

Risk Management 3

Risk Management (cont'd)

What can go wrong?

If fundraising is as important to a nonprofit as oxygenated blood is to the human body, under what circumstances could the negative consequences of fundraising endanger rather than fuel the life of a nonprofit?

A local mentoring program receives a restricted grant from a community foundation to fund the expansion of a mentoring program serving children with a history of violence. At the end of the one-year grant period, the funder elects not to renew its funding, citing its interest in start-up ventures and inability to provide operating funds. The executive director vows to continue the program due to its success as evidenced by a waiting list for next year's program. However, the executive director has not developed a plan to replace the core funding.

An inner-city tutoring project receives a donation of books from a publishing house and begins using the texts immediately. Several weeks later, a television news magazine reports that the publisher's history texts gloss over the terrible conditions under which most slaves lived during the 18th and early 19th centuries. Due to the donation, the organization spent the original textbook funds on new computer software. The project director decides to continue using the questionable texts.

A homeless shelter is unable to afford the cost of a paid development person. Instead, it hires a fundraising consultant that it pays a percentage of the money she raises for the agency. Following a successful campaign generating \$100,000, the board invites a major contributor to attend a board meeting to receive a personal thanks. During the meeting, the donor learns that the shelter remitted a commission of 40 cents of every campaign dollar raised to the professional fundraiser. He expresses dismay at the high cost of the campaign and announces his intent not to support the organization in the future.

In these examples, the organizations' fundraising and financial management strategies created serious challenges. The organizations could have avoided these problems if they had employed the techniques of risk management. Practicing risk management involves asking three basic questions about ongoing as well as new activities:

1. What could go wrong?
2. What will we do?
3. How will we pay for it?

Each agency might have avoided the harmful impact of its actions by considering the consequences of various approaches to fundraising. In the first scenario, the executive director might have considered what he would do if the funder declined the renewal funding before starting or expanding the mentoring program. What other sources of funds were available to keep the program going? What would be the effects of discontinuing the program after one year? In the second scenario, did the

organization review the donated texts for accuracy and bias before deciding to use them? In the final example, what might contributors think if they knew that the nonprofit spent more than 40% of the campaign contributions on administrative costs?

Funding With Strings: Let the Recipient Beware

Donors who wish to remain anonymous and demand little in exchange for their support are a vanishing breed. As demands for accountability by charities increase, contributors frequently attach burdensome "strings" to their gifts. Two major mistakes are common among nonprofits accepting donations with strings. The first is the failure to acknowledge and account for the strings attached to a gift. However, restricted grants are not the only type of funding with strings attached. Other funders may donate property or cash while requiring the nonprofit to maintain the property or acknowledge publicly the contribution. Whether short-term or lasting, minimal or significant, always recognize the strings associated with donations and consider what the donor will require.

Second, too many nonprofits manage restricted funds ineffectively. This may lead to net losses on grant funded projects or the creation of an insupportable infrastructure. Optimistic nonprofit managers hope to find replacement funds for an important project before they spend the money. A more cautious and sensible approach requires that restricted funding be regarded as temporary in nature. From the outset, a plan to end the project should be established.

Managing Fundraising Risks: Tips for Consideration

1. Pursue restricted grants with caution and accept the temporary nature of all projects supported with restricted funds. You must meet the promises made to a funder during the grant negotiation stage. It is easy to become caught up in the excitement around "closing" a deal and promise things you may be unable or unwilling to deliver. Keep your wits about you and always consider whether the organization has the capacity to deliver on its promises. Never assume that a project will be "renewed" for a second or third funding period. Your implementation plans for a short-term, restricted grant should always include ending the project.

2. Acknowledge, identify and monitor the strings attached to all donations. A chart or other form of "tickler" system may be helpful in monitoring the fulfillment of various grant strings. The system should indicate key deadlines, deliverables, and identify the person who receives the report.

3. Calculate the cost of fundraising efforts in evaluating the worthiness of a particular activity. Consider your donor's potential reaction if they learn of your actual costs. Special events are often very costly fundraising activities. Many nonprofits net 50% or less of what they spend to conduct an event. These events, however, may have other critical goals unrelated to fundraising, such as generating community support or publicizing a new program. In such cases, the investment required to undertake the event may be justifiable.

4. Pursue gifts that benefit your nonprofit and be wary of those where the principal benefit accrues to the donor. The growing popularity of charitable remainder trusts and other strategies that pair a donor's interest in minimizing tax liability with making a contribution to a charity should raise questions

for nonprofit recipients. Always seek expert advice about the true cost and resultant value of a gift whenever it appears that the donor will derive substantial benefit by making a contribution to your organization.

