Communities Learning Together

Advancing HIV Care and Support through Fiscal Management and Organizational Development

Legal and Liability Issues for Nonprofit Organizations

Alameda Co. CLT III Training
August 1, 2008
Cathy Lins

Developed under cooperative agreement with HHS, HRSA, HAB
Access Ryan White TA at careacttarget.org

Agenda

- Review of Live meeting features/General Guidelines
- Objectives
- Roles & Responsibilities
- Systems for Oversight of Executive Staff
- Systems for Oversight of Organizational Finances
- Question and Answer
- Training Evaluation

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Live Meeting Features

- Seating chart
- Chat Function
- Recommended Audio Functions:

To hear a help menu	*1
To reach a support agent anytime during the presentation	*8

General Guidelines

- To manage the discussion, CF staff will serve as the overall moderator
- Use the color-coded seating chart to indicate your desire to respond to a question, ask a question, or offer input to a discussion

General Guidelines Continued

- The lines will not be muted because of the interactive nature of the training.
  - Please use the mute system for your individual lines to cut down on background noise
- If working in small groups – use the 1:1 chat system to discuss with your partner

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Objectives

Participants will

- **explore what accountability and transparency looks like when managing day to day liability and legal compliance**
- **understand what structures are needed to manage their agency's legal obligations**
- **discuss example policies, forms, and practices, including information pertaining to legal requirements of non-profit organizations in the Alameda Co./Oakland jurisdiction**

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Nonprofit Accountability

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Accountable to Whom?

Serving the Public's Interests

- Communities Served

Representing the Public's Interests

- IRS
- Congress
- State Regulators (Attorney General, etc.)
- State Legislatures
- Courts

THE MEDIA

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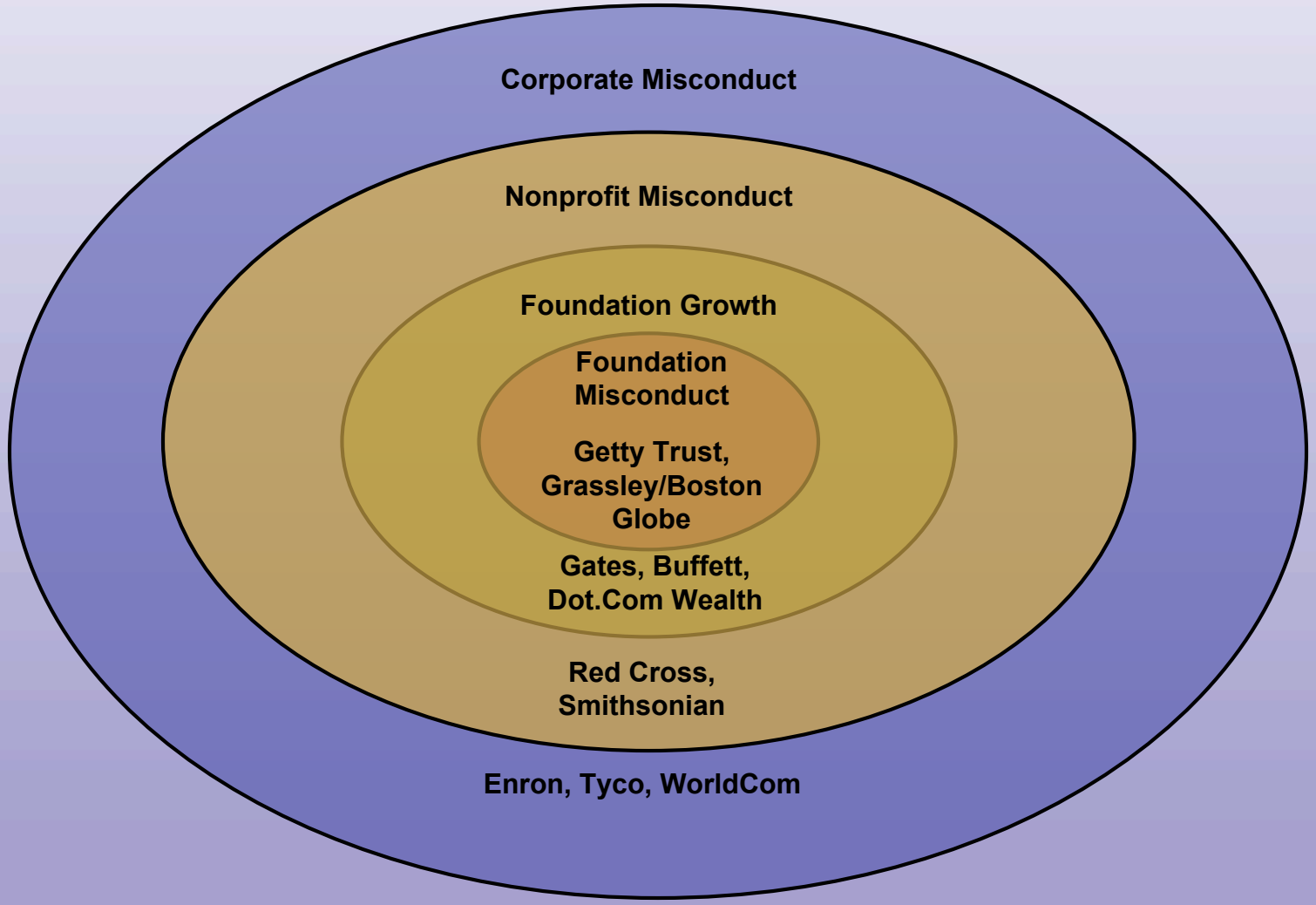
The Push for Greater Accountability



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The Push for Greater Accountability

California

- California Nonprofit Integrity Act (2004)
- AB 624 (Coto): The Foundation Transparency Act (2008- in Committee)

Congress

- Sarbanes-Oxley Act (2002)
- Pension Protection Act (2006)
- New House hearings on charities & foundations (2007)
- Senate leaders call for 990/990-PF reforms (2007)

IRS

- New Form 1023 (2004): conflict of interest policy
- Executive compensation study (2007)
- Good governance practices for charities (2007)
- New 990 governance, management, reporting section (2007)

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Accountable for What?

- Governance practices
- Communications/Disclosure
- Programs
- Finance
- Administration
- Personnel
- Public Policy
- Mission & Strategy
- Evaluation

Transparency

- Transparency refers to the public's right to know how a nonprofit organization is acquiring and using its resources while pursuing its mission.

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BoardSource, the nation's authority on nonprofit boards of directors, indicates that the public has the right to know that a nonprofit is:

- **Well-managed**
- **Properly governed**
- **Financially secure**
- **Abiding by ethical standards and values**
- **Obeying the law**
- **Functioning in a productive and resourceful manner**

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Test Your Accountability IQ

Does Your Agency

- ❑ Hold staff and board trainings on ethics or take other measures to foster a culture of accountability and transparency?
- ❑ Have a code of ethics and statement of values and post it on your website?

Test Your Accountability IQ

- Follow a conflict of interest policy and post it on your website?
- Have board members with financial expertise?
- Have its financial statements independently audited?

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Test Your Accountability IQ

- ❑ Have board members review financial statements, including the Form 990?
- ❑ Have your CEO or CFO sign the Form 990?
- ❑ File your Form 990 electronically?
- ❑ Post your Form 990 on your website?

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Test Your Accountability IQ

- Post your policies, financial information, and information on programs results on your website?
- Have a whistleblower policy?
- Take steps to remain current with the law?

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Principles for Good Governance and Ethical Practice

Presents 33 principles in 4 categories:

1. **Legal Compliance and Public Disclosure**
2. **Effective Governance**
3. **Strong Financial Oversight**
4. **Responsible Fundraising**

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Legal Compliance and Public Disclosure

- **Principles 1-7:**
- **Responsibilities and practices to assist nonprofit organizations in complying with legal obligations and providing information to the public**

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Effective Governance

- <u>Principles 8-20</u>:
- Policies and procedures a board of directors should implement to fulfill its oversight and governance responsibilities effectively

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Strong Financial Oversight

- **<u>Principles 21-26</u>:**
- **Policies and procedures an organization should follow to ensure wise stewardship of charitable resources**

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Responsible Fundraising

- Principles 27-33:
- Policies and procedures for organizations that solicit funds from the public should follow to build donor support and confidence

Risk Management

- Asking and answering three basic questions:
  - What can go wrong?
  - What will we do (both to prevent the harm from occurring and in the aftermath of an "incident")?
  - If something happens, how will we pay for it?

In many nonprofits the focus of the risk management effort is on:

- Screening volunteers to protect clients from harm;
- Checking motor vehicle records for all employees and volunteers driving on the nonprofit's behalf;
- Developing board orientation and training materials;

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- Coordinating the development and consistent use of employment practices;
- Negotiating the availability of bank credit and purchasing property and liability insurance to address the organization's principal exposures;
- Addressing hazards associated with the organization's fundraising events; and
- Recommending policies and procedures that insulate the organization from liability when it enters into relationships with partner or affiliate organizations.

What is Risk?

- Simply speaking, a risk is any uncertainty about a future event that threatens your organization's ability to accomplish its mission.

Nonprofit assets fall into the following categories.

- People -- board members, volunteers, employees, clients, donors, and the public.
- Property -- buildings, facilities, equipment, materials, copyrights, and trademarks.
- Income -- sales, grants, and contributions.
- Goodwill -- reputation, stature in the community, and the ability to raise funds and appeal to prospective volunteers.

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Organizational Risk

- General liability
- Worker's compensation
- Fidelity insurance
- Other potential liabilities
  - Wage and withholding
  - OSHA
  - Securities laws
  - Environmental laws
  - ERISA
  - EEO
  - IRS violations, etc.

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Personal Risk

- Directors can be held personally liable for their actions as directors
- Directors can be named as defendants for actions of the foundation
- Defending a case can be expensive for both the individual and the agency

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Minimizing Risk for Directors

- Indemnification
- Charitable Immunity
- D & O Insurance

Developing a Risk Management Program

1. Establish the purpose of the risk management program.
2. Assign responsibility for the risk management plan.
3. Acknowledge and identify risk.
4. Evaluate and prioritize risk.

Developing a Risk Management Program Continued

5. Decide how to manage your risks, using risk management strategies.
6. Implement your risk management plan.
7. Review and revise the plan as needed.

The Role of Insurance

- For most nonprofits, insurance is a valuable risk financing tool. Few agencies have the reserves or funds necessary for complete self insurance of their exposures.
- Purchasing insurance, however, is not synonymous with risk management. In the nonprofit sector, practicing risk management is living the commitment to prevent harm.

Disaster Planning

- Whatever one chooses to call it — disaster planning, emergency preparedness, or business continuity — the goals are ultimately the same: to get an organization back up and running in the event of an interruption.

