore, a hold-harmless agreement only transfers the liability losses from those activities covered by the contract.

INSURANCE VERSUS RETENTION

Most nonprofits use a combination of risk financing techniques. An organization may retain a certain portion of specific losses and purchase insurance for losses in excess of the retained amount. Also, risk financing techniques work in conjunction with various risk control techniques.

Every organization needs to decide how much, if any, it is willing to retain for each type of loss. The other side is how much insurance, if any, it needs to purchase for each risk or exposure. One option is to purchase as much insurance coverage as it can obtain and afford. Most small and medium-size nonprofits rely on insurance to pay the first dollar of all insured losses. Insurance companies often require a deductible or retention. This is true with various policy types, including building and business personal property, automobile physical damage, computers, directors' and officers' liability, and excess liability.

Another alternative is to use insurance to fund primarily catastrophic exposures and losses. For example, a nonprofit may decide to retain the first $50,000 (or more) of any general liability loss: The organization pays for any loss, including defense and investigation costs, up to the first $50,000. When a loss reaches or exceeds the retained limit, the insurer pays the balance up to the policy limit. The retention level can vary from none to whatever an organization's financial resources and appetite for risk will allow. However, if an organization selects this alternative, it also needs to establish a funding mechanism to pay for the losses within the retained limit. The insurance marketplace and an organization's culture, goals, and financial resources are the only limitations on selecting the balance between retention and insurance or other forms of transfer. For insurance, one purchasing guideline is for the organization to insure whatever part of a risk the premium cost makes economically attractive or cost effective.

Chapter 14

Working with Insurance Professionals

This chapter explores some of the common liability and insurance policies purchased by nonprofits. Before a nonprofit can purchase a commercial insurance policy, it must identify someone to act as an intermediary between the nonprofit and prospective insurance providers. These intermediaries are generally referred to as agents, brokers, or consultants. This chapter refers to them simply as insurance professionals.

Why Does a Nonprofit Need an Insurance Professional?

With rare exceptions, most companies selling commercial insurance (coverage sold to organizations rather than individuals) require that coverage be *placed*, or handled, by an insurance professional. An insurer's alternative to working through licensed professionals is to sell direct, which means selling directly to the insurance consumer. Nonprofits across the spectrum of experience, size, and sophistication can benefit by working in partnership with a competent insurance professional. For the inexperienced insurance buyer and seasoned insurance manager alike, an insurance professional should be seen as a partner and resource in protecting the nonprofit's assets. Some of the tasks that an insurance professional should undertake for his or her nonprofit clients include:

- Advising the nonprofit about the availability of various insurance products that address the nonprofit's exposures.
- Helping the nonprofit determine what limits and deductibles meet the organization's needs.
- Being available to answer any questions the nonprofit's managers and leaders may have about terms, conditions, pricing, or other issues affecting the nonprofit's insurance policies.
- Assisting in the preparation of materials that summarize the components of the nonprofit's insurance program (collection of insurance policies).
- Forwarding questions from the nonprofit to the insurance company.
- Forwarding notice of claims to the insurer on the nonprofit's behalf.
- Collecting the policy premiums from the nonprofit and remitting these in a timely manner to the appropriate insurers.

What Qualities Should a Nonprofit Look for in an Insurance Professional?

The most important qualification a nonprofit should seek in its insurance professional is experience working with other nonprofit organizations. The insurance industry is dynamic, and many aspects of it change regularly: the players (insurers, alternative market mechanisms) and the terms, conditions, and pricing of commercial coverages. An insurance professional who has experience working with nonprofits is in the best position to advise a nonprofit about its choices in coverage (terms and conditions), pricing, and providers (carriers).

Another important quality in an insurance professional is responsiveness. When the renewal of your nonprofit's policies is being negotiated, questions will arise about the terms and conditions of coverage, as well as the pricing of various policies. A responsive insurance professional admits what he or she does not know while promising to find answers to questions. The responsive insurance professional stays in touch with clients during the annual coverage renewal process and keeps them abreast of changes in the industry and the carrier that could affect clients' insurance programs.

Fee or Commission? The Compensation Debate

Most insurance professionals are paid directly by insurance carriers on a commission basis. The commission amount is a percentage of the premium for that account. When the premium increases, the dollar amount of the commission also goes up. When the broker obtains a lower-priced policy for a nonprofit, his or her commission generally goes down as well. Besides commissions, agents and brokers may earn additional fees or other rewards from carriers based on the volume of business placed with a particular provider. The commission percentage amount may be based on the volume of business an agent or broker places with a particular carrier. The highest commission rates are generally reserved for a company's preferred brokers, or others who place what the carrier considers a substantial amount of business.

Commission-based compensation for insurance brokering services has several disadvantages:

- It creates a disincentive for a broker or agent to obtain the lowest possible premium for the best coverage.
- There is the lack of a connection between the amount of work involved serving a nonprofit's account and the commission earned (many agents agree that the smallest accounts require the most time and energy).
- An agent or broker may be motivated to steer nonprofit clients to a carrier that pays him or her a higher commission instead of to the carrier offering the coverage that best meets client needs.
- The client is not involved in determining or participating in the negotiation of compensation for a professional advisor.

Advantages of commission-based compensation include:

- Removing the requirement that the client pay a broker separately for services provided.

- The absence of a time element to the consumer-advisor relationship, which frees up the client to make requests on an as-needed basis rather than having to stay within a fixed budget of hours for insurance assistance.

Many experts in the industry believe that a change to fee-based compensation is long overdue. Some large brokers report that a significant percentage of their business is conducted on a fee basis, with the client compensating the broker directly for the work the firm performs. These brokers admit, however, that commission-based compensation is still the norm for small consumers of insurance.

Every nonprofit should give some thought to how the organization's insurance professionals are compensated, discuss the pros and cons of a commission-based versus fee-based arrangement with its advisor, and consider tying a percentage of compensation to success in meeting central goals (e.g., policy delivery deadline, responsiveness). When a nonprofit selects the organization's insurance advisor, it should consider the possibility of compensating this important advisor on a fee basis. If the nonprofit prefers to continue with a commission-based arrangement, it can inquire about how much commission the advisor is earning on the account and request clarification about whether the broker is receiving any incentive compensation from the carriers with which it places business.

Chapter 15

Insurance

In this chapter we explore various types of coverage commonly purchased by nonprofit organizations. The descriptions of these coverages are presented as background information. To fully understand the coverage provided in a policy purchased by your nonprofit, you must take the time required to read the policy. If you encounter terms or provisions that are unclear, consult your insurance professional (agent, broker, or consultant) for assistance.

The process of purchasing commercial insurance for a nonprofit is complicated and time-consuming. Since very few nonprofits have a full-time staff member serving as risk manager or in a related capacity, the task of managing a nonprofit's insurance program often falls on a staff member who wears other "hats" in the organization.

10 Strategies for Financing Risk Responsibly

(These tips are used here with permission from the Nonprofit Risk Management Center. They appear in the Center's book, *Coverage, Claims & Consequences: An Insurance Handbook for Nonprofits*. For more information, visit www.nonprofitrisk.org.)

Each nonprofit needs to decide what insurance, if any, is right for the organization. The vast majority of very small nonprofits do not purchase any insurance. This may be because the board does not recognize any need for it or board members think they cannot afford it. For most people insurance is a mystery and a puzzle that they often do not want to solve until a loss occurs. However, insurance is too important and may be an integral part of a nonprofit's survival. The following 10 strategies outline guiding principles for nonprofit managers in the establishment of an insurance program.

1. You Cannot Insure Everything

Many nonprofit managers and volunteers do not realize that you cannot insure every risk. First, a risk may be uninsurable due to its speculative nature or the impossibility of assigning a dollar value to the loss (such as reputation), or the insuring of such a risk may be against public policy. For example, you cannot purchase insurance to cover potential losses in the financial markets. The cost to restore your organization's reputation in the aftermath of a scandal is also uninsurable, since it is too difficult to assign a dollar value to the loss. Insurance is not available to pay fines the nonprofit owes to the Internal Revenue Service due to a violation of tax law or the failure to pay employment taxes. Second, most nonprofits must consider affordability as they decide what insurance to buy. In many cases an organization cannot finance every insurable risk and decides to *go bare* with respect to some risks. For many organizations, the initial cost of some coverage, such as sexual abuse or employment practices liability, puts the coverage out of reach. In other cases, an organization that ignored risks and experienced either frequent claims or more than one severe or catastrophic loss may have a hard time obtaining affordable coverage in the future.

The purchase of insurance does not negate the need to practice risk control, which can aid in obtaining insurance or reduce the premium. Insurance is not the same as risk management. The more successful an organization is at minimizing the likelihood of harm and responding effectively when harm occurs or is alleged, the more successful and insurable it will be.

2. Consider Nontraditional, as well as Traditional, Financing Mechanisms

As an outgrowth of a hard insurance marketplace in the late 1980s, various nontraditional risk-financing models developed and grew. The alternative market includes risk retention groups, risk pools, self-insurance, captive insurance companies, and much more. The traditional risk-financing approach of purchasing coverage through a commercial insurance carrier has lost substantial market share to the nontraditional market. Not long ago, many of these alternatives were only available to the largest organizations. This is no longer the case, and the availability of alternative-market programs has opened up to small nonprofits. During the hard-market cycle that returned at the beginning of the new millennium, these alternative risk-financing measures will face new challenges, and perhaps unprecedented growth. One expert estimates that within the next 10 years, more than 50 percent of all risk financing will be placed in the alternative market.

3. Take Responsibility for Your Risk-Financing Decisions

Due to the complexity of insurance and other risk-financing options, it is easy to become overly dependent upon insurance advisors. Every person responsible for managing a nonprofit's risk management and risk-financing program should vow never to say, "Because my broker/agent told me to." The person with authority to manage a nonprofit's insurance program should accept responsibility for the decisions he or she makes about risk-financing matters, including how much the nonprofit will retain, what types of insurance coverage it will buy, what limits of coverage are appropriate, and what coverages it does not need. Design your risk-financing program primarily to protect your nonprofit from catastrophic financial losses, keeping in mind what can be done to prevent and mitigate losses.

4. Do Not Delegate the Insurance Program to the Wrong Person

In many nonprofits the insurance program is delegated appropriately to a senior manager with a background in finance. The insurance program is too important to an organization's future to assign it to an entry-level or midlevel manager, or other employee without the training, authority, or support needed to accomplish the job effectively. The person with the responsibilities of *insurance program manager* must keep abreast of important issues, both inside the organization and within the realm of the insurance industry. When selecting the person to be responsible for your insurance program, consider:

- Is this employee able to understand the provisions of your insurance coverage?
- Does he or she know where to go for support and assistance on insurance matters?
- Does the employee know enough about the organization's operations to handle its insurance needs appropriately?
- Is the employee in the loop and kept informed of pending changes within the organization?
- Does he or she have the authority to work with the outside vendors effectively?