5. Proceed with caution when offered a gift with long-term restrictions. Circumstances change quickly in the nonprofit sector, and boards must be in position to redirect a nonprofit's resources to a more efficient or appropriate purpose. Upkeep costs that may be manageable today may become unmanageable in years to come.

6. Recognize that fundraising outcomes must grow steadily to meet basic expenses. If unsuccessful in "growing" revenues, the organization will have to keep trimming expenses. The expenses of most nonprofits grow between 5-10% per year. Many managers begin their budget worksheets with the expense side of the budget. After determining "what I need," they move on to "where the revenues will come from." This approach often results in unrealistic projections in major fundraising categories -- "I will just add 5% to last year's outcomes in order to get the numbers I need for a balanced budget." This is a dangerous approach to budgeting and financial management. Instead, begin with the "revenue" side of your budget and develop realistic expectations of what you can expect to raise in the year ahead. Then move on to expenses and identify areas where growth is possible or trimming necessary.

7. Carefully monitor restricted grants to ensure that total spending does not exceed grant revenues. Avoid restricted grants that require institutional growth (such as the hiring of permanent staff) or projects that your nonprofit will be unable to sustain once the funding cycle is complete. Too many nonprofits see restricted grants as a way to grow an organization -- "This new grant will enable us to hire a full-time program director for the first time." View restricted, temporary grants as short-term sources of revenue. If a grant program is fundamental to the mission of your nonprofit, finding replacement funding should be a top priority.

8. Recognize the distinction between fundraising and business development. Both result in additional revenues, but imply very different sets of relationships between the nonprofit and the revenue source. A donor with charitable intentions is very different from a person interested in business development. The first type of contributor derives satisfaction from making a gift and witnessing the continued existence of your agency. The business development contributor wants to see his "investment" in your organization pay dividends in his business.

9. Assess your fundraising plan, prospective donors, and partnerships in relation to your organization's mission or purpose. Will the receipt of a grant or donation enable the nonprofit to fulfill its mission and maintain the public's trust? While it is difficult, there are times when your association with a contributor will have a negative net effect. To prevent this from happening, the board of directors should consider and adopt fundraising policies that guide the solicitation of funds.

10. Budget conservatively for first-time fundraising activities. While special events or new campaigns may be an effective way to raise money, it is extremely difficult to project revenues accurately for a

first-time activity. Contact organizations that have planned similar events and inquire about their first-year revenues. The failure to realize a projected "profit" from an event or other new fundraising activity will dampen enthusiasm on the part of donors and volunteers for future activities. Conduct research before preparing projections and always budget conservatively to improve your chances of generating income.

What constitutes a basic insurance package for a nonprofit organization?

For most nonprofits, purchasing insurance is an essential component of managing and financing risk. Purchasing insurance is not, however, synonymous with practicing risk management. Risk management encompasses a wide range of activities related to anticipating, avoiding, controlling, and financing risk.

If it is not risk management, what is insurance? One way to look at the concept of insurance is to define it in terms of a trade. Insurance involves trading the uncertainty of a large financial loss for the certainty of a fixed premium. Most nonprofits are unable to maintain a reserve fund adequate to pay for potential claims. Insurance provides an affordable and appropriate mechanism for financing covered losses.

The types of coverages appropriate for a specific organization depend on the exposures facing that organization. It is impossible to say, therefore, that all nonprofits should carry certain coverages. Although most nonprofits go directly to the purchasing decision, a nonprofit should undertake a careful review of its exposures before deciding what coverages to buy. The staff of a nonprofit, assisted by volunteers, an agent or broker with nonprofit experience, or a consultant, can conduct a review that is called a "risk assessment" or "exposure analysis."

Insurable Risks

Claims made against nonprofit organizations fall into three general categories: claims and lawsuits filed against the nonprofit and its staff, claims by staff, and claims to repair or replace property a nonprofit owns or controls. Various types of insurance are available to cover these claims.

1. Claims and lawsuits filed against the nonprofit and its staff. In the first category, the following types of insurance coverage apply:

- commercial general liability (CGL)
- directors' and officers' liability (D&O)
- improper sexual conduct/sexual abuse
- automobile insurance (Business Auto Policy)
- professional liability (PL)
- umbrella or excess insurance
- employment practices liability (EPLI)
- employee benefits liability
- water craft and aircraft (owned and nonowned)

2. Claims for injuries to staff and volunteers. Under this second category, the following types of insurance coverage are among those available:

- workers compensation and employers' liability (employees and sometimes volunteers)
- accident and injury coverage (volunteers)

3. Claims for property a nonprofit owns or is responsible for. Under the final category of claims, available insurance coverages include:

- general property coverage (including property of others)
- crime coverage (including employee dishonesty and money & securities)
- boiler and machinery (heating, air conditioning, and ventilating equipment)
- computer equipment and software
- property in transit and off premises

NOTE: Most U.S. insurance companies provide very limited coverage for international exposures. If your nonprofit has any overseas or international operations, you should investigate the need for an international policy.