End of Module

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Question and Answer Process

- **There are two ways to ask questions:**
  - **Through audio/telephone**
    - Switch your seating chart color to purple
    - CF staff will prompt you when to ask your question
    - Once your question has been asked, switch your seating chart color back to green
  - **Via the web-based question box**
    - Use the small question box at the bottom of the screen to type in and send your question to the CF moderator
    - The moderator will read your question(s)

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Training Evaluation

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Fiscal Management and Planning
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The Most Common Risks

An organization can evaluate the risks facing it by the magnitude of the threat to its core assets. The likelihood and potential consequences of a risk materializing determine whether it is a high priority risk requiring immediate attention. The risks most common to nonprofit organizations include:

Injuries to Clients, Employees, Volunteers, and the Public
The nonprofit's major risk or exposure is the possibility of someone getting hurt. The injury may be the result of the organization's negligence or a non-fault accident. Every nonprofit, when serving clients or raising funds for its programs, must exercise a level of care necessary to protect people from harm. Injuries may arise from an automobile accident, workplace hazards, client participation in a regular program, or the sponsorship of a special event.

Nonprofit managers must understand the important concepts of liability and negligence to assess and prioritize risks. An organization is liable when it is financially responsible for its actions or failure to act. Claims made against nonprofit organizations frequently allege negligence, or the failure to act as a reasonable person would under similar circumstances. To prevail, a party alleging negligence must prove that:

1. A duty exists -- An organization cannot be found negligent unless it first had a duty to exercise care.
2. The duty is breached -- An organization that does not meet its duty of care may be found negligent.
3. An injury occurs -- Negligence will not be found unless someone is hurt or something is damaged.
4. The breach of duty caused the injury -- In order for an organization to be found negligent, the injury must be tied directly to the entity's breach of its duty of care.

If the four elements exist in a given situation, a court may hold an organization liable for an injury or damages. One of the greatest risks facing a nonprofit is the failure to provide the requisite level of care required under the circumstances. The required standard of care, however, varies with the situation, the people involved, and the community in which the incident takes place. Nonprofits serving children or other vulnerable populations must exercise a higher level of care than if the agency serves adults.

Damage to Property
Every organization owns some property even if it is antiquated office furniture and computers. The damage or destruction of the nonprofit's property could impair the organization's ability to continue operations. A fire, tornado, flood, wind, explosion, vandalism, theft or electrical malfunctions can cause damage to the organization's property. The need to abandon or temporarily vacate unusable offices would severely impact the operations of most if not all nonprofits. The organization could face substantial costs to locate and establish temporary or new offices. A property loss has both operational and financial consequences.

An organization's property can be more than its office furniture and equipment. Many nonprofits own automobiles, mobile equipment (cellular phones, two-way radios, tools), boats, and lawn or maintenance equipment. What would the impact of a major property loss be on your organization?

Many nonprofits do not consider the risk of damage to property that it has borrowed or rented. Most property rental agreements assign responsibility for damage to the property to the lessee (the organization). Even if you borrow equipment without a contract, the owner may expect restitution if your organization lost or damaged the property.

A word of caution: many organizations assume that a general liability policy will cover damage to another's property. However, most general liability policies exclude damage to property owned by or in the care, custody, and control of the insured.

Employment Practices
Data supplied by several insurers indicates that employment-related matters represent the largest share of claims filed against nonprofits under directors' and officers' liability policies. Coregis, a large insurer of nonprofit D&O coverage, reports that employment-related allegations account for more than 75 percent of nonprofit claims. The Nonprofits' Insurance Alliance of California (NIAC) reports that lawsuits alleging wrongful termination represent 60 percent of all suits filed against nonprofit boards. Charges of sexual harassment and discrimination are the next leading causes of employment practices claims. Nonprofit managers and boards must carefully establish and follow employment policies and procedures to reduce the risk of employment practices claims.

Employment risks arise from the existence of extensive laws regulating the employer-employee relationship. The laws apply to all aspects of the employment relationship -- including the hiring, supervision, and termination of employees. Non-compliance can result in an employment claim and significant fees, fines or settlements.

The laws and regulations include federal, state and local requirements. Some of the issues addressed by the laws are sexual harassment, discrimination (based on sex, age, race, color, creed, national origin, disabilities, sexual orientation), wage and hour, fair labor standards, and benefit plans administration.

Fraud
Every nonprofit is vulnerable to fraud. The theft or misappropriation of funds can have severe consequences. A single major theft of funds or equipment could jeopardize seriously a nonprofit's viability. The organization may suffer a cash flow crunch, loss of donor confidence, reduction in services and a loss of jobs. The public reporting of a loss could be devastating as media reports affect donations, the availability of volunteers and public goodwill.

According to Robert Hailstone at Australia's Criminal Justice Commission, the true costs of workplace crime in Australia totaled $10 billion in 1996. Hailstone also reports that fraud accounts for two-thirds of all crime. A study estimated the 1996 U.S. cost of workplace crime at $300 billion. The lack of effective internal controls may enable the thief to be successful. Even a small nonprofit with very limited resources could lose it all if an employee or volunteer steals or squanders its money.

Legal Requirements
Nonprofit organizations, as holders of the public's trust, are subject to specific laws and regulations. Organizations must meet IRS requirements to maintain their tax-exempt status. The Internal Revenue Code addresses the organization's charitable mission, political and lobbying activities and proper accounting of income and expenses. Violations can lead to fines, loss of tax-exempt status or possible dissolution. Besides the IRS, every state has charitable solicitation and other laws applicable to nonprofit organizations.

In addition to laws regulating the operation of nonprofits, many organizations must follow operational rules and regulations. Medical clinics must follow hazardous waste handling procedures and meet state requirements for a medical facility. Organizations serving children must report suspected cases of child abuse and follow other health and safety regulations. If an organization fails to comply with these regulations, the regulatory authority may impose a fine, suspend its operating license or permanently close the operation. If the media reports the incident, the adverse publicity could also effect the organization's ability to function.

To manage the risks of legal compliance, every organization must research and keep current on the rules, regulations and statutes that apply to its operations. Noncompliance can both initiate governmental action and create the basis for a liability action against the organization.

Developing a Risk Management Program

Large organizations may have a risk management department responsible for answering the three basic questions. In addition, the department may manage litigation, coordinate product and plant safety programs, and undertake the complex analyses required to set monetary reserves for future claims. In many nonprofit organizations, a volunteer Risk Management Committee working in partnership with the executive director and finance officer oversees the risk management function.

For small to mid-size nonprofits, risk management need not be an expensive or highly technical process requiring vast resources. Instead, incorporating risk management into your operation is simply anticipating events, planning a response, and, wherever possible, providing adequate financing if something does go wrong. A critical element for the effective management of risk is the belief that by promoting safety, protecting clients, and conserving scarce resources, the agency frees up its resources to focus on mission-critical functions. The following steps are essential:

1. Establish the purpose of the risk management program. The first step is to decide your organization's purpose for creating a risk management program. Your purpose may be to reduce the costs of insurance or to reduce the number of program-related injuries to staff members. By determining its intention before initiating risk management planning, your agency can evaluate the results to determine its effectiveness. Typically, the executive director of a nonprofit, with the board of directors, sets the tone for the risk management program.
2. Assign responsibility for the risk management plan. The second step is to designate an individual or team (typically a risk management committee) responsible for developing and implementing your organization's risk management program. While the team is principally responsible for the risk management plan, a successful program requires the integration of risk management within all levels of your organization. Operations staff and board members should help the risk management committee in identifying risks and developing suitable loss control and intervention strategies.
3. Acknowledge and identify risk. Every nonprofit's operation involves some degree of risk or uncertainty about future events. An important step in managing those risks is to identify them. Some risks are generic and inherent to all organizations -- the possibility of a visitor slipping on a wet floor, an employee embezzling the agency's funds, or a former employee alleging violation of his civil rights. Other risks are unique to your organization -- injury at a special event, embezzlement of funds by your contract accountant, or negative publicity following the launch of a strategic alliance with a controversial business. No matter how improbable a risk may seem, if you can envision it happening in your organization, you should list it during this stage of the risk management process.

4. Evaluate and prioritize risk. Under this step, the risk management committee assesses the probability of each risk becoming reality and estimates its possible effect and cost to the agency. An organization should look at its past accidents and near misses and check with similar nonprofits in developing probability and cost estimates. Also, consider the possible public reaction to an adverse event. Priority areas of concern will include those risks that are most likely to occur and are expensive when they do happen -- such as an accident or injury at a community pool. Lower priority risks are those that seldom occur and are not likely to cost as much when they do happen -- such as a fall in the agency's well-maintained offices.
5. Decide how to manage your risks, using risk management strategies. The risk management committee's next task is to develop a written plan. The plan outlines how the agency will manage its major risks and describes the suggested strategy, or combination of strategies that the nonprofit will employ. The four basic strategies for controlling risk are:

    - Avoidance. Do not offer or cease to provide a service or conduct an activity considered too risky.
    - Modification. Change the activity so that the chance of harm occurring and impact of potential damage are within acceptable limits.
    - Retention. Accept all or part of the risk, and prepare for the consequences.
    - Sharing. Consider sharing the 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 service provider through a contractual arrangement.
    - Traditional risk management texts categorize the purchase of insurance and use of contractual arrangements to allocate risk as methods of "risk transfer." This term is misleading, however, as transferring risk is virtually impossible for a nonprofit. For example, when a nonprofit purchases a general liability policy, the insurance carrier agrees to defend and pay for losses incurred by the nonprofit for certain causes of loss. The insured nonprofit, however, retains the potential loss of its reputation in the community and reductions in the pool of volunteers available to serve the organization. No currently available contract of insurance will restore a damaged reputation or replenish a pool of capable and enthusiastic volunteers.

6. Implement your risk management plan. Once the appropriate governing body or management personnel has reviewed the plan, the agency should formally adopt and implement it. A risk management plan placed on a shelf in the executive director's office is a waste of time. Implementation begins with the risk management committee distributing and explaining the plan to everyone

affected by it. While every staff member should have the opportunity to comment on the plan and its implementation, they may require some special training. Certain employees and volunteers may need training to enable them to meet their specific risk management responsibilities.

7. Review and revise the plan as needed. Nonprofits are dynamic organizations that must adapt -- on an ongoing basis -- to new client needs, funding constraints, and service delivery challenges. The dynamic nature of your organization requires that the risk management committee revisit its strategies at least annually. The committee should evaluate the risk management plan to ensure its continued relevancy, comprehensiveness, and effectiveness. Have your risks changed due to the addition of new services or curtailment of programming? Are greater or fewer resources available for controlling risks? Having a risk management committee that meets periodically can help ensure that the issue of risk management receives ongoing attention. The risk management committee also needs to evaluate the strategies it sets up. Have the risk management techniques had the desired affect? Were injuries or accidents reduced? Did insurance premiums go up or down at renewal? Is the plan having the desired impact or do you need to make some revisions?

