IDENTIFYING AND MANAGING RISK

One of the board’s primary responsibilities is to identify and manage risk, working to use it as a strategic advantage rather than an impediment to achieving its mission. However, risk management is a complex topic — one that many boards do not fully understand. This resource is designed to help. To effectively fulfill their oversight responsibilities and govern a successful organization, boards must develop comprehensive plans and policies that protect its assets, recognizing the challenges and opportunities risk presents.

WHAT IS RISK MANAGEMENT?

Most commonly, risk management policies are thought of as a way to safeguard an organization’s assets and ensure compliance with legal regulations. While those aspects are vital, strong policies go beyond the basics, protecting people — staff and the community served — an organization’s reputation, and its future.

Creating and periodically reviewing those policies that relate to risk provides organizational leaders with the opportunity to identify and analyze the organization’s capacity for risk, which changes over time due to external factors and organizational growth. By doing so, they are better prepared to withstand unexpected setbacks and take advantage of opportunities.

HOW SHOULD NONPROFITS DEVELOP RISK MANAGEMENT POLICIES?

The board must take the lead in developing an organization’s risk management policies, but it should not do so alone. The chief executive and pertinent staff members can assist the board by providing insight about operations and any internal rules currently in place.

Comprehensive Approach
Thoughtful development of risk management policies is a lengthy process. Board and staff leadership must be prepared to undertake a complete evaluation of organizational processes while educating themselves about their individual responsibilities.
An important aspect of establishing risk management policies is that it raises awareness among leadership about different types of risk and how to remain vigilant as the organization grows. Providing key personnel with foundational knowledge about identifying and managing risk lays the groundwork for strong governance for years to come.

**Context**
When developing new risk management guidelines, board and staff leadership should review sample policies while considering their organization’s unique operating environment and any relevant external factors. Items to discuss may include the following:

- Current economic climate, specifically as it relates to the organization’s mission
- Lifecycle stage of the organization and whether it encourages increased or minimal risk
- Community served and/or staff roles (e.g., an organization operating within a war zone needs to spend a considerable amount of time analyzing staff risk)

Overall, the organization must decide how it wants to approach risk — Does it want to operate from a risk-tolerant or risk-averse standpoint (or somewhere along the spectrum)? There are benefits and challenges to each option. One individual’s preference — for example, the chief executive or board chair — should never govern an organization’s risk management. The approach must be well thought out and mutually agreed-upon by board and staff.

**Mission Fulfillment**
Oftentimes, nonprofits fail to consider their mission when evaluating risk. Attempting to eliminate risk altogether — while being almost impossible — may prohibit the organization from effectively serving its community. A nonprofit that incurs no risk may be less legally volatile, but that will hardly matter if it is unable to make sustainable progress toward achieving its goals.

Organizational priorities and initiatives associated with the mission may also factor into decision-making. If the board is focused on expanding the organization’s services, for example, it will almost certainly need to consider defining the acceptable risk associated with that expansion. And doing so may provide opportunities for increased growth that were not previously attainable.

**WHAT SHOULD BE INCLUDED IN YOUR RISK MANAGEMENT POLICIES?**

Risk management policies are not one-size fits all. One organization’s risk management policies should look different than another’s policies. However, to get started, most organizations should consider certain elements common to most policies.
Risk management policies generally address a combination of key risk factors:

**Financial**
- Insurance Coverage

**Legal**
- **Do we really need D&O insurance?**
  Even if a nonprofit has general liability insurance, D&O insurance is still important. Typically, D&O policies provide defense and indemnification for a nonprofit’s directors and officers. They serve as an extension of a general policy, protecting against employment-related claims and employment practices liabilities. However, since all policies are different, it is important to check the specific language before moving forward.

**Human resources**
- directors’ and officers’ insurance (D&O)
- commercial property
- employee dishonesty
- general liability
- workers’ compensation

**Reputational**

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**Insurance Coverage**
Insurance coverage is often the first thing many boards address when establishing their risk management policies and requires careful consideration. Nonprofits should explore many types of insurance, including:
- directors’ and officers’ insurance (D&O)
- commercial property
- employee dishonesty
- general liability
- workers’ compensation

When reviewing options, board members must read proposals carefully, paying as much attention to what is not included in a policy as what is. Additionally, all board members, as well as the chief executive, should fully understand the policy before purchase. Ask that the answers to your questions be submitted in writing and require the insurance agent to provide a Schedule of Insurance — an itemized listing of policies, limits, deductibles, expiration dates, key policy features and exclusions, annual premium, and carrier.