5. Learning Something about Insurance

Although too much information can overwhelm and confuse, the more you know about insurance and the insurance marketplace, the better able you are to choose the best risk-financing strategies for your nonprofit. Once assigned responsibility for managing the insurance program, you need to develop a training program for yourself and learn how to rely on insurance professionals to help you acquire the knowledge you will need to be successful. Allow your understanding to build gradually over time. You should ask questions of your professional advisors and vendors, talk to other risk managers, take an insurance or risk management course, and read your insurance policies. Numerous companies offer books and training courses in insurance and risk management. Many community colleges offer short courses on insurance. Learn as much as you can so you can manage your risk-financing program effectively.

6. Identify a Competent Advisor

Few nonprofit managers or volunteers can afford the time to become true experts in the field of insurance. While it is essential that you understand a number of basic concepts and the terms of your policies, you will still need the services of an insurance professional occasionally. Nonprofits generally require outside expertise in accounting, legal, and insurance matters. Your insurance consultant, broker or agent is a valuable and often indispensable member of your professional support team. The Nonprofit Risk Management Center recommends strongly the selection of an insurance professional (an agent, broker, or consultant) with special understanding of the insurance needs of a nonprofit organization like yours. For example, a mentoring program may work with a professional who specializes in youth-serving groups. A sports and recreation program should search for a professional with expertise in the unique needs of such programs.

7. Educate Your Vendors

The selection of a competent insurance professional does not eliminate the need to educate your advisor and your insurer(s) about your operations. Insurance professionals, even those that specialize in nonprofits, work with a diverse spectrum of clients. It is easy to generalize or stereotype organizations and unintentionally ignore the distinct characteristics of each nonprofit. The most valuable and practical legal, financial, insurance, or management advice takes your particular circumstances and environment into consideration. Therefore, your insurance advisor should also recognize your unique operations, risk management program, and other important issues. However, you are ultimately responsible for explaining your nonprofit's activities and services fully to your insurance advisor. Your insurance professional cannot recommend the appropriate coverages or course of action if he or she does not understand all that your organization is doing and your plan for the immediate future.

8. Read Your Insurance Policies

Working with a competent insurance professional is no substitute for reading and trying to understand the policies you are relying on to protect your nonprofit's vital assets. An insurance policy is a contract and like any contract, should be read. You would not sign a lease you have not read nor an employment contract you do not understand. Therefore, you should never rely exclusively on the representations made by your insurance professional. Many insurance companies provide attractive marketing materials that summarize key coverage elements or compare policy provisions with a competitor's form. These materials usually include a disclaimer that in the event of a coverage dispute, the policy wording applies, not the statements contained in the materials. Do not get seduced by the glossy brochures and abdicate your responsibility for understanding what you are buying. Be aware that timing is often a critical issue. In a *hard market* particularly, insurance *binders* (summary documents that evidence critical elements of coverage) are often issued at the renewal date, with policies to follow sometime in the future. These binders should be reviewed carefully, as well. And every nonprofit insurance program manager needs to make demands upon the outside insurance advisor for timely policy delivery.

9. Welcome Competition

During the recent *soft* market the insurance industry became extremely competitive with respect to writing nonprofit accounts. Companies focused on niche marketing, targeting certain groups of nonprofits. During the soft market insurers introduced a wide range of policies that addressed the unique needs of nonprofits. For example, a scaled-back nonprofit directors' and officers' policy offered to nonprofits with annual revenues under $250,000 was introduced by one company and quickly copied by several others. Soft-market conditions and the perception that nonprofits in general are good risks led to increasing price competition, dramatic policy enhancements, and greater choices for the nonprofit buyer. Does competition to write nonprofit accounts disappear during hard-market conditions? Although many nonprofits struggle to find coverage at any price in a hard market, there is still active competition for many classes of nonprofit business, and this will continue for the foreseeable future.

10. Welcome Cooperation Too

The competitive marketplace of the 1990s generated benefits for smaller or *more hazardous* nonprofits. First, many insurance companies were willing to develop special programs for homogeneous organizations or similar groups of organizations. Group programs may offer participants better bargaining power in the insurance marketplace than they would receive as individual organizations. Second, a group program may lead to the development of specialized coverages or features only available to participants. Third, the process of underwriting a group should enable an insurance carrier to better understand the risks and unique circumstances of those service providers. With a solid understanding of the group, underwriters may be willing to place fewer restrictions on the coverage afforded to the group. A word of caution: Although your nonprofit meets the guidelines of a group program, you should still evaluate the coverages offered in light of your organization's needs. Some group programs offer a variety of special coverages that you may not need. This excess coverage increases the cost of your insurance. You should consider carefully whether it is appropriate for your nonprofit to join a group insurance program designed for similar nonprofits.

Overview of Common Property and Liability Policy Types

Nonprofits typically need three broad types of insurance policies: liability policies, property policies, and hybrid liability–property policies.

Liability Insurance Policies

Most nonprofits should consider purchasing at least eight different types of liability coverage.

1. COMMERCIAL GENERAL LIABILITY

General liability insurance responds to claims alleging bodily injury or property damage caused by an accident. The general liability policy has three parts: Coverage A, Coverage B and Coverage C.

Coverage A covers everything except liabilities specifically excluded. Commercial general liability (CGL) is sometimes referred to as *premises and operations insurance*, and this is essentially what it covers. General liability policies do not specify the types of claims that they cover. Here is a summary of some of the types of claims that are generally covered under a CGL policy:

- Injuries arising from the insured's premises
- Injuries to clients under the insured's supervision
- Injuries to volunteers while working for the insured
- Injuries to guests at special events
- Injury caused by products the insured sells or manufactures
- Fire damage to the insured's landlord's building
- Damage to property not owned by the insured or in its possession

Like other policies, CGL policies feature standard exclusions that eliminate coverage for certain exposures. Common CGL exclusions include:

- Exposures considered uninsurable
- Intentional or criminal acts
- Contractual liability
- Damage to the insured's products
- War
- Exposures that should be covered under another liability policy, such as auto, watercraft and aircraft liability, injury to employees, liquor liability, pollution liability, and mobile equipment
- Exposures that should be covered under a property policy, including damage to property owned by the insured and damage to property in the insured's care, custody or control

Coverage B, *personal injury and advertising injury liability*, responds to claims alleging libel, slander, false arrest, malicious prosecution, wrongful eviction, wrongful entry, violation of privacy, infringement of copyright, and unauthorized use of an idea in advertising.

Some of the standard exclusions under Coverage B include intentional falsity, acts prior to policy effective date, violation of a penal statute, contractual liability, breach of contract, pollution, advertised quality or performance, wrongful description of the price, and insureds in the business of advertising, broadcasting, or publishing.

Coverage C, *medical payments*, provides accident rather than liability coverage, and most CGL policies offer a standard limit of $5,000 per person. The policy responds to accidents at a nonprofit's premises, or at activities the organization conducts off the premises. Coverage is provided regardless of the nonprofit's liability.

Some of the standard exclusions under Coverage C include injury to insureds, injury to persons hired, injury to residents, workers' compensation or disability benefits, injury arising out of athletics, injury from products or completed operations, war, and any injuries excluded under Coverage A.

2. PROFESSIONAL LIABILITY INSURANCE

Professional liability insurance, sometimes referred to as malpractice insurance or errors and omissions insurance, responds to claims alleging errors or omissions in the delivery of professional services. Here's a simple guide for determining whether a nonprofit has a professional liability exposure for which professional liability insurance may be available:

- Does the nonprofit have one or more employees or volunteers who are licensed, accredited, or certified to provide services to patients, clients, or students?
- Does the nonprofit have one or more employees or volunteers providing traditional or nontraditional health care services?
- Does the nonprofit have one or more employees or volunteers who are mental health counselors, including marriage, addiction, youth, adolescent, family, or pregnancy counselors?
- Does the nonprofit have one or more employees or volunteers who are social workers, especially if involved with child placement, crisis intervention, or the criminal or juvenile justice systems?
- Does the nonprofit have employees who are members of professional associations and who provide services in accordance with the standards of their profession?

Professional liability policies respond to allegations of wrongful acts, professional incidents, or medical incidents. Understanding what is covered requires a careful reading of the definition of coverage contained in either the insuring agreement, the policy definitions section, the declarations page, or an endorsement. There are four common formats for professional liability coverage in the nonprofit sector: profession-specific professional liability, miscellaneous professional liability, allied health care professional liability, and social services professional liability.

3. DIRECTORS' AND OFFICERS' LIABILITY INSURANCE

Commonly referred to as D&O coverage, directors' and officers' liability coverage addresses actual or alleged wrongful acts by directors, officers, and other insureds under the policy. The plaintiff in a lawsuit covered by a D&O policy may be an insider, such as an employee or volunteer, or an outsider, such as a service recipient, donor, or governmental official.

Although directors' and officers' liability insurance may provide defense against allegations of fraudulent, criminal, or dishonest acts, these acts are not insurable (nor indemnifiable) as a matter of public policy. However, many policies amend the exclusion so that it applies only when a final adjudication establishes such acts. *Final adjudication* means that a court has found the directors or officers liable. The wording of this exclusion varies by policy and does not always rely on a court finding.

Insurance companies write D&O policies in a variety of ways for nonprofits. Some carriers offer a traditional D&O policy with additional coverages provided through endorsements to modify coverage for nonprofits. Some policies provide minimal coverages to corporate directors with substantive exclusions, and the nonprofit coverages are restored through various endorsements that modify the provisions in the main policy. Another choice for the nonprofit buyer is designed for nonprofit organizations and provides the essential coverages. These policies may be called nonprofit organization liability insurance, not-for-profit organization professional liability insurance, or something similar.

Every nonprofit must decide for itself whether or not it should purchase D&O insurance. Most nonprofit bylaws contain an indemnification agreement whereby the nonprofit agrees to pay the legal expenses incurred by board members who must defend themselves in suits based on their work as board members. These board member indemnification agreements are hollow promises unless the nonprofit has financial resources to fund the indemnification. Although a small percentage of nonprofits may be able to set aside funds to pay for future litigation costs, the vast majority of organizations find it easier to pay an annual premium for D&O insurance.

4. EMPLOYMENT PRACTICES LIABILITY INSURANCE

Anecdotal reports from insurance companies suggest that most of the claims filed under nonprofit D&O policies allege wrongful employment practices. This means that for many nonprofits, it makes most sense to purchase a D&O policy that includes coverage for employment-related claims. It is important to know that employment practices liability (EPL) coverage is also available as a stand-alone policy. However, a separate EPL policy may not provide a nonprofit with the depth of coverage that a nonprofit D&O with EPL coverage may include. Many stand-alone EPL policies do not include the organization, all employees, or volunteers as insureds. The definition of the *covered employment actions* may be more narrow than a nonprofit D&O with EPL coverage. Finally, a stand-alone EPL policy may be more expensive and include a large retention or possible coinsurance provision, in which the insured must pay a certain percentage of the loss.

Purchasing employment practices coverage as part of a D&O policy has one disadvantage. A blended policy provides coverage for two very distinct exposures with one policy limit. The inclusion of EPL coverage dilutes the limit of liability (including defense costs) available to protect the directors' and officers' personal assets and to protect the nonprofit and its employees and volunteers. The defense and resolution of an employment-related claim will reduce and, possibly exhaust, the D&O policy limits, thereby leaving limited or no funds for any additional non-EPL claims. The majority of nonprofit D&O policies provide no separate limit for EPL coverage. However, some companies are introducing either a sublimit or separate limit for EPL coverage. Therefore, a nonprofit should carefully evaluate the adequacy of its D&O policy limit when it purchases a D&O policy that includes EPL coverage. At the same time, decision-makers should keep in mind that most nonprofits will never face a claim that is not related to employment, and therefore a D&O policy with EPL coverage may represent an affordable and appropriate option.

5. FIDUCIARY LIABILITY INSURANCE

Fiduciary liability policies protect the fiduciaries of health and welfare or pension plans from claims by employees who suffer financial loss. Coverage is provided as a separate policy or as an endorsement to a nonprofit D&O liability, and it responds specifically to liability under the Employment Retirement Income Security Act (ERISA) and its amendments. Carriers base premiums on the assets of the plans in question, including the annual contributions to the plans. Most fiduciary liability policies are written on a claims-made basis and are subject to a retroactive date for prior acts.

In comparison to employee benefits liability (EBL), which protects only against mistakes in the administration of an employee benefits program, a fiduciary liability policy may cover discretionary decisions in administering benefits plans, as well as administrative errors and mistakes in the administration or communication of employee benefits. Suits against fiduciaries may allege negligence in decisions related to investment portfolios or the acceptance of exorbitant fees from investment managers. Since coverage for administrative errors is included, EBL may be unnecessary for an organization that purchases fiduciary liability.

6. EXCESS LIABILITY COVERAGE

Excess liability policies provide coverage when the limits of underlying policies have been exhausted. Excess policies are written to *follow form*, which means that they are subject to the same terms and conditions as the underlying policies. They do not cover claims that would be excluded by the primary policy.

7. UMBRELLA LIABILITY INSURANCE

Umbrella insurance policies provide broader protection than excess policies, because in addition to providing excess coverage over underlying limits on primary policies, umbrella policies *drop down*, covering losses that are not covered under primary insurance policies. Typically, an umbrella policy is triggered after the liability insurance in other policies runs out. For example, if a nonprofit has a professional liability policy with limits of $1 million, the umbrella policy will pay claims above that amount, up to the umbrella limit selected. It will also provide additional coverage over and above the amount the insured is entitled to under its professional liability policy. Because the professional liability policy will pay out first, it is considered primary, and most of the risk is assumed under the primary policy. This enables insurers to help keep the premiums for umbrella policies at a lower rate.

8. ACCIDENT (MEDICAL EXPENSE) INSURANCE

Accident policies are relatively inexpensive policies that finance the cost of medical treatment for individuals (volunteers or participants) who are injured while delivering services for or receiving services from an organization. These policies usually pay the costs of emergency room services and follow-up treatment to predetermined limits based on the kind of injury. For example, a broken leg may have a limit of $2,500, whereas an eye injury might be limited to $1,500, unless the injury resulted in the loss of sight in the eye, in which case the limit may be $15,000 (These amounts are hypothetical and intended for illustrative purposes only.) Usually these policies do not have deductibles. *Note: An accident and injury policy does not respond to illness, nor does it protect the organization from liability for the injury.*

One distinctive feature of an accident policy is that it will pay a claim regardless of who is at fault. These policies are generally written as *excess insurance*, meaning that they pay only after other available insurance—generally the insured's personal health insurance—is exhausted. If the volunteer or participant is uninsured, the accident policy would drop down and become primary coverage for the injury.

Accident policies provide affordable coverage for an organization concerned about volunteers or participants who may be uninsured or underinsured for injuries sustained while volunteering.

Property Insurance Policies

Property policies fall into two classes—those covering direct damage and those covering loss of income from direct damage.

DIRECT DAMAGE

Nonprofits purchase property coverage to finance the risk of damage to or loss of a variety of assets, including

- real estate/buildings
- valuable papers, money and securities
- computer equipment
- boiler and machinery
- personal property of others
- fine arts (owned/nonowned; transit and exhibition)
- buildings under construction or renovation

Property insurance generally covers incidental expenses, such as fire department charges, expenses incurred to save the property from damage, and debris removal.

Property coverage is triggered when the policyholder's property is damaged or destroyed due to certain causes of loss. Typically, a property policy covers every type of cause, except those specifically excluded in the policy, such as nuclear war. Some policies only cover damage caused by specific causes, such as fire, lightning, wind, water, or objects falling from the sky. Many policies do not cover significant catastrophes that affect a wide geographical area, such as floods or earthquakes.

ELECTRONIC PROPERTY COVERAGE

Other coverages for direct property damage deal with electronic property and with crime losses.

The majority of electronic equipment is insured on a policy specially written for computer coverages. Each company has a different name for its electronic form, but the most common are computer coverage or electronic data processing (EDP) coverage. For simplicity's sake this book refers to it as a computer policy. However, remember that a nonprofit should insure all of its electronic office equipment (e.g., telephone system, copiers, and facsimile machines) under this form. The purpose of this coverage is to protect electronic equipment and data from physical loss, and the resulting loss of income and extra expense incurred due to damage to electronic equipment and information.

Crime Coverage

Crime coverage generally refers to a package of coverages that includes financing for insider and third-party theft. *Fidelity bonds*, or *employee dishonesty bonds*, address a single type of exposure: theft and embezzlement committed by a staff member. A nonprofit can purchase a fidelity bond separately as a crime policy or as part of a commercial insurance package. Theft and embezzlement committed by a staff member are the focal point of a fidelity bond. Thus, if a third party steals from the petty cash, the fidelity bond will not respond. Likewise, if a burglar steals a laptop computer, there is no coverage under a fidelity bond (however, there may be coverage under the theft portion of the nonprofit's property policy). Most nonprofits purchase blanket position bonds rather than list specific people on the policy. For example, an insurer writes the bond to cover board members, the executive director, treasurer, and the bookkeeping staff. The following conditions apply under a fidelity bond:

- The perpetrator must be an employee (most policies do not cover board members or other volunteers unless certain endorsements are purchased).

- There must be a dishonest act (e.g., theft or forgery) to recover under a bond, and many bonds require that the nonprofit report the loss to the police. (Bonds do not compensate for poor business decisions, failure to follow expense account rules, inventory shortfalls, or sloppy record-keeping.)
- A fidelity bond will only provide coverage if the staff member intends to (a) cause a loss to the nonprofit, even though temporary, and (b) confer a financial benefit on himself or herself or a third party.
- The dishonesty must occur, be discovered, and the claim reported, during the bond period.

BUSINESS INTERRUPTION AND EXTRA EXPENSE COVERAGE

Together, business interruption and extra expense coverage reimburse an insured for the loss of its net income plus expenses that continue during a period in which the nonprofit cannot operate due to damage to or destruction of its property. A nonprofit's property includes the organization's buildings, contents, equipment, and vehicles that it owns or leases or that are owned or leased by others.

Because of a fire during which a nonprofit's headquarters is destroyed, the organization is unable to hold a scheduled fundraising event and therefore loses the estimated $10,000 in net proceeds anticipated from the event. The organization faces a number of additional expenses to cancel the event, including the cost of telephoning ticket holders and sponsors. In addition to paying its regular staff overtime, the nonprofit hires several temporary workers to assist in calling ticket holders and sponsors to inform them of the cancellation. The organization also incurs considerable cost for mailing letters explaining the cancellation and extra expense for renting an office from which the staff can operate until the headquarters is rebuilt. These costs should be covered under the business interruption and extra expense policy form.

Hybrid Liability/Property Policies

Hybrid insurance policies combine in one policy coverage for both property and liability losses. These "package" policies bring together combinations of insurance protection that many insureds usually wish to purchase.

Two such hybrid policies that are especially popular among nonprofits pertain to (1) commercial vehicles and (2) business operations.

COMMERCIAL AUTO COVERAGE

When a nonprofit owns vehicles that it uses to transport staff, service recipients, or materials and equipment, it must purchase commercial auto coverage for these vehicles. Commercial auto coverage is often referred to as a business auto policy (BAP). When a nonprofit simply uses vehicles owned by private individuals, such as staff members and volunteers, to conduct its business, it should purchase nonowned and hired auto liability coverage. Nonowned and hired auto liability coverage is the only auto coverage a nonprofit will require if it does not own any vehicles.

The principal coverage provided under a BAP or commercial auto policy is auto liability. Auto liability coverage responds to claims that result from an accident involving the covered vehicle for which damages due to bodily injury or property damage are owed. In some cases an auto liability is referred to as third-party coverage, because the policy protects the first party (the buyer of the policy, or nonprofit) from lawsuits or claims filed on behalf of third parties—the person(s) who suffered bodily injury or property damage.

The second category of coverage provided in a commercial auto policy or BAP is physical damage coverage, which consists of collision coverage and comprehensive coverage. Collision coverage responds to losses resulting from a collision between an insured auto and other auto or object. Comprehensive coverage responds to a loss from any cause except the covered auto's collision with another object or the covered auto's overturn. Physical damage is known as first-party coverage. Thus, it protects the financial interest that the first party (the nonprofit, or insured under the policy) has in the auto.

BUSINESSOWNERS POLICY

A businessowners policy (BOP) is a package policy designed for small to medium-size businesses. The Insurance Services Office, a rating and filing organization supported by the insurance industry, developed a standard BOP, but most insurance companies have developed their own version of the policy. Several insurance companies that specialize in underwriting nonprofit organizations developed their own BOP for their nonprofit insureds. Although each company's BOP program is different, there are some basic similarities among the policies. Every BOP includes a basic package of property and business liability coverages with options to add additional coverages or exclude or restrict other coverages. The policy's rating system is simplified and usually based on the amount of property coverage.