What is a risk management committee?

Many businesses and large nonprofit agencies employ full-time, professional risk managers who coordinate the organization's loss control, claims reporting, insurance purchasing, safety programs and other functions. Other organizations use an outside advisor to review exposures and develop risk management strategies on an ongoing basis. While the roles vary by organization, these professionals generally provide leadership in identifying, controlling, and financing risk.

For many small and mid-size nonprofits or those that are volunteer driven, budget limitations preclude the hiring of a risk management professional. However, a Risk Management Committee is a highly effective method for addressing the organization's risk management needs. The Risk Management Committee can function as the organization's risk management department or be a valuable and supportive partner to the agency's risk manager.

A Risk Management Committee is the group responsible for the development and oversight of an organization's risk management program. The Committee's primary efforts are to identify, control and finance risks. In the nonprofit sector, a risk management committee typically includes both employees and volunteers. A diverse membership enables an organization to get a broad and unique perspective on its risks while encouraging creative problem solving.

Forming A Risk Management Committee

The composition of a Risk Management Committee will vary depending on the organization's unique risks. A nonprofit health clinic's risk management committee may include medical personnel, an attorney, an insurance professional and a member of the administrative staff. In contrast, a nonprofit mentoring program serving at-risk youth may include the volunteer coordinator or intake professional, one or more of the volunteer mentors, an attorney, and an insurance professional on its committee. One key factor in selecting the committee's members is to identify individuals with a range of expertise and first hand knowledge of the organization's risks.

Nonprofit exposures or risks fall generally into the following categories:

- Traditional business risks such as the loss of equipment due to fire or the filing of a wrongful termination claim;
- Exposures unique to the nonprofit sector -- tax assessments from unrelated business income, contractual liability resulting from a volunteer's apparent authority, or liability from an auto accident involving a volunteer using his car to transport clients;
- Service delivery-related risks -- exposures associated with the specific services that the organization delivers, such as abuse of vulnerable clients/members, or the negligent referral to an unqualified service provider.

An organization should select individuals familiar with traditional business/operating risks and people who know the details of an agency's operations. Therefore, the organization should include at least one employee on an otherwise all volunteer Risk Management Committee. The most effective committee will consist of people with knowledge of and experience with the nonprofit's operations, future programming plans, legal structure, and operating procedures.

The Core Responsibilities of a Risk Management Committee

- Identify and evaluate exposures -- The Committee's responsibilities are similar to the duties of a risk manager. The first step in the process is to identify and measure the risks facing an agency. Some organizations may use an outside consultant for this effort. Here, the Committee supports the process by participating in interviews with the advisor and helping to identify the various risks facing the organization. If an agency decides to undertake the risk management process without outside help, the Committee's work begins with a brainstorming session. The members identify and discuss "what could go wrong" and the likelihood of each identified harm occurring.
- Develop risk management strategies -- The Committee's job continues with the identification of practical, affordable loss control strategies to reduce the chance of harm occurring or minimize losses if the risk becomes real. A committee with broad experience and differing perspectives is important. The Committee should draw in additional employees and key volunteers to ensure that the its recommendations are practical and acceptable. In addition, the Committee answers the following questions. What risks should the organization avoid completely? What risks can be minimized through operational changes? What risks can be self-insured by reserving funds to pay anticipated losses? What risks require outside financing, such as the purchase of an insurance policy?
- Implement the risk management plan -- For the next phase, the Committee develops a plan outlining the nonprofit's strategies for addressing its major risks. The plan identifies who is responsible for carrying out each facet of the plan. Additionally, the plan documents the steps required to carry it out. Include information on risk financing programs such as insurance policies, coverages, renewal dates, and claims reporting procedures.
- Monitor and update the plan as needed -- In some respects, the Committee's work is never finished. Managing a nonprofit's risks requires an ongoing commitment to revisiting strategies, looking for emerging or changing exposures, and staying abreast of developments that effect the likelihood of harm. The activities and programs of most nonprofits vary considerably each year. The Risk Management Committee examines how each change affects its risk. Will the addition of a new service create a professional liability exposure? Another Committee responsibility is to submit reports to the nonprofit's board highlighting the committee's activities.

The Committee must keep the board advised of any developments that may significantly affect the organization.

Other important tasks of a risk management committee may include:

- Developing an organizational risk management policy that affirms the organization's commitment to safeguarding its assets and establishing its risk management goals (i.e. improving client safety);
- Selecting an insurance advisor (a broker or agent) and negotiating insurance arrangements;
- Communicating the agency's risk management plan and loss control procedures to affected parties, including employees, volunteers, the board of directors, clients and the public; and
- Overseeing loss prevention activities.

The designation of a Risk Management Committee is often the starting point for a nonprofit's commitment to controlling risk. A committee structure offers invaluable support in the identification of exposures and the development of practical strategies for preventing losses and minimizing the impact of losses when they occur.

What is the board of directors' role in managing risk?

The primary responsibility of a nonprofit board of directors is to guide the organization in accomplishing its mission. In fulfilling this obligation, the board has a legal duty to use the organization's assets prudently. The assets of a nonprofit vary, but generally fall within one of the following categories: people (board members, volunteers, employees, clients, donors, and the public), property (buildings, facilities, equipment, materials, copyrights, and trademarks), income (sales, grants, and contributions), and goodwill (reputation, stature in the community, and the ability to raise funds and appeal to prospective volunteers). The board's oversight role empowers it to exercise tremendous influence in ensuring that the organization protects and uses its core assets solely to further the goals of the organization.

To discharge its important responsibility for insuring the health of a nonprofit, an effective board provides leadership and direction for an agency's overall risk management program. The board should pay close attention to the risks inherent in its governance activities.

Through the board's failure to act or mistakes, the directors may expose the organization's assets to losses and thus prevent the agency from achieving its mission. When the board takes the lead in protecting the organization's assets, it supports the organization's successful operation. A successful organization helps to ensure the agency's positive impact on the community for many years to come. The principal risk management goals for most nonprofits are:

- Protecting clients, staff, volunteers, and the public from harm;
- Conserving the agency's assets for its community-serving mission; and
- Ensuring that resources are available to compensate individuals harmed by the organization's activities.

The board's position enables it to protect a nonprofit against potential risks by:

- Establishing long-term goals and short-term objectives for the nonprofit's program initiatives, board and staff;
- Measuring performance against established goals and objectives;
- Approving an action plan to meet the organization's goals and objectives, and delegating responsibility for plan implementation to the nonprofit's chief executive;
- Monitoring the plan's implementation;
- Ensuring the availability and proper use of funds to support administrative and program activities through active participation in fundraising programs and the development and monitoring of financial management and fundraising policies; and
- Directing necessary changes in focus and monitoring the impact of these changes.

The board of a nonprofit can contribute significantly to managing risk by paying close attention to hot spots -- the areas most likely to result in claims. By adopting practices that minimize the likelihood of such claims, the board places an organization on the right footing. Suggested practices are outlined below:

1. Carefully select the Chief Executive Officer. The board should make the delegation of responsibility for day-to-day management with care. This care begins with the thoughtful selection of a chief executive officer, commonly called the CEO or executive director. The board's ability to fulfill its legal duties and risk management responsibilities will largely depend upon the competence, skills, and cooperation of the CEO.

In recognition of a range of liability concerns, the board should receive legal advice about recruiting and hiring a chief executive. In addition, if the board decides to negotiate an employment contract with its new CEO, the parties to the contract (the board and the CEO) should both seek counsel.

1. Oversee employment practices. While the board's responsibility for hiring generally ends in the selection of the CEO, its overall responsibility for the employment practices of the nonprofit extend a great deal further. Employment-related actions are the largest source of claims filed against boards of directors under Directors' and Officers' (D&O) insurance policies.

   The board's role is not to micro-manage every action taken by the executive director. Instead, the board is acting appropriately and responsibly when it questions whether the agency applies its employment practices consistently and uniformly. The board should also determine if the organization is following the board established employment policies. In addition, members of the board should ask what steps the staff are taking to prevent unlawful discrimination or other actions that could result in agency liability (for example, training of supervisory staff). Lastly, when the directors deem it necessary, they should direct the senior staff to strengthen or revisit such practices.

2. Oversee financial management and fundraising policies. Nonprofit boards are often described as "fiduciaries" entrusted by the public with charitable funds. Few nonprofit board members are experts in nonprofit finance, nor must the organization require financial management skills in prospective board members. To discharge their fiduciary duties and the duty of care, board members must be committed and diligent in reviewing information related to the organization's financial position. After establishing goals and objectives and approving the strategic plan, the board should approve an annual budget. The board meets its financial management responsibility by reviewing financial statements regularly and questioning whether expenditures are consistent with the program priorities and operating policies established by the board. Is the organization on a sound financial footing? Are the staff's revenue

projections realistic? Do the financial statements present a clear picture of the financial condition of the agency?

Fundraising is one area in which nonprofit boards are most active at the operational level. Nonprofit board members' ability to raise funds or access potential donors is often considered in their selection. The board's role in managing fundraising and development-related risks includes developing policy for fundraising strategy and practices. For example, does the nonprofit reject unsuitable gifts? Does it have procedures in place to account for the "strings" attached to certain donations? Are policies and controls in place to ensure that funds will be spent according to the provisions of restricted grants?

3. Review Directors' and Officers' (D&O) coverage. D&O policies have evolved considerably over time to meet the needs of nonprofit organizations. While some nonprofits continue to purchase traditional corporate D&O policies, most select policies that respond to the unique exposures facing nonprofits. Board members should be knowledgeable about the agency's D&O coverage and request information that will enable them to evaluate whether the coverage purchased by the organization is appropriate and responsive to the nonprofit's exposures.

   For example, will the insurer advance defense costs or require that the nonprofit pay counsel and await reimbursement by the company after they resolve the claim? Does the policy contain a broad definition of insured or is coverage limited to current directors and officers? Does the policy provide broad coverage for employment practices liability or exclude employment-related claims? Given the growing number of D&O claims (especially employment practices allegations), nearly every nonprofit can benefit from buying a D&O policy. The current competitive marketplace for D&O coverage and most nonprofits' lack of a loss reserve fund also support the benefits of purchasing D&O insurance.

