

What is the Board of Director's Role in Managing Risk?

Fiduciary Responsibility of Nonprofit Board of Directors

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.

2. 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.

3. 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?

4. 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.

5. 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.

Where to go for additional information

Guidebook for Directors of Nonprofit Corporations, published by the American Bar Association, Nonprofit Risk Management Center, Washington, 1993.

Healthy Nonprofits: Conserving Scarce Resources Through Effective Internal Controls, Nonprofit Risk Management Center, Washington, 1996.

The Board's Role in Risk Management: More Than Buying Insurance, Tremper, Charles and Babcock, George, published by National Center for Nonprofit Boards, Washington, 1994.

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*The Alliance (2002), What is the Board of Director's Role in Managing Risk? [On-line]
<http://www.allianceonline.org/faqs.html>*