A BOP is a viable insurance product for small to medium-size nonprofits, especially BOPs designed for nonprofit organizations. A BOP is usually less expensive than other forms of package policies due to its rating methodology. This product is not for every nonprofit, but it meets a definite need for many organizations.

Alternative Risk Financing

Alternative risk financing programs and self-insurance alternatives are often considered appropriate for only large nonprofit organizations. A closer look at this growing field reveals that there are a number of examples of small to medium-size nonprofits working together to jointly insure each other. The forms these insurance mechanisms take vary from captive insurance companies to risk retention groups and mutual insurance companies. A variety of these alternatives exist today. Among the most prominent is a risk retention group for colleges and universities, a risk retention group for mental health agencies, a reciprocal insurance company for a variety of nonprofits, and a group of nonprofit insurers that includes an insurance pool in California, a risk retention group for a dozen other states, and a captive reinsurer service company.

The easiest way to evaluate the financial stability of an insurer of any type is to rely on the rating issued by a prominent ratings agency, such as A.M. Best (www.ambest.com) or Moody's (www.moodys.com). However, these ratings are not the only way to determine the viability of an insurer or alternative risk financing mechanism. It is important to remember that an A or A– rating is not a guarantee that the insurance company or risk retention group will be around to pay future claims. During the past decade there have been a number of high-profile bankruptcies of large insurance companies that enjoyed relatively strong ratings before their demise. In addition, new insurers are at a disadvantage with respect to obtaining a favorable rating, simply because they are new in the marketplace.

One company, A.M. Best, requires that an insurer have five years of experience before it is eligible for a letter rating. And even when it does assign a rating without five years of operation, in practice it does not assign a rating of higher than B++ to a new carrier, no matter how optimistic the rating agency is about the future of the company.

An appropriate approach for the nonprofit insurance buyer is to ask its insurance professional (agent, broker, or consultant) for their insights on current or prospective insurers, including alternative risk financing mechanisms, such as captives and risk retention groups. Decision-makers should learn as much as possible about the provider's reputation, financial structure and experience so that the nonprofit will be able to make an informed decision.

Epilogue: A Risk Management Decalogue

This book has sought to empower you to direct a nonprofit organization through uncertain seas, voyaging to fulfill its mission. It has tried to give you much information and many insights for dealing constructively with risk—both threats of loss and opportunities for gain. Managing these threats and opportunities well enhances your organization's future. Your task now is to remember and apply all that this book offers.

To help you with this task, this book now concludes with the 10 most important points, the 10 most vital principles, for you to remember in managing a nonprofit's risks. This decalogue by no means summarizes the factual content of the book, yet its every page gives you guidance in putting one or more of these principles to work for your organization. If, five years from now, you remember nothing else from this book, remember these 10 principles of effective risk management and work with all your colleagues to make them realities within your organization. The people with whom you work, and more importantly, the people whom your organization serves, will thank you.

1. Anticipate Change and Surprises—Both Threats and Opportunities

Five years from now, the world will have changed. (Actually, tomorrow it will have changed—probably just a little, but perhaps a lot.) Much as any of us may like the present, there is little any one person or organization can do to stop these changes. In fact, nonprofit organizations work to bring about changes that, in their view, make the world a better place as their respective missions are more fully achieved.

With change come risks—possibilities that, even tomorrow, the world may be surprisingly different than we now expect. Even though we cannot predict the direction, extent, or frequency of specific bad or good surprises, the first principle of good risk management is to expect some surprises—do not expect everything to stay the same. Whatever the surprising changes—whether they materialize as horrific accidents or as wondrous opportunities for progress—try to be prepared for and to make the best of whatever happens. Try to shape as safe and as successful a future as best as you can, but prepare for what you cannot control. Foster these same positive attitudes about change, risk, and opportunity within your colleagues and clients.

2. Put Your Organization's Mission First

For any nonprofit, its mission is its central objective . . . its reason for being . . . its polestar. All other objectives are secondary, supportive of the mission. So it is with a nonprofit's risk management objectives. Thus, while a profit-seeking organization works to maximize its long-term profits (revenues that exceed expenses), a nonprofit aims to enhance its abilities to serve its clients. The risks a nonprofit faces—the accidents that threaten it, the opportunities it may choose to pursue—have importance to the extent they may jeopardize or nourish the organization's capacity to carry out its mission. So, for any given nonprofit, consider which risks are the most important. The specific answers will differ among organizations and over time for any one organization. But the way to reach these changing answers is always to be asking the same basic question: What risks, which threats and opportunities, matter most to our mission? Deal with them first, whenever they arise; the others can—and should—wait. The mission-central threats and opportunities hold your nonprofit's future, and the well-being of your clients, in their grasp.

3. Build a Positive Risk Management Culture

Because changes are always everywhere, so are risks—both threats and opportunities. No one person can see them all, not even all the risks that arise daily within any single nonprofit. Furthermore, because everyone's activities create risk, and everyone's attentiveness is needed to reduce hazards and to recognize opportunities, everyone who works for a nonprofit should participate in its risk management effort. Since effective risk management is essential to the success of a nonprofit's mission, everyone who works toward that mission must help to manage its risks.

Therefore, each employee and volunteer within a nonprofit should understand and support the risk management elements of its culture. For example, everyone should be aware of the accident potentials that are inherent in each of a nonprofit's major activities and of the safety measures for controlling these hazards. Everyone should also accept safety as his or her personal responsibility. At the same time, everyone—especially members of a nonprofit's management— should realize that some acceptable, controlled levels of hazard are essential to progress and that the organization should not be paralyzed by unfounded fears. A healthy risk management culture recognizes and respects risks—both threats and opportunities —while enabling its members with the confidence to manage both threats and opportunities in ways that serve the nonprofit's mission. This confidence flourishes best when a nonprofit's leaders show everyone associated with the organization that they are aware of the risks, the threats, and the opportunities facing the organization, that they are prepared to control the threats and seize the opportunities, and they ask all the nonprofit's staff and other supporters to do the same. Risk management needs to be a total team effort.

4. Follow a Risk Management Process

Every well-managed organization has regular processes and procedures for conducting its normal, ongoing activities. For example, the processes by which all sound organizations select and train their workers, purchase raw materials and supplies, establish plans and budgets for coming fiscal periods, and handle collections and disbursements of funds are essential to managing these activities, measuring how well these activities are being performed, and teaching others how to carry out these functions well.

The same is true of risk management. If risks are to be managed well by people throughout a nonprofit now and in the future, there has to be a process for everyone to follow. Risk management—no more than finance, production, marketing, or any other essential activity—cannot be a hit-or-miss, or shoot-from-the-hip activity. This book has recommended a structured, step-by-step process for managing various risks that a nonprofit is likely to face. This process should work in most nonprofits, with perhaps a few minor modifications dictated by each organization's particular circumstances at particular times. The precise steps in the process are not as crucial as the fact that some regular process does exist within each nonprofit. Moreover, it is vital that the entire process not be abandoned just because some glitches may have arisen in some highly unusual crisis. The process may be adjusted and refined as circumstances change—for change is inevitable—but an orderly process for risk management should never be ignored or abandoned in even the most desperate crisis. Some structured process, understood and accepted by all, indeed ingrained in the organization's senior leaders, must be the rock on which its overall risk management effort rests.

5. Enhance Your Organization's Resources

To serve a nonprofit's mission, effective risk management must enhance the resources that a nonprofit devotes to its mission. Enhancing resources means much more than just preserving the people, property, income, and reputation that a nonprofit already possesses. Enhancing resources involves more than simply "standing pat," resolutely taking no risks lest something might be lost in an accident. "Standing pat" as the world moves forward almost inevitably puts the overly conservative organization farther behind, more removed from accomplishing its mission.

Enhancing resources requires increasing the ability of a nonprofit's resources to fulfill its mission. Enhancing resources encompasses increasing the productivity of these resources, raising the likelihood that these resources will be available when needed (especially in an emergency), reducing the expenses required to make these resources available to those whom the nonprofit serves (i.e., raising the cost-effectiveness of the nonprofit's client services)—all by managing risk well. Thus, risk management copes with uncertainty—threats of loss and opportunities for gain—in ways that enhance the quantity, reliability, and productivity of all the resources a nonprofit devotes to its mission.

6. Follow Decision Priorities

Just as a nonprofit needs to follow an orderly risk management procedure in dealing sensibly with each of its risks, so it also needs a set of decision priorities to make consistent choices about how it chooses to handle different threats and opportunities. Consistency is essential to making good choices in stressful situations and to avoiding the reality or the appearance of a jumbled, confused risk management program in which minor threats or opportunities receive great attention while major ones go unrecognized or virtually ignored, where two or more equally important risks get vastly different treatment, or where different rationales are used to support diverse risk management decisions (such as taking one action because doing so saves money, but taking another very expensive action in another case because doing so will strengthen the nonprofit's reputation). To avoid the confusion that such seemingly random decisions often spawn, a risk management program should be based on a well-articulated set of risk management policy objectives that are consistently applied. These objectives—dealing with commitments to the protection of life and property, to growth of the organization, to diversification of risk (both threats and opportunities), to acceptable levels of loss from both accidents and business ventures, as well as to other matters calling for judgment and balance within a nonprofit's risk management program—set guidelines for reaching sound decisions about the risks that are bound to arise in any nonprofit's future.

7. Apply Risk Management Preferences

Even in this less than fully predictable world that holds many surprises, events have some natural tendencies that usually prevail in the long run. In managing a nonprofit's risks, both threats and opportunities, it is best to prefer actions that give these long-term tendencies a chance to materialize, an opportunity to help your nonprofit where they can. Over time, it is better to prefer the strategies that "bet" with nature over those that "bet" against it, even though, occasionally you and your nonprofit surely will lose. Here are three such strategies:

1. *Watch magnitude more than frequency.* Both threats of loss and opportunities for gain—some big and some small—occur somewhat surprisingly from time to time. We cannot predict with great accuracy how

often they will happen (their *frequency*) or how big they will be (their *magnitude*, as either losses or gains). It is this unpredictability that makes them risks. It turns out, however, that for both accidents and opportunities, magnitude is much less predictable than is frequency. The real risk is not so much in how many accidents your nonprofit may suffer, say, in the next year; rather the real risk is in how large one really severe accident may be. A single $3-million accident would swamp 50 $300 accidents, just as a $1-million gain on one business venture more than makes up for 20 $5,000 business losses. Therefore, in deciding which threats of loss or opportunities for gain deserve your first attention and perhaps the bulk of your risk management budget, give preference to the ones that *potentially* are the largest, the ones that can ruin you or make your fortune at one stroke. The smaller, more routine threats or opportunities certainly are collectively important, but for them your nonprofit can budget more easily and with less risk.

2. *Prevent before paying.* For accidental losses, another tendency of nature is epitomized by Benjamin Franklin's maxim: "An ounce of prevention is worth a pound of cure." In general, a nonprofit will save money in the long run by focusing on loss control measures to prevent accidents or to reduce their size than it will by simply paying for losses as they occur. This is true whether the nonprofit pays for accidental losses directly out of its funds or whether it relies on insurance to pay for any losses. If an insured's losses are high, insurers increase premiums to eventually cover not only an insured's actual losses but also to recover the insurers' operating expenses and to generate an underwriting profit or increase the insurer's surplus. In contrast, devoting resources to loss control usually—not always, but very often—cuts accidental losses, while also reducing a nonprofit's risk financing expenditures. Working to control accidental losses generally increases the resources a nonprofit can devote to its mission; ignoring safety and simply buying insurance typically is wasteful misuse of these resources. To ignore risk financing for accidental losses, to assume no major losses will ever occur, is to irresponsibly risk ruin; but to practice loss control first is prudent wisdom.

3. *Retain before transferring.* The leaders of many nonprofits have an understandable inclination to buy all the insurance their organizations

can afford. They often believe that letting their nonprofits suffer any uninsured loss implies that they have failed in their duties as trustees to safeguard the resources that others have donated to their community-serving missions. With respect to accidental losses, these trustees prefer—often demand—transferring risk to insurers rather than retaining risk within their nonprofits.

For truly large, and typically quite infrequent, accidental losses these leaders are correct. Their "insure first" preference is generally the correct one. Insurance may be the best strategy for financing recovery from major accidental losses. But for all other accidental losses, the strategy may waste money on insurance premiums that they, as nonprofit trustees or other leaders, should be devoting more directly to their nonprofit's missions.

The better, more responsible and cost-effective, preference is to retain first—to use the nonprofit's own funds first to pay:

- losses that are small relative to the nonprofit's own resources
- losses that, over the long run, occur with predictable, budgetable frequency
- losses for which insurance is not available or is substantially overpriced relative to the nonprofit's exposures

In each of these cases, a nonprofit should consider retaining at least the first "layer" of small losses within a deductible, with an insurer paying only for larger losses. Within any first layer of losses that most nonprofits would consider low, an insurer and an insured nonprofit typically would be merely "trading dollars"—and incurring clerical and other administrative costs for this swapping. Therefore, retaining losses saves a nonprofit premium dollars that it otherwise would be contributing to an insurer's expense loadings and underwriting profit or surplus. For these losses, paying them directly saves a nonprofit money it can better channel to its mission.

8. Act Ethically

The high ethical standards that underlie all of a nonprofit's conduct naturally should apply to its risk management activities. Honesty, fair bargaining, and the Golden Rule should be as important to a nonprofit in dealing with is collaborators in potentially favorable business ventures, its insurers, with their marketing and claims representatives, and with potential claimants who feel the nonprofit has somehow wronged them as these kinds of conduct are important in the nonprofit's dealings with its staff, clients, contributors, and kindred nonprofits. Good ethics are good ethics, in risk management as elsewhere.

Beyond this generalization, risk management can raise some special ethical concerns. How a nonprofit deals with accident hazards in its own operations affects the safety of others: its staff, its neighbors, its clients, and, potentially, the entire world. Should a nonprofit ever retain an insider, such as a board member, as its insurance advisor? Beyond potential legal liability issues, does a nonprofit have an ethical obligation to safeguard everyone from hazards that it creates or that it is best positioned to control? In trying to protect itself from threats of accidental loss or to pursue opportunities for gain, to what extent is a nonprofit ethically entitled to shift these threats onto others or to deprive others of opportunities for gain? These and similar questions have few valid general answers, but they are questions the senior management of each nonprofit should work to answer specifically in their daily risk management dealings. Before trying to take undue advantage of others with respect to either threats of accidents or opportunities for gain, it is good to remember that risk management often involves situations where others have the power to treat you as you have treated them.

9. Combat Uncertainty

If there could be no good or bad surprises—if the future were fully predictable, there would be, there could be no risk and no risk management. (Nor could there be much economic profit or personal joy.) Everything would be "business as always—and always, and always" in a very boring but wholly certain world. Buildings would still burn down, people would still get injured, inventions would still revolutionize our lives, and some nonprofits would still gloriously achieve their missions while others dissolved in failure—but we would all know in advance exactly what was going to happen forever into the future.

Such a "no-surprises" world is difficult to imagine, and it almost certainly will never come to pass. But to the slight extent a nonprofit can even approach such a world—to the extent it can reduce uncertainty in its own operations—it can better control its future and more efficiently achieve its mission in that future. In whatever ways a nonprofit can make its key resources more secure—its property more secure from accidents, its people less vulnerable to injury or disease and more productive, its income more definite and ideally increasing, and its reputation positively secure in the eyes of the community it serves—then, to that extent, it is closer to controlling its future and to achieving its mission in this still largely uncertain world.

How can a nonprofit reduce the uncertainties it faces? Some possibilities are:

- to practice safety in controlling accidental losses
- to plan how best to finance recovery from seemingly inevitable accidental losses
- to take wisely those business risks that enhance the resources available to serve its mission
- to continue exploring all aspects of each nonprofit's world, so that its future becomes less and less surprising for those who guide its voyage toward fulfilling its mission

10. Set Examples for Others

The final principle of effective risk management for any nonprofit is to help others manage their risks—the threats of accidental loss they face and the opportunities for gain that may be open to them—by setting good examples of sound risk management. Doing so improves your own management of risk.

Risk management is not a contest that some must lose in order for others to win. The hazard in your neighbor's yard threatens your yard too, whether your "neighbor" is across the hedge (as in the case of a pile of oily rags that may catch fire in the yard next door) or across several time zones (a highly communicable disease, for example). Your neighbor's prosperity in a new venture heightens your opportunities to prosper—contributions to nonprofits are much higher during "boom" times than in recessions. Everyone's efforts to reduce a particular type of insured loss tend to lower premium rates for all buyers of that coverage. For the benefit of society as a whole—and your nonprofit is part of society—sound risk management is everybody's business.

So, perhaps with a few exceptions relating to proprietary matters, effective risk management is not a strategy that gives any nonprofit a competitive advantage that it should try to keep just for itself—it is a general approach for dealing with risk that is most effective for your nonprofit if everyone does it with you. Thus part of good risk management is to teach it to others, set examples for them, and be open to learning from their good examples. In managing risk, both threats of loss and opportunities for gain, your nonprofit organization alone can almost surely *survive*. But by managing risk together—efficiently, ethically, and creatively—your nonprofit, those whom you serve, and your entire community can positively *thrive*.

Glossary

accident Unexpected or chance event.

accident medical reimbursement insurance Covers medical expenses for injuries arising out of accidents, regardless of liability. Traditionally also provides a schedule of payments for death or severe injury, such as loss of limb or sight. Can be written to provide coverage for volunteers in the course of their work for the insured, participants in the insured's activities, or clients while under the insured's supervision.

actual cash value (ACV) Replacement cost of damaged or lost property less depreciation.

actual damages (also known as *compensatory damages*) Sum of money a plaintiff (injured party) is entitled to as compensation for actual economic loss sustained.

additional insured endorsement The contract by which an additional insured (a person or entity other than the named insured), is protected by a particular insurance policy.

admitted carrier An insurance company licensed by a particular state, monitored by the state for financial stability, covered by the state's guaranty fund, and subject to the state's regulations for licensed insurance companies.

agent An insurance professional or intermediary that markets and explains insurance products to insureds and prospective insureds. Agents, like brokers, are licensed by state regulatory agencies. However, they are restricted in the marketing and placement of coverage to carriers with whom they have a contractual relationship. Some agents have relationships with a number of companies, while others represent a single insurer. An agent, therefore, represents the company or companies with whom she or he has a relationship.

aggregate limit Maximum amount that the insurer will pay under a liability policy during one annual policy period, regardless of the number of occurrences, usually in addition to legal defense costs. For general liability, policies are sometimes written with the aggregate limit applying separately to each scheduled location.

alternative market Nontraditional risk financing, including risk retention groups, risk pools, self-insurance, and captive insurance companies.

A.M. Best Company, Inc. An independent company that rates insurance companies on their financial stability and future claims-paying ability.

appraising risks Identifying the portfolio of risks and assigning values or weights to the risks. Risk appraisal is a hybrid of list making and brainstorming. This is the second step in the risk management process.

auto insurance (also known as *business auto policy (BAP)*) A standard business automobile policy that is designed to cover the liability and physical damage of motor vehicles. Liability coverage can be provided for the organization, regardless of whether a nonprofit, a staff member, volunteer, or other party owns the vehicle.

avoidance Risk management strategy in which a nonprofit avoids an activity or service that it considers too risky.

board of directors Governance body of a nonprofit made up of individuals who are appointed or elected and whose function it is to provide policy, and sometimes management and direction for the purpose of accomplishing the organization's mission.

boiler and machinery/equipment insurance Insurance coverage that protects against damage caused by the sudden and accidental breakdown of mechanical, electrical, or refrigeration systems. This coverage pays for the property damage, any consequential damages, such as spoiled food from the breakdown of a refrigerator, and any amount for which the nonprofit is liable, subject to policy limits.

breach of contract A civil wrong growing out of a contractual relationship.

broker An insurance professional or intermediary that markets and explains insurance products to insureds and prospective insureds. Brokers are typically licensed by a state to place insurance on behalf of clients (individuals and organizations) with any number of companies, although other brokers represent a single insurer. A broker technically represents the client.

business auto policy A hybrid policy that provides both property and liability coverage; main coverages are auto liability and physical damage coverage.

business interruption insurance (loss of income coverage) Insurance coverage designed to protect the insured against loss of earnings resulting from the interruption of business caused by an insured peril, subject to the policy provisions.

bylaws Set of rules that outline how a nonprofit organization operates, including rules describing key positions and their respective duties, election of officers, frequency of board meetings, and quorum requirements.

captive insurance company Subsidiary of one or more parent or member organizations formed for the purpose of insuring the exposures of the parent or member organization(s).

care, duty of Standard of behavior required by a nonprofit board member or officer in making decisions. The standard is to use the level of care that a reasonably prudent person would exercise in a similar situation.

casualty insurance A category of insurance that offers protection against claims resulting from negligent acts, errors, or omissions that causes bodily injury or property damage to others. Commonly referred to as a liability insurance.

cause of loss The force that most directly or most predominantly brings about a loss.

certificate of insurance A form that indicates the types of insurance policies written, policy dates, and coverage limits.

charitable immunity Legal defense, now largely defunct, by which charitable organizations were protected from litigation by virtue of their charitable status.

charitable risk pool A nonprofit property or casualty insurance company that insures nonprofit organizations and qualifies as a charitable risk pool pursuant to federal tax laws and is exempt from federal income tax. A *qualified charitable risk pool* may consist only of nonprofit organizations that qualify under section 501(c)(3) of the Internal Revenue Code.

civil wrong Wrongful action that causes harm to one or more specific individuals or organizations.

claim A demand for payment for a loss.

claims-made basis A liability coverage form that requires that claims be reported to the insurance company while the policy is still in force in order for coverage to apply. In other words, a claim must be *made* while the policy is in force. The claims-made form is one of two types of liability policy forms. The other, more common form is called an occurrence form. Under an occurrence form policy, a claim occurring during the policy term may be reported to the insurance company at any time, even years after the policy expires.

claims management Involves proper and timely notification and record-keeping of specific claims and overall loss history for the organization.

commercial general liability (CGL) insurance Insurance that covers claims filed by another party (e.g., clients, general public) alleging bodily injury, personal injury, or property damage arising from the nonprofit's premises or operations.

commercial property insurance Covers risk of loss to an organization's buildings or personal property. Usually includes buildings, personal property of the insured, and personal property of others on site and in insured's possession. Coverage can be on an *all risk* or *specific perils* basis.

conceptual competition A method of choosing an insurance provider. Establish a comfortable relationship with a new insurance provider (agent, broker, or consultant) before obtaining firm coverage proposals.

conditions Part of every insurance policy; conditions qualify the various promises made by the insurance company.

consequential damage insurance Optional coverage for equipment insurance that insures against spoilage of specified property (food or plants) from lack of power, light, heat, steam, or refrigeration.

context The environment in which the risk exists.

crime coverage A package of policies that protects an organization against intentional theft by insiders, as well as theft of assets by third parties. Crime coverage generally includes a fidelity bond plus a basic menu of other coverages.

criminal wrong Wrongful acts that not only harm particular individuals or organizations but also endanger the community as a whole.

danger An action or a condition that tends to increase the probability or the magnitude of a loss.

declarations Usually the first page of an insurance policy; summarizes key information specific to the policy; sometimes called a *dec page*.

deductible Amount deducted from a loss. The deductible is an amount assumed in advance by an insured as required by the insurance company or as a means of obtaining a lower premium for the coverage. Also: the amount of the loss that the insured must pay.

defendant Individual or organization against whom a lawsuit has been brought.

defense coverage Source of funding for the defense of a legal challenge filed against the nonprofit.

definitions Part of every insurance policy; definitions explain the special meaning of the designated words (identified in bold print or set off by quotation marks) in the context of insurance.

dimensions of risk The three dimensions of risk are (1) directional (positive/negative), (2) probability (more/less often), and (3) magnitude (major/minor).

directors' and officers' liability insurance (D&O) Insurance that provides coverage against wrongful acts, which might include actual or alleged errors, omissions, misleading statements, and neglect or breach of duty on the part of the board of directors and other insured persons and entities. Many D&O policies include employment practices liability coverage.

disability insurance Gives an employee security by providing an income should he or she become sick or injured and unable to work.

doctrine of contra proferentem Latin term referring to practice of reviewing courts to construe ambiguous insurance policy terms in favor of the insured policyholder.

earthquake coverage Purchased as separate policy as most property policies do not protect against damage by earthquake.

electronic property coverage An inland marine floater designed specifically for computers and other electronic equipment. Provides coverage for perils not normally included in a standard property policy, such as electrical surge and loss of data.

employee Individual who is paid to perform specific duties under the direction and control of the organization. The individual is provided with a wage or salary and sometimes benefits.

employee benefits liability (EBL) Covers errors and omissions in the administration of the insured's employee benefits, such as health insurance or pension benefits.

employer's liability insurance Coverage protecting an employer against claims that are not covered under workers' compensation statutes and that allege employer negligence stemming from work-related injuries, illness, or death. Claims may be filed by injured workers or their spouse or family members for economic losses. This policy is generally bundled with workers' compensation coverage.

employment practices liability insurance (EPLI) Insurance that provides coverage for claims arising out of employment practices. EPLI policies generally cover the organization and its directors, officers, and employees.

endorsement Part of most insurance policies; policy forms that modify the main coverage form; changes to the policy language.

equipment breakdown insurance (previously known as *boiler and machinery coverage*) Supplements property insurance that specifically excludes physical damage and the financial damage stemming from equipment breakdown to cover the unique causes that can damage equipment.

excess and surplus lines carrier Insurer that is not admitted (not licensed) to do business in a particular state, but is permitted because coverage is not available through licensed insurers.

excess liability insurance Provides coverage over and above the underlying policy in one of two way is: triggered when the limits of a primary policy have been exhausted to provide additional limits of liability for defense costs, judgments, and settlement expenses; and mirrors the terms and conditions of the underlying policy.

exclusions Part of every insurance policy; policy provisions that eliminate coverage for specified exposures.

extra expense insurance Covers the extra cost of continuing to deliver services following the destruction or damage to a nonprofit's facility or equipment due to a covered peril. Extra expense coverage is generally sold in tandem with business interruption coverage.

fidelity bond (also known as *employee dishonesty coverage*) A bond that reimburses an employer, up to the stated amount, in the event that an employee commits a dishonest act covered by the bond. A nonprofit can purchase a fidelity bond as a stand-alone or part of the crime coverage package.

fiduciary liability Protects the fiduciaries of health and welfare or pension plans from claims by employees alleging financial loss due to mismanagement of funds.

fiscal year The 12-month period in which the organization keeps its financial records and books.

frequency A measure of how often the risk is likely to materialize, or the probability of the risk materializing.

fundraising The process by which a nonprofit organization solicits and obtains donations (monetary, in-kind) for general or specified purposes to enable it to achieve its mission.

goodwill An organization's reputation, stature in the community, and ability to raise funds and appeal to prospective volunteers.

grant The transfer of money or property from one entity, usually a charitable foundation or governmental entity, to another (either an individual or charitable organization), to enable the recipient to offer some service or charitable benefit.

group insurance programs Special programs generally developed to serve homogeneous or geographically similar groups of organizations; may offer better rates, specialized coverages or features, fewer restrictions, and better acceptance of the risks inherent in the group programs.

hammer clause A policy provision that acts as a financial incentive for an insured to agree to a settlement proposed by the insurer.

hard market A phase of the insurance market cycle during which time coverage may be more costly, terms may be more restrictive, and policy conditions and requirements more stringent. The opposite of a hard market is a *soft market* in which insurance is more competitively priced and policy terms and conditions are more favorable to the insurance buyer.

hazard A condition that may create or increase the possibility of a loss due to a peril.

health insurance Covers medical expenses for accidents or sickness, on a first-party basis and regardless of fault.

hired and nonowned auto liability Coverage that protects a nonprofit for claims that result from the use of a vehicle not owned by the nonprofit but used on the nonprofit's behalf, such as an employee's or volunteer's personal vehicle. Hired and non-owned coverage is excess over the insurance on the auto involved in the accident. The policy protects the named insured, not the driver of the vehicle. This coverage can be purchased as an add-on to the CGL policy, as an adjunct to the business auto policy, as part of a business owners policy, or as a separate policy.

hold-harmless agreement Contract by which legal liability for damages of one party is assumed by the other party. One party agrees to hold the other party harmless (and usually indemnify) from the liabilities associated with the hazards of a particular activity or venture. Contracts may contain a hold-harmless clause.

hybrid policies Having both liability and property coverages. Examples are business auto policy, international coverage, volunteer accident medical reimbursement, and personal liability policies.

immunity A provision in the law that shields a person or organization from legal obligations.

improper sexual conduct coverage Coverage that protects an organization against claims alleging improper sexual conduct.

income An organization's revenue, such as sales, grants, investment earnings, and contributions.

indemnification agreement When one party (the indemnitor) assumes the liability of another (the indemnitee) in the event of a claim or loss. An example is a hold-harmless agreement.

indemnify Compensate for actual losses sustained.

individual causing harm The person whose actions led to the injury or loss.

informed consent The assumption of liability by a volunteer or service recipient after the identification of specific hazards by a sponsor organization.

inland marine coverage (also known as a *floater endorsement*) Insures special items, such as computers, light and sound equipment, and camera equipment in an agreed amount.

innovation A change in technology, operating procedures, products, marketing, or any other aspect of a nonprofit's activities that its management actually creates—a new way of doing something that is better than anyone has ever done it previously.

in-service In-house training session for staff and volunteers.

insurance Traditional risk-financing tool used to transfer the financial hazard of risk. An insurance policy spells out what is or is not covered caused by *all* or *specific* perils (causes of damage or injury). Insurance is also a contract whereby an organization agrees to indemnify another or to pay a specified amount for covered losses in exchange for a premium, or both. For many nonprofits, insurance provides the funds to pay for the nonprofit's unexpected losses of people, property, and income while keeping the organization in operation.

insurance agreement Part of every insurance policy; specifies what the insurance company has agreed to pay for or to provide in exchange for the premium.

insurance policy A legally binding contract that defines the obligations of both the insured and the insurer.

insurance professional An agent, broker, or consultant.

insurance program review A review of the nonprofit's current insurance coverages for the purpose of identifying coverage gaps and overlaps, and commenting on the adequacy of specific policy terms, limits, and deductibles.

Insurance Services Office (ISO) An insurance industry-supported agency that creates standard policy forms and collects premium and claims statistics.

insured versus insured exclusion Negates coverage for claims brought by one insured against another insured.

Insuring agreement Part of every insurance policy; specifies what the insurance company has agreed to pay for or to provide in exchange for the premiums.

intentional acts Deliberately fraudulent acts or omissions; wanton, willful, reckless, or intentional disregard of any law or laws.

joint and several liability A form of liability in which all the individuals involved are fully liable as individuals and also as members of a group.

joint liability A form of liability in which liability is shared by more than one person or organization.

joint venture A business endeavor in which two or more parties combine their resources for a single undertaking and share profits and losses as agreed on. A joint venture is usually unincorporated and limited in scope and duration. A CGL policy generally does not cover a joint venture unless it is listed as an insured.

latent injury Injury that manifests itself years after the event occurred, such as those from asbestos, medical malpractice, and sexual abuse or molestation.

liability Any enforceable legal obligation, for example, the failure to meet the duty of care of a reasonable person under similar circumstances.

liability insurance Insurance covering the financial risk of civil lawsuits.

liquor liability Liability arising out of the manufacture, distribution, or sale of liquor. Under the standard CGL policy, coverage is excluded if the insured is in the business of serving alcohol.

litigation Describes the activities that emerge from a lawsuit or legal proceeding. The nonprofit receives a summons and must defend itself in court.

long-tail exposure Exposures for which a claim might be filed long after the insurance policy or policies expire. Loss may not be recognized for many years, involving such latent injuries as asbestos, medical malpractice, and sexual abuse or molestation.

loss control Analyzing hazards and determining a course of action to reduce the risk of loss while carrying out the nonprofit's mission.

loss experience report (also known as *loss runs* or *hard copy loss runs*) A report compiled by the insurance company that provides detailed history of an insured's claims information.

loyalty, duty of Standard of behavior that requires a director or officer (of a board) to pursue the interests of the organization, particularly financial, rather than his or her own or the interests of another person; to place the organization's interests ahead of his or her own.

magnitude Measure of the positive or negative cost should a risk materialize.

market assignment Method of choosing an insurance provider. Choose several insurance agents or brokers as bidders for your account and assign one or more insurance companies (markets) to each.

Media liability Policy protects the insured from extensive personal and advertising injury, as well as publishers' liability for all forms of media.

minutes Minutes are a summary of a board meeting. The specifications for acceptable minutes will vary with the organization but they should include who attended the meetings, the significant issues discussed, the actions taken on motions and resolutions, and reports of officers or committees.

modification Modification is a risk management technique and means of changing the activity so that the chance of harm occurring and the impact of potential damage are within acceptable limits.

Moody's An insurance rating service that provides credit ratings on an estimated 700 insurance companies worldwide.

named insured An individual, business, or organization that is identified on the policy declarations page as the insured under a policy. Most policies, especially liability policies, have insureds or *additional insureds* other than the named insured (such as employees, volunteers, board members, and landlords), but only the named insured is responsible for premium payments, receipt of notices, and adjustment of losses.

negligence Failure to use the standard of care that a reasonably prudent person would exercise in a similar circumstance.

nonowned auto insurance Insurance protection for the organization against liability arising from the use of a vehicle not owned by the nonprofit but by someone acting on behalf of the organization, such as an employee, volunteer, or independent contractor.

Nonprofit Corporation Act State legislation that provides for the establishment and operation of nonprofit corporations. The legislation outlines the rights and duties of nonprofit corporations in addition to specifying rules for the election of officers, holding of meetings, and procedures for the dissolution, liquidation, or other changes in an organization's legal status.

nonprofit (or not-for-profit) organization An organization in which no part of its income is distributable to its members, directors, officers, stockholders, or other individuals and that meets the state statute designation of a nonprofit entity. Note: Although most people equate nonprofit organizations with charitable or 501(c)(3) entities (those that are eligible to receive tax-deductible contributions), other categories of nonprofits exist as well, including trade associations and labor unions. An organization need not be tax-exempt to be recognized and organized as a nonprofit under state law.

nonprofit sector (also called *independent sector, charitable sector, voluntary sector,* or *tax-exempt sector*) A collection of organizations that are formally constituted, private (as opposed to governmental), serving some public purpose, self-governing, voluntary, and nonprofit-distributing.

obedience, duty of Standard of care that obligates a director or officer (of a board) to act in a manner that demonstrates faithfulness to the organization's mission and to obey all applicable laws, statutes, and regulations.

occupational accident Accident to an employee that occurs within and arises out of the course of employment.

occurrence basis A liability coverage form that covers claims that occur during the policy period, and for which claims can be reported to the insurance company at any time during or after the policy period.

officer Individual who has a fiduciary responsibility within a nonprofit. This individual can be a member of the organization's board or executive committee, or an employee of the organization.

open bidding Method of choosing an insurance provider by sending a request for proposal (RFP) to a list of firms inviting them to bid for your business.

people Category of nonprofit assets at risk, including board members, volunteers, employees, clients, donors, and the general public.

personal injury liability Injury to a person or organization caused by slander, invasion or privacy, false arrest or detention, malicious prosecution, or wrongful entry or eviction.

personal liability policy (volunteers) Provides protection if a volunteer is liable for bodily injury or property damage arising out of the performance of his or her duties; generally written on an excess basis. Purchased separately or bundled with accident medical reimbursement insurance and/or excess automobile liability insurance for volunteers.

personally liable Liability that an individual assumes when he or she is directly involved in the occurrence and cannot defer the liability to another person or entity.

plaintiff Individual or organization that initiates a lawsuit to obtain a remedy for an injury.

premium The payment for an insurance policy or bond.

prior acts coverage Coverage for all acts that occurred before the policy was issued. Prior acts coverage is one of the means of covering the gap in coverage when switching from a claims-made policy to another claims-made policy or to an occurrence policy. The prior acts coverage is provided by the new policy, as opposed to *tail* coverage, which is added by endorsement to an expired claims-made policy.

probability The percentage of times a specified event might occur in the future.

professional liability insurance Also known as *malpractice coverage* or *errors and omissions (E&O)* coverage; covers liability for damages arising from the rendering of or failure to render professional services.

property Category of nonprofit assets at risk that includes real property (buildings, improvements, and betterments), personal property (furniture, fixtures, valuable papers and records, equipment, and supplies) and intangible property (copyrights, business goodwill, and trademarks).

property insurance Insurance that covers direct damage to the nonprofit's property, including consequential losses (business income, loss of rents, extra expense) caused by an insured peril.

prudent person rule Legal rule that individuals are expected to act with the same degree of care that a reasonably prudent individual would demonstrate in a similar situation.

punitive damages Damages awarded by the court in excess of those required to compensate the plaintiff for the loss sustained. These damages are a type of punishment for the offender for failing to take proper care.

quorum The minimum number of individuals required in the bylaws to be present to conduct business at a meeting.

reinsurer A company that insures upper layers of coverage for commercial carriers, risk retention groups, captive insurance companies, and other insurance providers.

replacement cost basis The cost of replacing the appraised or inventoried property.

reputation An organization's goodwill, stature in the community, and the ability to raise funds and appeal to prospective volunteers.

respondeat superior Legal principle by which employers are held responsible for the actions of those they supervise. Literally, the master shall answer for the acts of his servant. In the context of volunteer organizations, the nonprofit is the *master* and paid and volunteer staff are the *servants* working on the organization's behalf.

retention A tool or technique in risk management whereby the nonprofit accepts all or a portion of the risk and prepares for the consequences. A deductible on an insurance policy is a form of retention.

risk A measure of the possibility that the future may be surprisingly different from what we expect. Strategically, there are both downside risks of loss and upside risks of gain.

risk assessment A thorough examination of the exposures of the nonprofit, both insurable and uninsurable.

risk evaluation and prioritization A step in the risk management process that examines the possibility of each risk becoming reality and estimates its probable value to the nonprofit.

risk-financing plan The monetary tools used to protect the nonprofit's resources so that the lion's share may be devoted to its community-serving mission. Primarily used to protect an organization from catastrophic financial loss.

risk-financing pools A nonprofit association that benefits its members by pooling their contributed premiums in order to finance losses.

risk identification The second step in the risk management process that identifies the risks that are relevant to the organization.

risk management A discipline for dealing with the measure of the possibility that the future may be surprisingly different from what is expected.

risk management committee A representative group of staff, volunteers, and advisors who identify exposures, develop a risk control program, and establish a risk-financing strategy for the nonprofit. May act in place of a staff designee in small nonprofits. In midsize and large organizations, this group may work in partnership with the staff designee, such as a finance director or professional risk manager.

risk management process A five-step process nonprofits undertake to address the risks an organization faces: (1) establish the context, (2) appraise the risks, (3) decide what to do and communicate, (4) act on the decision, and (5) follow up and adjust.

risk management program Educated projections about the future and sound management practices.

risk management techniques Strategies for controlling risk, including avoidance, modification, retention, and sharing.

risk modification Changing an activity so that the chance of harm occurring and effect of potential damage are within acceptable limits.

risk retention A method of funding loss using internal money.

risk sharing A risk management tool whereby an organization shares risk with another organization. Examples of risk sharing include mutual aid agreements with other nonprofits, purchasing insurance and sharing responsibility for a risk with another through a contractual agreement.

safeguard An act or condition that makes a gain, not a loss, larger or more likely.

self-insurance Arrangement by which an organization's own internal resources are used to fund losses. A nonprofit may self-insure risks through a formally structured risk-financing program, such as a captive insurer, or by setting aside funds to pay for losses. A nonprofit can also be self-insured on an informal basis when it has made no arrangements to finance losses and must use operating funds when losses occur.

self-insured retention (SIR) Similar to a deductible except that until the SIR is exhausted the insured will generally be responsible for performing the loss-adjustment functions that would otherwise be undertaken by an insurance company. For umbrella liability, the SIR is the amount the insured is obligated to pay for claims when there is no underlying insurance.

soft insurance market Insurance companies that are eager to write new business.

special endorsement Written language appended to an insurance policy that changes the coverage in regard to special circumstances.

special events insurance General liability insurance for events that are outside the day-to-day operations of the insured, such as fundraising events.

speculative risk An insurance term that includes the possibility of gain or loss.

sponsored insurance program Members, chapters, or affiliates of a national, regional, or statewide organization create a group insurance program by partnering with a commercial insurance provider or endorsing the services of an agent or broker.

staff Paid and volunteer personnel who carry out the work of an organization.

Standard & Poor's A nationally recognized organization that rates insurance companies on their financial strength.

standardized form A document prepared in a prescribed arrangement or words and layout.

strategic risk management A discipline that counters downside risks by reducing the likelihood, magnitude, and unpredictability of losses and financing recovery from these losses; seizes upside risks by searching for opportunities to more fully, more certainly, and more efficiently achieve an organization's nonprofit goals and developing plans to act on these opportunities when the future presents them.

strategic risk management process Five steps to empower an organization to be all it can be in a less than fully predictable world: (1) establish the risk management context, (2) appraise risks, (3) decide what to do, (4) take action on the decision, and (5) follow up and adjust.

tort A civil wrong that does not grow out of a contractual relationship.

umbrella liability insurance Provides excess coverage over several primary policies, such as CGL, auto liability, and employers liability. Increases the amount of liability insurance beyond that of the basic policies carried by the nonprofit and reaches out to cover areas of unknown exposures lacking in the basic insurance policy.

uncertainty Lack of knowledge or belief about something.

underwriting The process of determining whether coverage will be offered, what policy provision will be included, and at what price.

vicarious liability Liability imposed on a person or organization for the acts, errors, or omissions of persons serving on its behalf. Vicarious liability can be imposed even if the individual or organization is not directly involved in the occurrence. The liability of one party is imputed to another.

volunteer Individual who freely provides services to an organization without compensation other than reimbursement for reasonable expenses.

volunteer excess automobile liability Auto liability insurance that covers claims arising from a volunteer's use of his or her own vehicle. This policy pays in excess of the volunteer's personal auto policy. No coverage is provided to the nonprofit.

waiver The giving up of a right or privilege. Nonprofits frequently require participants in recreational or other programs to waive the right to sue in the event of injury. Courts often invalidate waivers on the grounds that the individual did not fully appreciate the rights being waived or that the waiver did not specifically indicate that it covered liability for negligence.

workers' compensation and employers liability insurance Workers compensation covers expenses an employer is mandated to pay by state statute to cover specific benefits for employee injuries. Employers liability insurance protects employers from employee-related suits based on injuries covered by workers' compensation claims.