4. Adopt and follow procedures. "Good procedures, regularly followed" could be the risk management mantra for any nonprofit. Several policies and procedures can be invaluable to a board as it strives to fulfill its legal duties and risk management responsibilities. These include the use of position descriptions for board members and an annual self-evaluation process, and the adoption of conflict of interest policies, attendance policies, and board minute procedures.

What risks are associated with nonprofit fundraising?

For most nonprofits, fundraising is a required but rarely easy task. As the number of nonprofits and the need for charitable services continue to grow, securing donations and grants is an increasingly difficult and competitive business. While nonprofit fundraisers may feel anxiety about approaching a funder for the first time, or asking a long-time supporter to increase her annual contribution, most pursue these tasks with enthusiasm and creativity. Fundraising activities, however, can be among the riskiest programs a nonprofit undertakes. The failure to acknowledge and control the risks associated with fundraising efforts can seriously threaten an organization's survival. Therefore, a nonprofit can and should apply risk management techniques to every major component of its operations, including fundraising.

Risk management increases the probability of attaining goals successfully and fulfilling a mission by anticipating challenges and planning alternatives around possible barriers. The nonprofit's range of potential, harmful future events varies. Future "harm" might be a lawsuit alleging wrongful termination, or a long-time funder's insistence that funds be returned.

In many areas of operations, insurance products are available to finance a particular risk. For example, Employment Practices Liability (EPL) policies provide moneys to fund the defense of an employment-related suit and pay settlement or judgment costs. No policy, however, compensates a nonprofit for the return of funds to an unhappy donor or revenue shortfalls due to unrealistic fundraising projections. Insurance, also, does not protect against damage to a nonprofit's reputation following its association with a controversial corporate donor.

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) polices 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.

How do I review my organization's insurance contracts?

An insurance policy is a contract that defines the obligations of the two parties involved, the insured (your organization) and the insurer (insurance company). Most non-insurance people believe that insurance policies are incomprehensible. However, with a little insight into the mysteries of insurance contracts, you can make sense of your policies. Remember that besides providing coverages, policies also assign certain responsibilities to the insured. If you do not meet your obligations, you may impair the policy's coverage. The following review process will help guide you through the maze of insurance contracts.

Policy Parts

Every insurance policy has four parts: Declarations, Insuring Agreements, Exclusions, and Conditions. Use these sections as guideposts in reviewing a policy. Examine each part to identify its key provisions and requirements. You need not undertake this process alone. Remember that your insurance advisor, whether an agent, broker or consultant, can be a valuable resource in analyzing your organization's policies.

Declarations

The Declarations or "dec" page is usually the first page of the policy. It summarizes key information specific to the policy. The dec page shows the insured's name and address, the policy dates, a brief description of the business, coverages provided, coverage limits, premiums and the forms applicable to the policy.

Beyond the Declarations, the policy will also contain "schedules." A schedule identifies the location(s) of the insured's operations (including values or limits), the various assigned rating classifications, the rates and rating basis, and any special property covered (cameras, fine arts, contractors' equipment, etc.).

Insuring Agreements

The Insuring Agreements specify what the insurance company has agreed to pay for or to provide in exchange for the premium. Often a policy contains a section clearly marked "Insuring Agreements," although there may be additional agreements buried in the policy. Also, the policy may call an insuring agreement a "coverage" and many policies include more than one coverage. For example, a commercial general liability policy may provide Coverage A - Bodily Injury and Property Damage, Coverage B - Personal and Advertising Injury, and Coverage C - Medical Payments. Policies also call insuring agreements Supplemental, Additional or Extended Coverages.

An insurance policy begins by declaring what it covers and then proceeds to restrict, limit and exclude coverages. Therefore, you cannot just read the insuring agreements to understand the coverage. You must read the entire policy and refer back to the various insuring agreements and other provisions. Patience and a clear head are invaluable tools as you undertake this process.

One insuring agreement that is often easy to identify explains what triggers the policy's coverage. The two possible coverage triggers are "occurrence" or "claims made." Under an occurrence policy, the policy "triggers" or provides coverage based upon when the loss occurred. If the loss occurred during the policy's period, the policy will cover the loss. For example, if the policy period is January 1 - December 31, 1999 and a loss occurs in June 1999, barring the denial of the claim for other reasons, the policy will cover the loss. If the policy initiates coverage by a claims made provision, the policy in force when the insured submits the claim is the policy that responds. For example, assuming the same policy period as before, an organization reports the filing of a wrongful termination suit on January 10, 1999. The suit alleges that the organization terminated the employee on December 31, 1998 (one day before the policy took effect) for unlawful reasons. Assuming the company does not deny the claim for other reasons, the reporting of the "claim" during the policy period triggers the coverage. The policy responds despite the fact that the alleged wrongful act (the termination) took place before the policy was in effect. Claims made policies include many provisions that impact coverage and the implications of timely reporting of claims are quite complex. If your policy is claims made, ask your insurance advisor to explain the policy.

Definitions
Insurance policies contain many common words that have special meaning within the context of insurance. The policy identifies these words usually by bold print or quotation marks. Most policies contain a section entitled "Definitions" where they explain the special meaning of the designated words. Since definitions may restrict or limit coverage, it is essential that policyholders read definitions carefully and seek clarification whenever a definition it unclear.

Exclusions
Every insurance policy has exclusions or policy provisions that eliminate coverage for specified exposures. Exclusions serve as a way to clarify the coverages granted by the policy. Most policies have a section entitled, "Exclusions." However, an exclusionary provision can be anywhere in the policy. Furthermore, an exclusion may also contain a broadening provision. In the commercial general liability policy, the Aircraft, Auto, or Watercraft Exclusions eliminate coverage for the ownership, maintenance, use or entrustment of these vehicles or vessels. However, the exclusion has five exceptions where the policy covers watercraft such as while ashore on your premises and for certain nonowned watercraft. Read the policy carefully and note the provisions that apply to your operations.

Conditions
Conditions within an insurance policy qualify the various promises made by the insurance company. The insurer does not promise to cover all losses. The company will impose certain requirements or conditions on the insured, such as premium payment or duties to follow after a loss. Another example is that the insurer promises to pay and provide other services only if the insured event occurs and the insured has fulfilled its

contractual obligations. Review the policy to identify the conditions that you must follow. If you do not meet your obligations, the policy can void or otherwise restrict coverage.

The Review Process

Review your organization's insurance policies when you receive them. Before buying any new coverage, always request and review sample policies. Many people find it difficult to fully understand the scope of coverages without considering a specific loss. One approach is to identify the risks or types of losses you expect your organization to experience -- an office fire, windstorm, injury (suffered by an employee, volunteer, client), auto accident, theft or other risks. Then, determine if you think the policies will cover these expected losses. Your insurance advisor can assist you in the review process. Here are the steps.

1. **Review the policy for accuracy.**
   Insurance companies are notorious for issuing policies incorrectly. The policy may contain spelling errors, the wrong Named Insured, incorrect additional insureds, the wrong forms or not include a purchased coverage. Refer any errors to your insurance agent or broker immediately. If you do not address an error, it can become a problem if a loss related to the error occurs.
2. **Review the rating classifications and other schedules.**
   Check to see what rating classifications the company assigned to your organization. The company calculates the premium charge based on certain rating classifications. There can be substantial differences in the rates among the classifications. One insurance company assigned a "circus" rating classification to a workers' compensation policy for a nonprofit sports organization. The circus rates were much higher than the appropriate classification of "outside sales" and did not reflect the insured's exposures. Ask your insurance advisor to explain any classifications that do not seem to describe your operations.
3. **Read the policy and answer these questions.**

   - Is the expected claim covered by the insuring agreement?
   - Is there any exclusion or other provision that eliminates or restricts coverage?
   - Are there any exclusion exceptions that restore coverage?
   - What policy conditions must the organization comply with?
   - Are the people or operations affected by the conditions aware of them? If the policy requires that a burglar alarm always be operational, have you informed the office manager, maintenance staff or other appropriate personnel?
   - If the loss is covered, is there a deductible? The amount?
   - How much will the policy pay?

Summary

An insurance policy is a complex contract that often contains conflicting and confusing provisions. With a little patience and practice, you can learn to understand your policy's format and coverages. As a legal document, the courts have scrutinized insurance policies and argued over their meaning. Consequently, various courts have rendered conflicting interpretations. If judges and juries continue to disagree about the meaning of insurance policies, how can a nonprofit manager be confident about the coverages he or she has purchased? Most losses do not involve complex policy interpretations and the insurance company and insured quickly agree that the policy covers the loss. However, you must know and understand the many responsibilities placed on your organization by an insurance policy. Your noncompliance with a policy provision could have an adverse impact on coverage. So sit back, relax, and try to enjoy the learning process.

What are the essential components of a nonprofit Directors' & Officers' liability policy?

The D&O landscape for nonprofit organizations

Directors' and Officers' liability (D&O) policies provide protection for risks associated with the governance activities of a nonprofit organization. In the business world, corporate D&O policies exist primarily as protection against shareholder initiated actions against a board. While shareholder actions are not a factor in the nonprofit sector, other potential claimants may question the actions of nonprofit boards in a legal proceeding. Potential plaintiffs include representatives of government agencies, service recipients alleging injury from the nonprofit's actions or failure to act, or employees and volunteers.

Less than 10 years ago, many nonprofits encountered great difficulty in securing affordable and comprehensive D&O coverage. Only a handful of insurers offered a policy for nonprofits, and these policies often provided inadequate coverage. For example, a nonprofit board's greatest exposure is the organization's employment practices. Early nonprofit D&O policies excluded employment-related claims. In addition to limited coverage, many insurance companies refused to provide coverage because of their perceptions of the "risky" aspects of a nonprofit's operation. Nonprofits with a non-traditional approach to service delivery and those offering critical human services, such as community health clinics and adoption agencies, often faced reluctant insurers.

During the last decade, the nonprofit D&O landscape has improved substantially. Today, a growing number of insurers offer competitive, affordable coverage that addresses the principal governance and management exposures of nonprofit organizations. Furthermore, insurance companies have tailored and refined their D&O policies to reflect the specific needs of nonprofit organizations -- such as including volunteers (other than board members) as insureds.

However, even with the favorable insurance climate, many nonprofit organizations remain uninformed about the D&O coverage options and differences. As the number of claims increases, the importance of understanding the various policies becomes critical.

The frequency and nature of D&O claims

The number-one source of D&O claims against nonprofits is employees alleging wrongful employment acts. The nonprofits' experience reflects the national increase in employment-related claims in all economic sectors. In 1996, Americans filed more than 23,000 lawsuits in federal courts alleging discrimination based on impermissible considerations in employment, including race, sex, disability, and age. This is more than double the number of suits filed in 1992. Overall, job discrimination lawsuits have been rising at an average rate of 20 percent per year. Contributing factors to the growth in employment practices lawsuits include:

- The 1991 Civil Rights Act increased the availability of money damages to plaintiffs of successful discrimination claims.
- The 1990 Americans with Disabilities Act prohibits discrimination against physically or mentally handicapped workers.
- The 1992 Supreme Court confirmation hearings of nominee Clarence Thomas. Human resource professionals credit the hearings with raising the awareness of the issue of sexual harassment and causing a record number of complaints and suits. Complaints filed with the Equal Employment Opportunity Commission (EEOC) grew to more than 15,000 in 1996 from slightly more than 6,000 in 1990.
- Growing employee anger and resentment following an unprecedented period of corporate downsizing in the early 1990's.

Nonprofits are not immune from these national trends. The growth in D&O claims and the resultant intense media scrutiny has led to growing concern among current and prospective board members about their personal liability on these and other issues.

Other D&O claims include allegations of injury or financial losses caused by the nonprofit. Potential plaintiffs include clients, vendors, donors and employees alleging financial mismanagement. Government agencies such as the state attorney general can also file charges of violation of government regulations.

While nonprofit D&O claims are rare when compared to other types of claims, defending a D&O claim can be costly and disruptive to a nonprofit. Therefore, the organization's use of sound risk management practices to minimize the likelihood of a claim is important. In addition, the purchase of an appropriate D&O policy provides the availability of funds for defense and settlement costs.

Protection afforded by D&O policies

D&O policies protect against claims alleging harm attributable to the governance or management of an organization. Most policies do not list specific types of covered claims. Instead, the policy covers "wrongful acts" which is a term that the policy may define broadly. The definition of "wrongful act" can include actual and alleged acts, errors, and omissions, misleading statements, and neglect or breach of duty. The policy may narrow coverage by limitations and exclusions. Exclusions usually exist for one of two reasons. First, an exclusion can eliminate coverage for an exposure offered in another insurance policy such as bodily injury, employee benefits liability, and professional liability. Second, an exclusion can eliminate coverage for uninsurable exposures (i.e., illegal or dishonest conduct).

Every organization should examine its policy exclusions. A common exclusion with possible adverse consequences is the "insured versus insured" exclusion. Initially designed to eliminate coverage for struggles over organizational control, this policy provision may eliminate coverage for employment-related suits. For example, if the policy definition of insured includes the executive director, the policy would exclude his

or her wrongful termination claim against the board of directors. If your policy includes an "insured versus insured" exclusion, look for language that makes clear that the exclusion does not apply to employment practices claims.

Insurance companies write D&O policies on a "claims-made" basis. A "claims-made" policy requires that (1) the claim be made against the insured during the policy period; and (2) the incident giving rise to the claim occur within the policy period. Regarding the second requirement, many insurers will extend the policy period retroactively by providing "prior acts coverage" or extending the retroactive date to the date of the initial policy's inception. Prior acts or retroactive coverage is critically important with claims-made coverage. Without it, an organization faces a gap in coverage any time it changes insurance carriers.

The desirability of other policy features depends upon the needs of a particular organization. Nonprofits should consider the following features when selecting appropriate D&O coverage:

- Scope of coverage. The broad coverage offered under many nonprofit D&O policies is ordinarily preferable. Look for policies that offer:
    - A broad definition of "insured". Look for a policy with a broad definition of "insured." The definition should include the organization (often called "entity" coverage) and all past, present and future board members, employees, and volunteers. A savvy plaintiff's attorney alleging injury will name everyone connected to the event or decision in the suit. A broad definition of insured ensures protection if a defendant falls outside the narrow definition of "director" or "officer."
    - A broad definition of "wrongful act" and "claim." The definitions of "wrongful act" and "claim" determine the policy's scope of coverage -- what actions the policy covers. The "best" policy offers the widest range of coverage. Considering the growing probability of an employment-related claim, coverage for employment practices liability is a necessity for most nonprofits. Preferable policies provide coverage for claims for wrongful termination, discrimination, and harassment. An insurer may agree to provide a defense for claims filed with administrative agencies (for example, the EEOC or local human rights commission) in addition to coverage for lawsuits seeking money damages. A final consideration is whether the policy includes coverage for defense costs for certain categories of otherwise excluded claims (such as allegations of intentional wrongdoing or criminal acts).
- Deductibles. Most nonprofit D&O policies offer several options for the policy deductible. The premium generally increases when the insured selects a lower deductible (also known as the "retention"). In recent years, insurers serving the

nonprofit marketplace have become increasingly willing to offer deductibles as low as $500 or $1,000 as an option. Consider the amount you can afford as your policy deductible. Also important is whether the deductible is on a "per claim" or "aggregate" basis.

- Type of coverage for defense costs. A growing number of nonprofit D&O policies require that the insurer pays the litigation costs as the organization incurs them. "Duty to defend" policy defines the insurer's obligation to pay defense costs as incurred. For most nonprofits, this provision is essential. The alternative is for the insurer to reimburse the insured for defense costs after the dispute. While this may be appropriate for large nonprofits or those with substantial reserves, it is generally problematic for small, resource-constrained agencies. One major nonprofit D&O insurer reports that its defense costs for an employment claim average between $35,000 - $103,000.
- Annual premium. Many nonprofit insurance buyers regard the annual premium as the most important determining factor in comparing D&O policies. Nonprofits generally purchase insurance to finance risks that the organization is otherwise unable to eliminate or retain. Buying a low-cost policy that provides inadequate coverage is a waste of precious financial resources. Conversely, choosing the most expensive policy will not guarantee the best coverage. Obtaining appropriate coverage should be the organization's first concern. Buyers should compare premiums only after they have carefully considered policy wording and coverage differences.

Nonprofit managers should review and understand the provisions of D&O coverage. Policies differ in several areas. In recent years, many insurers have designed policies that recognize the needs and resource constraints of nonprofits. While most nonprofits and their boards will not encounter a D&O claim, purchasing D&O insurance can prevent the financial ruin of the directors and the organization itself if there is a claim.

D&O Insurance Buying Tips

1. Present your nonprofit in the best light, emphasizing your activities to minimize losses (internal controls, employment practices). Do not view the application as a burdensome paperwork requirement, but consider it an opportunity to protect your nonprofit and conserve resources.
2. Share the expiring premium, limits, and deductible from your existing carrier with prospective insurers for your account. Competition for your business will help you negotiate the best terms for your nonprofit.
3. Allow sufficient time for an underwriting review -- particularly with a carrier unfamiliar with your organization.
4. Fully complete the insurance company's application and attach all requested supporting information when you initially submit it. The information requested

usually includes the organization's bylaws, board roster, employee manual, and audited financial statements or Form 990.

5. Be accurate and truthful in answering questions on the application. Misstatements on the application can void coverage if discovered upon the filing of a claim.
6. Respond to the underwriter's questions (generally conveyed through your broker or agent) in a prompt fashion.
7. Fully disclose your agency's prior losses and provide detail on corrective action taken to avoid future losses.
8. Remember that coverage and pricing terms are, to some extent, negotiable. On occasion, the insurance company bases its preliminary quotations on inappropriate assumptions. If specific terms of the proposal are unacceptable, propose alternatives.
9. Request a sample copy of the complete policy. Carefully compare the policy wording and coverages summary to a list of features you require. Also, seek help from your legal counsel or insurance agent if you do not understand the policy wording.
10. When you are buying any form of "claims made" coverage and changing carriers, make certain that your new policy includes "full prior acts" coverage or the retroactive date is the inception date of your original policy.
11. Knowledge of any "incidents" that may lead to a claim must be indicated on any application or renewal form by the applicant. If you note any such incidents on an application for a new carrier, make sure that you reported the "incidents" to your current carrier. The new company will exclude these incidents from their policy.
12. Request information on an insurer's financial strength and status ("admitted" versus "surplus lines") from your agent when he or she submits proposals for your consideration.

What are the most common financial management risks facing nonprofits?

The management and protection of financial resources must be a concern for all nonprofit organizations -- from the smallest all-volunteer group to a large, national association. Without adequate financial resources, an organization is unable to achieve its mission and may not survive. Financial resources or assets fall into three categories -- money, goods, and services. Money consists of cash, checking and savings accounts, securities and other investments. Goods involve merchandise or stock, supplies, and equipment. Services are the programs and activities the organization offers to its clients. Accountants classify goods and services as resources because they have a value or may be used to create value or revenues.

The risks in financial management are any actions that contribute to the reduction in value or loss of any of the organization's financial assets. The decrease can be from the actions of an internal source such as an employee or volunteer, or someone outside of the organization can perpetrate the loss -- a burglar, "con man," or client defrauding the organization. Every organization should be aware of the possibility of a financial loss and take the appropriate protective actions.

A financial loss can have a tremendous impact on a nonprofit. The loss of money can create a cash flow crunch and force the organization to reduce its spending. The actions may include eliminating staff or reducing the hours worked plus adjusting the services offered to clients. Besides reduced services, the nonprofit may experience negative publicity about the incident. The bad press can lead to a decrease in donations and the willingness of volunteers to work with the organization. Lastly, a financial loss can affect the reputations of the people involved. Often, the board dismisses an executive director if a large theft occurs on his or her "watch." Members of the board are questioned by family, friends, associates and others about the details of the incident and how could it happen to that organization. All of these factors make it imperative for every nonprofit organization to have the proper financial controls in place.

Categories of Risk

Fraud

Fraud, the intentional pervasion of the truth in order to induce another to part with something of value or to surrender a legal right, is the umbrella term for most financial losses. Fraud is the most common crime perpetrated against nonprofits. Theft is a generic term for the fraudulent taking of property. In insurance terms, theft means any act of stealing. Types of theft include:

- Burglary -- breaking and entering into a building for the purpose of committing a crime.
- Swindling -- convincing someone to give or entrust property to you using deceit or false pretenses

- Forgery -- the unauthorized making or altering of a writing so that it looks to be lawfully authorized
- Embezzlement -- taking property lawfully entrusted to you and converting it to your own use.

Someone inside or outside the organization can commit a fraud or theft of organizational assets or resources. An employee can embezzle funds, steal office supplies or merchandise, pad their expense accounts or create a fictitious company and bill the organization for services never rendered. An outsider can sell bogus merchandise, overcharge the organization for materials or services, or entice the organization to make bad investments. Imagination is the only limit to the ways to defraud an organization. Unfortunately, for every control or security system the organization implements, there is always someone smart enough to breach it. Catching wrongdoing before it translates to sizable losses is key. Therefore, in addition to establishing internal controls, nonprofits must be ever vigilant in monitoring its programs.

Investments

The size and types of investments will vary with each organization. For the smaller organizations, investments might be cash on hand while large hospitals, colleges and universities may have sizable endowment funds. Regardless of the size of the investment funds, every nonprofit needs to control and monitor its investments. Many organizations lost money in the savings and loan crisis when banks and lending institutions closed. Another danger is that the organization may make poor investment decisions such as the purchase of junk bonds by Orange County, California that resulted in its bankruptcy. The New Era scandal is another example of a bad investment decision.

Another potential financial risk for an organization is investing in "politically incorrect" companies. If the nonprofit purchased stocks or bonds in a company that subsequently comes under public and media scrutiny, it may experience adverse publicity or a significant decrease in the value of the investment. Every board should establish an investment policy that will guide the nonprofit in its investment and financial decisions. Even an organization operating on a cash current basis should have a policy.

Misuse of Funds

All nonprofits exist for a specific purpose with a defined mission. The board is responsible for ensuring that the organization stays focused on its mission. An excellent way to monitor an organization's progress is through its use of funds. Many nonprofits receive gifts or funding with restrictions or limitations on its use. The improper use of these funds can cause the funder to withdraw the money, require repayment of the expended funds, and refuse to provide future funding.

A similar risk is the use of funds for purposes other than serving the organization's mission. Funds inappropriately expended can lead to the loss of the organization's tax

exempt status or other legal actions. As pressures continue to mount for nonprofits to meet social needs, it is often easy to lose sight of the organization's mission.

Tax Liabilities
Although most nonprofits are "tax-exempt," the government still requires them to pay many taxes. An organization must pay the appropriate employment taxes such as Social Security, FICA, and state and federal income taxes. Failure to pay these taxes will lead to large fines.

A nonprofit may also be responsible for charging and remitting sales tax on items sold. Also, unrelated business income is becoming a significant concern as nonprofits seek creative ways to raise funds. Every nonprofit is responsible for knowing and paying its tax liabilities.

Tax-Exempt Status
The IRS's approval of tax-exempt status is not a right but a privilege that it can easily revoke. One possible challenge to the status is that the organization is not meeting the charitable purpose guideline. If the nonprofit uses its funds for reasons not related to its charitable purpose, it can lose its tax-exempt status.

Private inurement is another cause for losing the exemption. In one case, the IRS revoked the tax-exempt status for a child care center. The board, whose members were parents of the children in the center, set a fee structure substantially below market rates. The board made up the short-fall with tax-deductible "contributions." The IRS ruled that it was unlawful private inurement, revoked its exemption and is investigating prior years.

Nonprofits have restrictions on the types of "political" activities they can undertake. The IRS guidelines bar any direct or indirect political activity. Lobbying is another area with restrictions. An organization may, however:

- Communicate with its legislators as a constituent
- Petition the government
- Respond to governmental inquiries and testify before legislative and administrative bodies
- Offer nonpartisan analysis of an issue to educate the public.
- A nonprofit cannot devote a "substantial part" of its activities to lobbying.

Fundraising
The financial risks for fundraising are two-fold and extend beyond the theft of the money raised. First, an organization must protect itself from unscrupulous fundraising. Many organizations have discovered fictitious groups raising funds on their behalf. However, the organization never receives any of the money. An organization may also suffer losses stemming from injuries at a fundraising event staged by the fictitous group. Every

nonprofit must guard against improper use of its name and logo, especially in regard to fundraising. The organization should respond quickly whenever it discovers someone using its name and logo without authorization.

The second issue concerns the selection and use of sponsors and cause-related marketing partners. An organization may spend hours and many dollars to negotiate a sponsorship arrangement only to later discover a flaw with the new partner. Although it did not involve a nonprofit, the Kathie Lee Gifford controversy regarding the use of child labor had a negative impact on sales. Imagine if your organization had been a partner in that deal. The potential damage to an organization's reputation and goodwill could have a lasting impact. A nonprofit needs to evaluate carefully its sponsors and partners to avoid a press relations incident and other losses.

Physical Assets

When discussing financial risks, most of the attention focuses on the loss of money or funds. However, all nonprofits have physical assets at risk. Every organization owns office furniture and other fixtures and equipment used to meet its mission that are subject to loss. A fire or flood can damage or destroy the office contents. Also, an employee, volunteer, computer hacker or other person wanting to harm the organization can steal or damage its assets. In addition, some nonprofits may have warehouses of supplies whether it is a food bank, soup kitchen, sports organization or mentoring program. The loss of the supplies could have a devastating effect on the organization's mission.

The best protection is systems and procedures that limit the access to these assets. Computers contain not only a wealth of information but also confidential data. Control and limit access to the people with the "need to know." Also, protect the organization's supplies and merchandise. Although every employee "borrows" a pen or pad of paper, what about the merchandise (sweatshirts, briefcases, coffee mugs, books) that the organization sells to raise money? Many organizations lose money on merchandise sales due to the lack of inventory and access controls.

Risk Management Techniques

One key to controlling financial management risks is the development and use of effective internal controls. Every nonprofit needs policies and procedures to control the access and use of its financial resources. The techniques involve general management controls and accounting controls.

General Management Controls

General management controls consist of the board's and senior management's responsibilities for establishing the proper oversight of financial operations. The board should require clear and informative financial reports and statements on a regular basis. The organization, if possible, should use a certified public accountant and have an outside independent audit. If it cannot afford an audit, it should at least have an outside party review it financial reports and accounting records. A word of caution, an audit is

not designed to detect fraud. An audit's purpose is to affirm the organization's financial records and position.

The board should establish the appropriate financial polices such as investment and loan policies. Senior management and the board also must ensure that the proper financial and accounting procedures are in place. Lastly, the board and senior management should set the organization's priorities and goals, keeping the nonprofit focused on achieving its mission.

Accounting Controls

Accounting controls are the procedures used to safeguard the nonprofit's assets. Proper accounting controls also provide reliable and accurate financial records. Both of these goals enable the board and senior management to monitor the organization's financial operations.

The creation of adequate accounting controls should focus on four areas -- authority and approval, proper documentation, physical security, and early detection. Authority and approval procedures require the identification of who has the authority to perform and approve certain transactions, such as approving invoices, expense accounts, signing checks, and dispensing supplies. Proper documentation is a part of the approval and authority process, in that every financial transaction should leave a "paper trail." Physical security addresses limiting access to various physical assets (accounting records, personnel files, merchandise, supplies, and other equipment).

Organizations often ignore the early signs of wrongdoing. If the proper controls are in place, the systems should alert someone to possible fraud. Unfortunately, people tend to ignore the early warning signs and let the deceit continue. Everyone must follow the established procedures for the controls to work. Any deviation from the system will enable someone to defraud the organization successfully. Good risk management may prevent a financial loss or catch the culprit early in the process, thereby minimizing the loss.

What practices minimize the risk of employment-related claims?

Employment-related claims are one of the fastest growing sources of claims for organizations in both the public and private sectors. During fiscal year 1996, employees and applicants filed approximately 78,000 complaints with the Equal Employment Opportunity Commission (EEOC). This number does not include claims filed with state and local regulatory agencies, or lawsuits filed in courts across the country. In the nonprofit sector, employment-related matters represent the largest share of claims filed under Directors' and Officers' (D&O) Liability policies. Coregis, a large insurer of nonprofit D&O coverage, reports that employment-related allegations account for more than 75 percent of nonprofit claims. The Nonprofits' Insurance Alliance of California (NIAC), a liability insurance pool, reports that 87 percent of all claims filed under D&O policies allege wrongful employment actions, ranging from wrongful termination (60%) to sexual harassment (17%) and discrimination (10%). Unfortunately, due to the publicity of multi-million dollar awards and the continued pressure on organizations to do more with less, there is little hope that the trend will reverse.

Defining employment-related claims

An employment practices claim is an action arising from the employer-employee relationship where the employee believes the employer has wronged him or her. The employee's claim may be a tort action alleging personal injury to the employee (note: a tort is a private or civil wrong or injury other than a breach of contract for which the law provides damages), or a statutory claim alleging the violation of an employment law or regulation (such as the Age Discrimination In Employment Act Of 1967). The most common employment-related claims are:

Wrongful Termination or Discharge -- Wrongful discharge claims encompass any unfair or illegal dismissal. Such actions can include "whistle blower" claims (where an employer dismisses an employee for reporting the employer to a regulatory agency), retaliatory discharge (where an employer discharges an employee for exercising a statutory right), breach of contract (whether or not a formal employment contract exists), or breach of implied covenant of good faith and fair dealing (a subset of breach of contract).

Sexual Harassment -- According to the EEOC, unwelcome sexual advances, requests for sexual favors, and other verbal or physical conduct of a sexual nature constitutes sexual harassment when:

- submissions to such conduct are made either explicitly or implicitly a term of or condition of an individual's employment,
- submission or rejection of such conduct by an individual is used as the basis for employment decisions affecting the individual,

- such conduct has the purpose or effect of unreasonably interfering with an individual's work performance or creating an intimidating, hostile, or offensive work environment.

Discrimination -- Under Title VII of the Civil Rights Act of 1964, an employer acts in an illegal and discriminatory fashion when it:

- Fails or refuses to hire or discharges any individual, or otherwise discriminates against any individual with respect to his compensation, terms, conditions, or privileges of employment because of some protected characteristic such as race, color, religion, sex, national origin, age or disability.
- Limits, segregates, or classifies employees or applicants in any way which would deprive or tend to deprive any individual of employment opportunities or otherwise adversely affect his status as an employee because of some protected characteristic.

Failure to Employ or Promote -- Causes of action alleging employment-related decisions that are not performance-based. Such actions are closely related to charges of discrimination.

Breach of Employment Contract -- Usually a subset of wrongful discharge but claims may also involve other implied conditions of employment such as promises to provide a bonus or salary increase.

Wrongful Discipline -- Causes of action alleging that an employer disciplined an employee inappropriately, such as placing an employee on probation for an alleged infraction.

Failure to Grant Tenure -- Claims that the employer did not grant tenure for an incorrect or illegal reason.

Negligent Evaluation -- Claims alleging that an employee's evaluation was inaccurate or not completed and affected the terms and conditions of his or her employment.

Another category of employment claims arises from the administration of employee benefits. Any organization offering employee benefits must comply with detailed, complex, and stringent legal requirements. Benefits administration requires the use of utmost care and the avoidance of conflicts of interest including the appearance of a conflict. Claims may stem from actions made by the plan's administrators ("fiduciaries"). Such claims typically claim that the fiduciaries:

1. Made imprudent investments,

2. Incorrectly calculated benefit payments, or
3. Gave inaccurate advice to participants regarding eligibility and benefits.

Practices to Minimize Employment-Related Claims

The claims described above arise from the perception by prospective, current, or former employees that an organization acted illegally or failed to treat them fairly. Perception and reality overlap in the world of employment litigation. As a result, organizations can avoid many potential employment-related claims by striving for clarity and consistency in the administration of employment practices.

Every nonprofit should ground its personnel practices in legal, defensible practices. In addition, the foundation for all employment actions should be a strong commitment to treat employees fairly. The effectiveness of this approach is only as strong as the weakest link in the nonprofit. Therefore, it is crucial that all supervisors and managers be trained and coached in the implementation of the organization's employment practices. It is not enough to distribute a list or manual containing the organization's policies. Training sessions should discuss potential problem scenarios and concerns. Those who administer employment policies must feel free to seek additional assistance or clarification when they do not understand the reasons behind a particular policy or the manner in which they should implement the policies.

Tips for minimizing the likelihood of an employment-related claim include:

- Develop concise, written policies on employment matters
- Conduct training on sexual harassment
- Follow a carefully documented procedure and exercise special care when handling terminations
- Carefully document all employment-related actions
- Conduct thorough, candid annual performance reviews
- Promptly investigate all allegations of harassment or discrimination
- Seek the advice of counsel before taking action

The following explains these strategies:

Develop concise, written policies on employment matters
Clear, written policies on employment matters are a nonprofit's first and best defense against employment-related disputes. Carefully written and up-to-date employee policies provide a thorough explanation of the organization's rules as well as advance warning of procedures that will the organization will invoke under special circumstances. Documents that are especially important include:

Screening and interviewing policies -- these policies define and explain the process the nonprofit will use to screen and interview applicants. Of particular importance in any screening or selection process is consistency in the treatment of applicants. Provide an interview guide to all supervisors, who should also receive training in the proper way in which to interview candidates, including interview do's and don'ts.

Job descriptions -- a detailed job description is the appropriate starting point in a thorough screening process. High performing employees know what is expected of them from the moment they are first considered for a position. A job description may allay the fears of an applicant or employee with regard to the skills that the employer requires in order to perform satisfactorily. Job descriptions should include any educational, experiential, and physical requirements for the position.

Employment applications -- the nonprofit's employment application is an invaluable tool that it should use for paid staff and volunteer positions. Applications should include a statement signed by the applicant giving the nonprofit the right to verify any and all information included on the application. In addition, the applicant should give permission for the nonprofit to conduct appropriate background checks. The appropriate personnel should review the applications carefully and verify key information contained therein, including past positions held. Unfortunately, a significant percentage of job applicants lie about their education and experience. In light of this fact, the application should provide notice to the applicant that any material misrepresentation or omission subsequently discovered by the nonprofit may result in discharge of the employee.

Employee handbooks -- an effective handbook provides insight into the nonprofit's philosophy regarding the workplace, including its commitment to treat employees fairly and consistently. In addition, a handbook is the appropriate place in which to summarize employee benefits. A handbook tells an employee both what he or she can expect from the employer and what the employer expects from the employee. While most counsel agree that an employee handbook does not materially alter the "employment at will" doctrine, the courts require employers to live up to the commitments made in such documents.

Follow a carefully documented procedure and exercise special care when handling terminations

The degree to which a nonprofit follows the policies outlined in the handbook and other documents may affect the employees' perceptions of a nonprofit's practices. Therefore, it is crucially important that the organization review such materials regularly, update as needed, and follow closely. As discussed earlier, terminations are the basis for a significant percentage of employment-related claims. As a result, their handling deserves special attention. A nonprofit should follow the following strategies when handling employee terminations:

Respect the employee's privacy rights -- conduct the termination conference in a manner and location that will not exacerbate the employee's embarrassment. In addition, details about the reasons for the termination should be shared with only those who "need to know."

Be honest about the reasons for the termination -- many wrongful termination claims stem from an employee's assumptions about the reasons he was discharged. Never tell an employee that he is being "laid off" when you are in fact terminating the individual for poor performance. Being candid and honest may be the best way to avoid a claim.

Empower the employee to determine whether or not she will be terminated -- except in cases of gross misconduct, give employees the time and opportunity to adjust their performance, correct deficiencies, and meet your standards. One way to do this is by imposing a 30, 60 or 90 day "probation period" before terminating an employee.

Require the independent review of all terminations by a senior manager -- require a second review of all terminations, including documents prepared prior to the termination. Your legal counsel or a senior manager well-versed in employment matters should conduct the review.

Strive for consistency in all employment-related actions, including terminations -- before terminating any staff member, ask whether another similarly situated employee would have received the same treatment.

Carefully document the reasons for the termination and the use of any processes or discipline leading up to the termination, including a probation period, warnings, and work-related deficiencies.

With the exception of terminations for "gross misconduct" err on the side of giving an employee a chance to correct a problem.

Carefully document all employment-related actions

Prepare a written summary of any conferences with an employee on a performance matter and place it in the employee's personnel file. The summary should be signed by the supervisor and employee. Notices of progressive discipline, including probation, should always be in writing and included in the employee's file.

Conduct thorough, candid annual performance reviews Annual performance reviews are an invaluable tool. However, these reviews must be candid and honest or they increase, rather than minimize the likelihood of an employment-related claim. An employee who receives a "satisfactory" or higher rating whom the nonprofit

subsequently fires for poor performance will no doubt assume that impermissible considerations factored into the decision.

Promptly investigate all allegations of harassment or discrimination
Thorough investigations of allegations are critically important in minimizing the likelihood of a claim. Many plaintiffs in employment cases take their grievances to court when they feel that the organization has ignored their concerns or complaints.

Seek the advice of counsel before taking action
The advice of an employment law specialist is invaluable in minimizing the likelihood of a claim. If your current outside counsel (paid or pro bono) does not have experience in this area, it is well worth your time and effort to find someone who can assist you as matters arise.

Summary

A nonprofit can reduce the likelihood of an employment-related claim through effective management practices. The strategies and practices outlined in this document provide a starting point. Overall, employees that know and understand the rules and see that the organization adheres to its own policies are less likely to file claims.

Disaster Planning for Your Technology

Taming the technology beast can be a daunting prospect for many nonprofits, particularly when it comes to emergency preparedness. Taming that beast involves a detailed assessment of your organization's current processes and systems.

Dennis Bagley, manager, and Michael Harnish CPA, Associate, technology, consulting and solutions at Plante & Moran provided an assessment questionnaire during the American Institute of Certified Public Accountants' Not-For-Profit Financial Executive Forum. Scoring is on a basis of 0 to 5 with no being 0 and 1, sort of and 5 for yes.

1. Within the past 12 months, has your organization made a detailed assessment of all its computer applications and identified which ones are of top priority in supporting routine business operations?
2. Based on the results of study and analysis, do you know the estimated dollar losses your organization would suffer if it had a computer or network outage for a week, two weeks, a month?
3. Do you think the quality and completeness of your organization's documentation and operating instructions for information systems would enable otherwise qualified strangers to understand and operate your systems without undue delay, research and guesswork?
4. Does your organization back up computer tapes (or diskettes) off-premises, so that at least minor recovery operations might be performed?
5. When was the last time you inventoried your organization's computer backups to ensure that all needed files are being kept? (Be sure to consider your newer applications and changes to older ones)
6. Within the past 18 months, have you formally surveyed or interviewed key representatives from departments that use and rely on your computers or network to obtain their views on what kind of manual or semi-automated processing could be accomplished if all services were suddenly cut off for periods ranging up to one month?
7. Does your organization have an up-to-date, detailed, written set of procedures on what to do in an emergency and on exactly how recovery operations would go forward if your computer facilities were destroyed or made inaccessible?
8. Has your organization performed tests under simulated disaster conditions in order to help verify that its computer processing can be accomplished at an alternate computer site under whatever provisions your organization has for backup and recovery operations?

A score of 40 indicates a good state of emergency preparedness; 30-39 shows a need for additional attention in some areas. Consider strengthening your disaster recovery plan in areas of relative weakness; 20-29 indicates you are unprepared for potential difficulties that could have been foreseen and avoided. Address the indicated weaknesses in your recovery plan; 10-19 shows very spotty attention to a number of key areas. Significant difficulties and delays in data recovery can be expected. Prompt corrective action is advised; 1-9 shows little attention has been given to a disaster recovery plan. A system disaster is sure to be very costly. A task force should be chartered immediately to address the development of a plan; 0 – Indicates the need for divine intervention to preclude major dollar losses and delays should you experience a disaster

Nonprofit Times
http://www.nptimes.com/howtos/risk.html

Techsoup.org The Technology Place for Nonprofits

Disaster Planning and Recovery Toolkit

Resources to help you keep disasters from becoming disastrous

In the wake of a disaster — whether typical disk failure or catastrophic flood — it can be difficult to know where to begin the recovery process. With so many other pressing concerns, how should you prioritize IT recovery? What steps need to be taken immediately, and which can wait?

In this toolkit, you'll find resources to help you plan ahead so that you can limit the damage from a disaster; a comprehensive, downloadable guide to recovery; and information about tools to help keep your nonprofit's data safe should the unthinkable happen.

We have setup the toolkit into three sections — Plan, Mitigate, and Recover — so you can take a step-by-step approach to disaster planning and recovery.

Plan Your Response Early

In the planning phase, your organization should focus on documenting critical information necessary for recovery and developing procedures to help ensure an efficient and thorough recovery.

Backing Up Your Data
Regular backups are vital insurance against a data-loss catastrophe, yet many organizations learn this lesson the hard way. We'll show you tools and strategies for safeguarding your nonprofit's hard-to-replace information.

Keep Your Data Safe with Online Backup Services
Online backup services automate the uploading of selected files to a remote computer and offer the ability to restore files using your Internet connection. Find out what to consider when choosing a provider.

The No-Excuses Guide to Automated Online Backup
Still not sure about online backups? We'll walk you through the setup for EVault Small Business Edition to help you get a sense of how such a process works and provide additional tips for choosing provider.

Technology Planning for Civil Emergencies
Depending on the type of disaster and the availability of resources, your organization may find itself acting as a de facto emergency service assisting victims with first aid, transport, or counseling. Here, we show you ways to prepare your organization to deal with the unthinkable.

Virtual Community Topic: Do You Use an Automated Online Backup Service?
Find out which backup services other nonprofits recommend and ask your own questions.

Hardware Topic: How Long Do Backup Tapes Last?
TechSoup forum experts answer one reader's question about the durability of tapes and offer strategies to keep them running.

Mitigate the Possibility of Damage

Once you have a solid plan in place, the next step is to take steps to prevent disasters from occurring in the first place. Believe it or not, you have more control than you think, especially when it comes to internal disasters, like hardware failure.