Creating an Insurance Program

Generally, a nonprofit should tailor its insurance program to cover the specific risks that threaten its ability to fulfill its mission. This usually means purchasing a combination of insurance coverages rather than relying on a single policy form. It is highly unlikely that any single insurance policy will address the wide range of insurable exposures facing an organization. Sometimes however, a nonprofit may elect to purchase insurance for a specific exposure and self-insure other exposures. Many of the nation's 1.4 million nonprofits do not purchase any form of insurance coverage. Organizations, even those with limited financial reserves, committed to protecting the agency's scarce assets should carefully consider the coverages described below to develop an adequate risk financing program.

Commercial General Liability (CGL) policies protect a nonprofit and its directors, officers, and employees against claims alleging property damage or bodily injury caused by the nonprofit's operations or activities. CGL policies generally offer broad coverage for damage to another's property, bodily injury, and personal injury (false arrest, malicious prosecution, and defamation). Although a CGL policy provides extensive coverage, it does not address every possible liability exposure. A CGL policy excludes specific exposures covered more appropriately under a special policy or endorsement (for example, medical malpractice or improper sexual conduct). A general liability policy will pay the costs to defend against allegations and for damages due to the negligence of the insured. Some insurers are willing to extend the CGL policy to provide

coverage for others such as volunteers, sponsors, and landlords.

Directors' and Officers' Liability Insurance (D&O) policies protect against claims alleging harm attributable to the governance or management of an organization. Generally, D&O policies do not list specific types of covered claims, but provide coverage for any "wrongful act." A "wrongful act" may be an actual or alleged act, error, or omission by the organization itself, its directors, officers, employees and volunteers. No "standard" D&O policy exists, so each nonprofit must review its policy's coverages and exclusions.

Effective nonprofit managers and boards take the time to review and understand the provisions of their organization's D&O policy. Policies differ in several critical areas. In recent years, however, many insurers have designed policies that recognize the needs and resource constraints of nonprofits. Buyers of D&O coverage should pay particular attention to:

- Policy exclusions, including definitions that may exclude certain types of claims.
- Whether the policy provides "entity coverage" (including the organization within the definition of "insured").
- The policy's "insured vs. insured" exclusion, and how it applies to employment-related claims.
- Whether the insurer has a "duty to defend" the nonprofit against claims or simply an obligation to reimburse the nonprofit and its directors and officers for the defense costs and settlement after the resolution of the dispute.
- Whether the policy includes defense costs within the limit or defense costs are provided in addition to the limit.
- The affordability of the policy deductible (also called the "self-insured retention"). Choosing a large deductible to save premium dollars may result in an inappropriate level of "retained" risk.
- Whether the policy includes defense costs for certain categories of otherwise excluded claims (for example, claims alleging sexual harassment or criminal misconduct).
- If you are changing carriers, whether the policy provides "full prior acts coverage" or the same retroactive date.

Automobile Insurance. Nonprofits that lease or own vehicles are aware of the need for physical damage and commercial auto liability coverage. A nonprofit can be held liable, however, for the damage and injuries caused by its employees or volunteers using their own vehicles or vehicles that the agency rents or borrows for its operations. If your agency uses vehicles owned by its staff or volunteers, consider purchasing nonowned and hired auto liability coverage. Nonowned and hired auto liability coverage protects the nonprofit (not employees or volunteers unless endorsed onto the policy) against

exposures in this area. A nonprofit can purchase nonowned and hired auto coverage with its commercial auto policy, commercial general liability policy, or as a separate policy. Under nonowned and hired auto coverage, the driver's insurance (whether it is an employee or volunteer) will pay first -- before the nonprofit's coverage engages. Volunteers and Employees Excess Auto Liability insurance provides additional protection for volunteers and employees. This policy protects the volunteer or employee (not the nonprofit) for claims in excess of the individual's personal auto policy limit when the individual uses his or her auto on agency business.