Bibliography

Accident Facts. Itasca, IL: National Safety Council.

Australian/New Zealand Standard for Risk Management (AS/NZS 4360:1999). Standards Australia.

Bernstein, Peter L. *Against the Gods: The Remarkable Story of Risk*. New York: John Wiley & Sons, 1996.

Church, Frederic C. *Avoiding Surprises*. Boston: Boston Risk Management Corporation, 1982.

Cost of Risk Survey. Tillinghast–Towers Perrin and Risk, and Insurance Management Society. (annual).

Elliott, Michael W. *Risk Financing*. First Edition. Malvern, PA: Insurance Institute of America, 2000.

Emerging Liability Issues for Schools, Non-Profit and Religious Organizations. Conference proceedings from June 1–2, 2000. American Bar Association Tort and Insurance Practice Section, Non-Profit Organizations Committee.

Giftis, Steven H. *Law Dictionary*. Woodbury, NY: Barron's Educational Series, 1975.

Glossary of Insurance and Risk Management Terms. Dallas: International Risk Management Institute, 2001.

Grose, Vernon L. *Managing Risk: Systematic Loss Prevention for Executives*. Englewood Cliffs, NJ: Prentice-Hall, 1987.

Guidelines for Managing Risk in the Australian and New Zealand Public Sector (HB 143: 1999). Standards Australia.

Guidelines for Museums on Developing and Managing Business Support. Washington, DC: American Association of Museums. www.aam-us.org/resources/ethics_guidelines/business_support.cfm.

Hauge, Jennifer Chandler, and Melanie L. Herman. *Taking the High Road: A Guide to Effective and Legal Employment Practices for Nonprofits*. Washington, DC: Nonprofit Risk Management Center, 1999.

Head, George L., editor. *Essentials of Risk Control*. Third Edition. Malvern, PA: Insurance Institute of America, 1998.

Head, George L., Michael W. Elliott, and James D. Blinn. *Essentials of Risk Financing*. Third Edition. Malvern, PA: Insurance Institute of America, 1996.

Head, George L., and Melanie L. Herman. *Enlightened Risk Taking: A Guide to Strategic Risk Management for Nonprofits*. Washington, DC: Nonprofit Risk Management Center, 2002.

Head, George L., and Steven Horn. *Essentials of Risk Management*. Third Edition. Malvern, PA: Insurance Institute of America, 1997.

Herman, Melanie L., editor. *Coverage, Claims & Consequences: An Insurance Handbook for Nonprofits*. Washington, DC: Nonprofit Risk Management Center, 2002.

Herman, Melanie L. *Full Speed Ahead: Managing Technology Risk in a Nonprofit World*. Washington, DC: Nonprofit Risk Management Center, 2002.

Herman, Melanie L., and Peggy M. Jackson. *No Surprises: Harmonizing Risk & Reward in Volunteer Management*. Washington, DC: Nonprofit Risk Management Center, 2001.

Herman, Melanie L., and Dennis M. Kirschbaum. *No Strings Attached: Untangling the Risks of Fundraising & Collaboration*. Washington, DC: Nonprofit Risk Management Center, 1999.

Herman, Melanie L. *Ready in Defense: A Liability, Litigation and Legal Guide for Nonprofits*. Washington, DC: Nonprofit Risk Management Center, 2003.

Hopkins, Bruce R. *Nonprofit Law Dictionary*. New York: John Wiley & Sons, 1994.

Hughes, Sandra R., Berit M. Lakey, and Marla J. Bobowick. *The Board Building Cycle: Nine Steps to Finding, Recruiting, and Engaging Nonprofit Board Members* (with Diskette). Washington, DC: National Center for Nonprofit Boards, 2000.

Ingram, Richard. *Ten Basic Responsibilities of Nonprofit Boards Kit*. Washington, DC: National Center for Nonprofit Boards, 1997.

Jacobs, Jerald A., and David W. Ogden. *Legal Risk Management for Associations: A Legal Compliance Guide for Volunteers and Employees of Trade and Professional Associations*. Washington, DC: American Psychological Association, 1997.

Jackson, Peggy M., et al. *Mission Accomplished: A Practical Guide to Risk Management for Nonprofits*. Washington, DC: Nonprofit Risk Management Center, 1999.

Kionka, Edward J. *Torts in a Nutshell*. Third Edition. West Group, 1999.

Leifer, Jacqueline C., and Michael B. Glomb. *Legal Obligations of Nonprofit Boards: A Guidebook for Board Members*. Revised. Washington, DC: National Center for Nonprofit Boards, 1997.

Lorimer, James J., Harry P. Perlet, Rederick G. Kempkin, and Frederick H. Hodosh. *The Legal Environment of Insurance*. Volumes I and II. Malvern, PA: AICPCU.

Patterson, John C. *Staff Screening Tool Kit: Building a Strong Foundation Through Careful Staffing*. Second Edition. Washington, DC: Nonprofit Risk Management Center, 1998.

Patterson, John C., and Barbara B. Oliver. *The Season of Hope: A Risk Management Guide for Youth-Serving Nonprofits*. Washington, DC: Nonprofit Risk Management Center, 2002.

"Quizzing for Quality Services and Strategic Partners," sidebar to "Run Fast, Not Scared," *Association Management*, September 2002. Washington, DC: American Society of Association Management.

Rohwer, Claude D., Gordon D. Schaber, and Anthony M. Skrocki. *Contracts in a Nutshell*. Fifth Edition. West Group, 2000.

Salamon, Lester M. *America's Nonprofit Sector: A Primer*. New York: The Foundation Center, 1992.

Smith, Barry D., and Eric A. Wiening. *How Insurance Works*. Second Edition. Malvern, PA: Insurance Institute of America, 1994.

Various authors. *The Board Member's Guide to Legal and Liability Issues* (set of four books). Washington, DC: National Center for Nonprofit Boards, 1996–1999.

White, Leslie T., John Patterson, and Melanie L. Herman. *More Than a Matter of Trust: Managing the Risks of Mentoring*. Washington, DC: Nonprofit Risk Management Center, 1998.

Resource Organizations

American Society of Safety Engineers A general loss prevention organization, offering a variety of written and audio-visual resources for both safety professions and general business managers, plus links to more specialized sites. (www.asse.org)

Independent Insurance Agents & Brokers of America, Inc. (IIABA) IIABA is the nation's largest association of independent insurance agents, representing a network of more than 300,000 agents and agency employees nationally. Its members are small businesses that offer customers a choice of policies from a variety of insurance. (www.independentagent.com)

Insurance Institute of America (IIA) IIA is an independent, nonprofit organization offering educational programs to people in all segments of the property and liability insurance business and risk management. More than 150,000 insurance practitioners around the world are involved in institute programs. (www.aicpcu.org)

International Risk Management Institute A commercial publishing and seminar-sponsoring organization for both general and specific risk control and risk financing. (www.irmi.com)

National Association of Insurance Commissioners (NAIC) NAIC is an organization of insurance regulators from the 50 states, the District of Columbia, and the four U.S. territories. A state regulator's primary responsibility is to protect the interests of insurance consumers through financial and market conduct regulation. NAIC was created in 1871 to coordinate regulation of multistate insurers, developing uniform financial reporting by insurance companies, new legislative concepts, new levels of expertise in data collection and delivery, and a commitment to even greater technological capability. A list of State Insurance Departments can be found at www.naic.org/1regulator/usamap.htm.

National Association of Professional Insurance Agents (NAPIA) NAPIA represents independent agents in all 50 states, Puerto Rico, and the District of Columbia. These agents are local agents serving local people. Their purpose is to educate agents about insurance, to foster cooperation among agents and between carriers and agents, to encourage uniform policy writing, and to assist in proper form completion. (www.pianet.com)

National Council of Insurance Legislators (NCOIL) NCOIL is an organization of state legislators whose primary area of public policy concern is insurance. Many NCOIL legislators serve in leadership positions—chair, vice chair—or are active members of the committees responsible for insurance in their respective legislative houses across the country. The purpose of NCOIL is to help legislators make informed decisions on insurance issues that affect their constituents and to declare opposition to federal encroachment of state authority in regulating the business of insurance as authorized under the McCarran-Ferguson Act of 1945. *The McCarran-Ferguson Act authorized the states to regulate "the business of insurance" under the oversight of Congress. As such, insurance is the only major business in the United States that is primarily regulated by the states.* (www.ncoil.org)

National Safety Council A fine source of booklets, brochures, and other shorter publications and videos to help the general public understand specific hazards and practical safety measures in workplace, home, and highway settings. (www.nsc.org)

Nonprofit Risk Management Center An independent, nonprofit organization dedicated to assisting nonprofits address risk management, liability, and insurance challenges. The Center provides free technical assistance as well as a wide range of affordable products and services, including publications, risk assessment software, and consulting services. (www.nonprofitrisk.org and www.nonprofitcares.org)

Professional Insurance Agents (PIA) PIA are voluntary, membership based, trade associations representing professional, independent property/casualty insurance agents. The PIA symbol represents associations affiliated with the National Association of Professional Insurance Agents, headquartered in Alexandria, Virginia. (www.piaonline.org)

Public Risk Management Association A professional society and a source of practical publications and videos, for risk managers of cities, counties, and other governmental entities, many of which face risk management challenges similar to those confronting nonprofit organizations. (www.primacentral.org)

Risk and Insurance Management Society The most inclusive professional society for risk managers in the United States and Canada, offering many general publications and videos that, although directed primarily to for-profit organizations, provide good information and strategies for all organizations, especially in risk financing. (www.rims.org)

Risk Management Resource Center This web site merges the on-line resources of the Nonprofit Risk Management Center, the Public Risk Management Association, and the Public Entity Risk Institute, enabling users to search all three sites simultaneously and to link to a very broad range of related organizations. (www.eriskcenter.org)

Society of Certified Insurance Counselors (SCIC) SCIC provides practical education for insurance professionals. SCIC, a member of The National Alliance for Insurance Education & Research, is a not-for-profit organization founded in 1969 that provides technical knowledge to all areas of the insurance industry. There are more than 59,000 participants in the CIC Program—more than 25,000 have earned the CIC designation. (www.marineproviders.com)

Index