Five Steps to Extending Your Computer's Life
Disasters aren't always caused by external forces. Just as you take your car in for scheduled tune-ups, so should you maintain your computers on a regular basis. We'll show you optimum protection and maintenance practices for keeping your computer healthy.

Recover with Confidence

Once you know how you've been impacted, it's time to begin the recovery process. Look to your plan to guide you. Additional assistance is provided in our Manual for Disaster Recovery, specifically designed for organizations without a plan in place or with lost plans.

Restoring IT Infrastructure: A Manual for Disaster Recovery (559 KB PDF)
This comprehensive document provides advice on getting technology systems working again in small- and medium-sized nonprofits where business continuity plans were not sufficient or did not exist. Included in this report are instructions on hardware recovery, restoring Internet connections, dealing with lost passwords, and a host of other information for your organization's recovery efforts. Download the accompanying Appendix Worksheets (41 KB XLS) for charts that will help you assess your IT infrastructure following a disaster.

http://www.techsoup.org/toolkits/disasterplan/index.cfm

Legal and Liability Issues for Nonprofit Organizations
Fiscal Management and Planning
Communities Learning Together

Risk Management

Insuring Volunteers

Given the millions of volunteers and the thousands of different roles they play, it is inevitable that on occasion, a volunteer will be injured while serving a nonprofit organization. Whether the nonprofit can be held liable for the injury is related to a number of factors that include:

- **Age of the volunteer**. If the volunteer is younger than 18 years of age, the organization generally assumes some responsibility for the welfare of the volunteer, unless a specific release of liability has been signed by the volunteer's parents, legal representative, or another organization. The execution of a legally enforceable release does not, however, preclude a suit by the minor or by the parent in the name of the minor.

- **Representations made to the volunteer when he or she was recruited**. Organizations should inform volunteers about any provision the organization has made for handling injuries. If the organization expects that volunteers will be responsible if they are injured while performing volunteer service, that expectation should be clearly conveyed to the volunteer from the outset. Many organizations require that volunteers sign an agreement that transfers to the volunteer responsibility for any injuries incurred in the course of a volunteer's duties. Such agreements must clearly and unambiguously explain the nature of the risks being assumed by the volunteer and will be closely scrutinized by the courts. Moreover, it is highly unlikely that responsibility for injuries relating to the gross negligence or intentional wrongdoing of the organization can be transferred to the volunteer by mutual agreement.

- **Degree of control exercised by the organization over the volunteer**. In a recent legal case involving a church group performing repairs to a summer camp, the court found that the camp was not responsible for injuries to a volunteer who was working on a bridge because the volunteer, not the camp, selected the specific project. Control of volunteers can be a two edged sword, however. While exercising little or no control over a volunteer may reduce the likelihood of a successful claim by a volunteer, it may actually increase the risk of a claim by a third party who is injured from the volunteer's actions.

- **Circumstances of the particular accident**. Underlying all action is the duty to act reasonably and prudently, a duty that is created as soon as some action is initiated. If an organization provides equipment, there is a duty to take

reasonable steps to provide equipment that is sound. In addition, there may well be duties to train the volunteer in how to use the equipment because misuse may be foreseeable. For example, if a volunteer was using a step-ladder belonging to the organization and the ladder cannot be extended to the last rung, or placed at too flat an angle, a volunteer without experience should receive instruction in its proper use.

- **If the volunteer was injured while volunteering for a project sponsored by his or her employer**. Corporate volunteerism is growing and the growth of these programs has been accompanied by increasing awareness of the need to clearly identify the relationship of the volunteer role to the individual's employment status. The more closely a corporate volunteer's activities are connected to his or her employment status, the more likely the employer will be held liable for the volunteer's injuries.

Insuring Volunteers Against Accidents or Injuries
There are two primary options that an organization should consider if it wants to insure volunteers against the possibility of physical harm incurred in the course of volunteer service on behalf of the organization: a volunteer accident-injury policy or workers' compensation coverage. Each of these options is discussed below.

Accident and Injury Policies. Accident and injury coverage for volunteers finances the cost of medical treatment for volunteers who are injured while delivering services for the organization. These policies usually pay the costs of emergency room services and follow-up treatment to pre-determined limits based upon the kind of injury. For example, a broken leg may have a limit of $2,500, while 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 for volunteers does not respond to illness nor does it protect the organization from liability for the injury.

One distinctive feature of an accident and injury policy is that it will pay a claim regardless of who is at fault. These policies are often excess insurance, meaning that they pay only after other available insurance - generally the volunteer's personal health insurance - is exhausted. If the volunteer is uninsured, the accident and injury policy would "drop down" and become primary coverage for the injury.

Workers' Compensation (WC). Some states permit the inclusion of volunteers in a nonprofit's workers' compensation program. On the surface, this appears to be an easy answer to the dilemma of providing a source of recovery for injured volunteers. Organizations are required to carry this coverage for their employees and it may be administratively less cumbersome to simply add volunteers to an existing policy.

WC policies may not, however, be the most effective way for a nonprofit to protect its volunteers. WC for employees include a number of benefits for which volunteers would not be eligible - reimbursement for lost wages, for example. In addition, WC premiums are based on the type of work performed and not the amount of time spent on the job. For example, the cost of insuring a patrol officer may be comparable to the cost of insuring a part-time police department volunteer who patrols a community as part of a crime deterrence effort. In addition, actual losses under workers' compensation policies can dramatically affect future premiums. With a large volunteer workforce, accidents may occur and drive up per-person costs to a substantial degree.

Volunteer Protection Act

The Volunteer Protection Act of 1997, signed into law on June 18, 1997, was created to "provide certain protections to volunteers, nonprofit organizations and governmental entities in lawsuits based on the activities of volunteers." The timing of the bill coincided with former President Clinton's Summit for America's Future calling for all Americans to get involved in community services and was aimed at removing potential volunteers' fear of liability.

The Act provides liability protection for volunteers under the following conditions:

- The volunteer was acting within the scope of the volunteer's responsibilities in the nonprofit organization or governmental entity at the time of the act or omission.

- If appropriate or required, the volunteer was properly licensed, certified or authorized by the appropriate authorities for the activities or practice in the State in which the harm occurred, where the activities were or practice was undertaken within the scope of the volunteer's responsibilities in the nonprofit organization or governmental entity.

- The harm was caused by willful or criminal misconduct, gross negligence, reckless misconduct, or a conscious, flagrant indifference to the rights or safety of the individual harmed by the volunteer.
- The Act does not affect the "liability of any nonprofit or governmental entity with respect to harm caused to any person," nor does it affect a nonprofit's taking civil action against any volunteer or the nonprofit. For more information, see U.S. Public Law No: 105-19.

Questions to Ask About Insurance

1. What kind of liability insurance does your organization carry? Under what conditions is it valid?

What situations does it cover?

2. What health and accident insurance does the organization carry? Is it primary or supplementary insurance?

3. What insurance are volunteers expected to have?

4. What insurance is in effect for rental vehicles if rented by professionals or volunteers?
5. Do certain activities (food sales, animal events) require notification or special event insurance?

Policies and Procedures

Sample Policies and Procedures for Volunteers

1. Names of agency clients and donors are to be held in strict confidence by both volunteers and staff. Inappropriate use of confidential materials is sufficient grounds for termination of both salaried and volunteer staff.

2. Client records are not to be reviewed by volunteers except with permission of the Executive Director.

3. On-going training meetings are part of the volunteer job. Attendance is required unless the Director of Volunteers excuses the volunteer.

4. When volunteers are going to be absent from their assignment, they should call the Director of Volunteers and/or their supervisor at least 24 hours in advance (except in emergencies).

5. The Director of Volunteers is the liaison between the volunteers and the agency. Volunteers should bring any problems, concerns, or suggestions to the Director of Volunteers and should let them know if they would like a change in assignment.

6. Volunteers are required to sign in and out when they work in the office. Volunteers who do not report to the office are required to turn in their hours monthly to the Director of Volunteers.

7. The Director of Volunteers will formally evaluate volunteer performance with input from other staff every six months. Volunteers will also be asked to evaluate their own performance at that time.

Volunteers will be asked for an evaluation of the volunteer program periodically and upon leaving the program. Comments and suggestions are welcome at other times as well.

Volunteer Records

Keeping accurate records is a way of keeping track of your program. Provide volunteers with a way of reporting their hours to you: a sign-in sheet, a monthly form for those who do their work away from the office, a phone-in system, or whatever works best for your organization.

A personal record for each volunteer is also important. You can keep a file on each volunteer listing length of service, changes in assignments, etc. A file folder with an application form and periodic performance evaluations can be an important record for writing references, which volunteers may ask for in the future. This entire record keeping is an important administrative aspect of the volunteer program manager's job. Some items to include in each volunteer's record include:

1. Volunteer hours

    a. Report form or sign-in sheet for each volunteer

    b. Monthly composite report of all volunteer hours

2. Volunteer Application Form

3. Individual file for each volunteer

    a. Information Form

    b. Periodic evaluations

    c. Exit interview write-up

    d. Final evaluation by the volunteer

Keeping volunteer records is also important to the organization because it helps to substantiate your organization's work. Following are some "why" and "how's" when it comes to using volunteer records:

- The number of hours served by volunteers may offer substantiation for the organization when seeking additional funds and documentation for the need for allocation of additional paid positions.

- Volunteer hours offer another means of evaluating the volunteer service: e.g., dependability, consistent performance of service, accountability, etc.

- Asking a volunteer to be responsible for reporting the number of hours served, and expecting them to do it, tells the volunteer that their work and position is important to the organization.

- Statistics provide decision makers with the necessary information to justify the program and evaluate the service. Cost/benefit figures go a long way in influencing decision makers who are preparing to allocate funds.

- As the volunteer program grows and the organization benefits from increased volunteer services, budgets for administration costs must also be increased. Only with a good reporting and recording system can the request be justified.

SAMPLE VOLUNTEER APPLICATION

Name_____

Address_____

Telephone Home _____ Best time to call _____
Work _____ Best time to call _____
Email address_____

Highest educational level: _____Degree_____

Special Training: _____

Interests or Hobbies: _____

Other organizations where you are/were a volunteer: _____
_____

Availability:
Weekday_____ Weeknights____ Weekends____ Seasonal____ By Appointment____

Would you prefer to work with Youth ____ Adults ____ Both_____

If you prefer to work with youth, what age level do you prefer? (Check all that apply)
( ) 5 to 8 ( ) 9 to 12 ( ) 13 to 15 ( ) 16 and over

References:
Please list three persons not related to you who have knowledge of your qualifications.

1. Name _____ Relationship _____

   Address_____

   Phone_____

2. Name _____ Relationship _____

   Address_____

   Phone_____

Signed_____ **Date**_____