Professional Liability. Professional liability policies provide coverage for claims arising from the delivery or failure to deliver professional services, such as medical or legal malpractice, and counseling. The CGL policy usually excludes coverage for professional services. Some policies provide limited coverage for certain professional exposures, while others cover a wide range of professional services subject to certain exclusions. Nonprofits should consider carefully whether they have any "professional liability" exposures and purchase coverage corresponding to these exposures. As your agency develops new programs and services or pursues collaborative ventures, new exposures in this area may arise.

Property Coverage. Property insurance protects against damage to buildings and equipment a nonprofit owns or is responsible for, such as rented or borrowed equipment. The organization can purchase additional coverage to cover the cost of salvaging or reconstructing valuable documents. A nonprofit may also obtain coverage to reimburse it for lost income or extra expense during a period in which it curtails operations due to an insured loss. The scope of coverage depends upon the type of property susceptible to damage and the cause of the damage. In addition to the property itself, property insurance may also pay for incidental expenses -- fire department charges, expenses incurred to save the property from damage, and debris removal. Recovery under a property policy is contingent on certain causes of loss or perils damaging the property. Many policies cover "risk of direct physical loss" unless the policy excludes or limited the loss by the policy (for example, nuclear war). Other policies only cover damage caused by specific causes like fire, lightning, wind, hail, or objects falling from the sky. Most policies do not cover significant catastrophes such as floods or earthquakes. However, a nonprofit with these exposures may purchase flood and/or earthquake coverages as a separate policy or endorsement. With increasing frequency, property insurance carriers will offer a range of endorsements that broaden coverage with no or a small premium charge.

Employee dishonesty bonds, or fidelity bonds, address a single type of exposure -- theft and embezzlement committed by an employee. Thus, if a client or service recipient steals from the petty cash or a burglar steals a laptop

computer, the fidelity bond will not respond. Some insurers will extend the policy to include dishonesty caused by volunteers. Most nonprofits purchase blanket position bonds that covers all employees rather than listing specific persons or positions on the policy. The agency can purchase an employee dishonesty coverage under a crime policy or as part of a commercial insurance package. The following conditions apply under an employee dishonesty bond:

- The perpetrator must be an employee (most policies do not include board members or other volunteers unless so endorsed).
 - There must be a dishonest act (theft, embezzlement, or forgery, and many bonds require that the nonprofit report the loss to the police. Employee dishonesty coverage does not compensate the organization 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 employee intends to (a) cause a loss to the nonprofit, even though temporary, and (b) confer a financial benefit to him or herself or a third party.
 - The dishonesty must occur and be discovered during the bond period.
- However, if the insured has had coverage in force for a number of years, the occurrence may extend over those policy years.

Workers compensation and employer's liability. Depending upon state law, workers compensation insurance is usually mandatory if the organization has one or more employees. Each state establishes its own eligibility requirements and benefits for workers compensation coverage. The policy provides benefits for employees' injuries arising out of and while in the course of their employment. An agency must purchase coverage for all employees whether full - or part-time. In most states, the definition of an employee does not include volunteers. However, if the state permits it, an organization can negotiate with its insurer to include volunteers as employees.

A standard workers compensation policy includes employer's liability coverage. This coverage pays for the costs to defend and settle a suit filed by an employee or the employee's family in connection with an on-the-job injury or death. Although states developed workers compensation insurance as the exclusive remedy for work-related injuries, the courts have granted exceptions. Therefore, an agency needs both workers compensation and employer's liability coverages.

Insurance Assurance

The wide range of needs among nonprofits and the relative low priority status the insurance function receives in most agencies make the purchase of appropriate coverage a difficult process. How can an organization improve its chances of buying appropriate coverage? First, be honest with your insurance advisor about the exposures inherent in your operations. Ignoring risks to get a

cheaper policy may result in not having the necessary coverage. Second, check all of your policies for exclusions. Often, the exclusions will eliminate essential coverage for the services delivered by your organization. Insurers may exclude coverage because the risk is uninsurable by law; the coverage may be available through a separate policy or endorsement; or the insurer simply does not want to assume the risk. The agency can negate exclusions falling under the latter two categories by purchasing endorsements and other appropriate policies. Sometimes, one insurer may cover an exposure excluded by another insurance company. Compare the coverages offered by different companies.

Third, select an agent or broker who understands your organization. Brokers specializing in nonprofit organizations can be an invaluable asset. You will spend your time wisely when checking the references provided by your prospective broker or agent. Fourth, require written proposals from any prospective insurers that include copies of the policy wording. Sample policies are particularly important for nonstandard coverages, such as D&O. The written proposal should also include any available payment terms. Don't wait until you have selected a policy and carrier before inquiring about the availability of premium financing. Finally, consider putting your insurance program out to bid every three to five years.