**Categories of risk:**
- **Financial**
- **Legal**
- **Human resources**
- **Reputational**

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**“What if” scenario planning**
No matter how far off the worst-case scenario may seem, nonprofits should always be prepared. The board should consider factors that are partially outside its control (e.g., an economic downturn, an opportunity for a merger, etc.) and create three or four scenarios outlining possible outcomes/implications, paths forward, and precipitating dynamics that could point to each solution. This exercise can help the board analyze its current operations and be better prepared to take advantage of promising future opportunities.

**Category of risk:**
- **Financial**
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**Business continuity plan**
Contrary to scenario or disaster planning, continuity plans do not focus on specific risks that may impact an organization (e.g., natural disasters, cyber-attack, etc.). Instead, they provide a more comprehensive analysis of critical operations and organizational processes that can be referred to for ensuring a nonprofit’s continued functioning in almost any event.

**Category of risk:**
- **Financial**
- **Legal**
Investment portfolio and policies
Even if an organization hires an external advisor to help manage its investments, the full responsibility for supervision of the portfolio still rests with the board. Hiring an advisor is preferable to the board managing the investments as long as the board sets goals and defines the risks it is willing to take to achieve them. Additionally, even after hiring an advisor, the board must ensure policies are in place to provide for a regular review of the investments.

Category of risk: 📈

Reserve balances
There is no one-size-fits-all answer for the optimal level of nonprofits’ operating reserves. The board must work with the chief executive and organizational staff to determine the correct level of reserves given its work and programs, the current economic climate, and any other pertinent factors. All nonprofits should have some buffer against unforeseen financial crises, but it falls to individual organizations to decide exactly how much.

Category of risk: 📈

Concentrations of revenue
Over-reliance on one (or even a few) sources of funding can be detrimental to any organization. The Measuring Fundraising Effectiveness framework identifies a “Dependency Quotient,” the extent to which an organization is dependent on its top donors to fund its work, as a measure of risk. It recommends that organizations seek to lower their Dependency Quotients to increase their resilience to changes in top donor giving.

Category of risk: 📈

Intellectual property
This can often be forgotten when boards are establishing risk management policies, but failing to protect intellectual property can weaken an organization’s reputation and make it difficult to achieve its mission. Intellectual property can include products, processes, names or symbols, and even trade secrets. Nonprofits should consult an attorney to be sure that they have identified all possible forms of intellectual property and have filed for protection under U.S. patent, trademark, and/or copyright laws.

Category of risk: 📈 ⚠️
Identifying and Managing Risk

Cyber security
In an increasingly digital world, cyber security has taken on an added importance for nonprofits. Many organizations deal with sensitive information that, if exposed, could threaten their reputation and expose their members to potentially illegal activity. Nonprofits should ensure that they are investing sufficiently in technology and are protected against cyber-attacks.

Category of risk: 🗡️...

Legal and regulatory compliance
As fiduciaries for nonprofits, board members are responsible for monitoring assets and resources while ensuring legal compliance. Board members must be objective, putting the organization's needs above their own, and should not engage in unnecessary risk. Additionally, board members must remain informed about all pertinent organizational activities and regulations. They cannot claim ignorance if charged with mismanagement — as fiduciaries, it is their job to stay informed.

Category of risk: 🕵️️...

Human capital
The chief executive is ultimately responsible for hiring and managing all staff; however, the board should still provide general oversight, keeping an eye out for potential red flags. Managing human capital is a collaborative effort aimed at hiring effectively, retaining high-performing staff, and developing team members to grow along with the organization. The board and chief executive must stay vigilant to prevent fraud, encourage ethical behavior, and abide by all regulatory requirements.

Category of risk: 🔍

Chief executive succession
All nonprofits should have an emergency leadership transition plan as well as a planned chief executive succession plan. Leadership transitions automatically put an organization in the spotlight within the community, so ensuring that proper protocols are in place can strengthen constituents' trust in its operations. Additionally, preexisting policies can help the board feel confident in following a defined roadmap and conducting a careful, thoughtful search that results in hiring the right person for the job.

Category of risk: 🔍...

BoardSource
Collaboration and partnerships
All nonprofit leaders should be focused on strengthening their organization and achieving its mission. However, this does not mean that all organizations must work alone. Oftentimes, strategic partnerships can benefit everyone involved — as well as the community served — as long as potential risks are analyzed. Collaborations that disproportionately benefit one organization, or that carry excessive financial or operational risks, should be carefully considered or negotiated until the board feels comfortable moving forward.

Category of risk: 📊 🤖

Resources:


