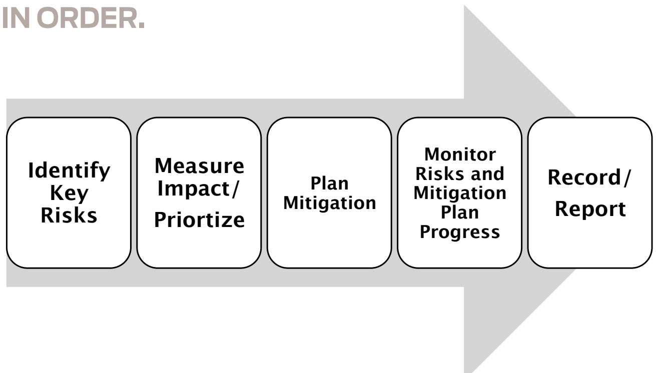
Risks Get Riskier for Nonprofits: ERM Can Help

Follow these five steps to protect against damage and loss.

By Donna Galer & Al Decker

Risk can create loss or opportunity. Many articles in *Nonprofit World* have urged you to take risks to create positive change. This article will focus on risks that create loss or damage. You must manage these risks to ensure your organization's sustainability.

TO ADDRESS RISKS, TAKE THESE FIVE STEPS IN ORDER.



Enterprise Risk Management (ERM) is a process you can use to address situations that may put your organization at risk. It consists of a series of linear steps:

1. Identify key risks.

Begin by choosing a team of people from your board and executive staff to lead the risk-management process. Then, together with this team, take the following actions:

Review your mission, goals, values, and overall strategy. These are the foundation of your organization, so you'll want to focus most urgently on any risk to them.

List broad areas of potential risk that you'll want to explore. A typical short list would include the following categories:

- financial risks (funding, investing, fraud, reporting)
- legal risks (potential lawsuits, licensing)
- regulatory risks (tax codes and laws governing human resources, safety, the environment)
- operational risks (performance, property)
- technological risks (systems, cyber security, digitization, on-line competition)
- strategic risks (changing client demographics, preferences, and needs as well as broad societal trends that may require a shift in strategy).

"You may decide to accept the risk."

Look at the risks that are common to all nonprofits. Examples include donor fatigue, staff burnout, trouble keeping up with changing technology, and dwindling support from funders. Reach out to the United Way, government agencies, and other nonprofits to see what risks they're experiencing.

Consider risks that are unique to your nonprofit. For example, a competing organization may have entered the arena, a key staffer may be leaving unexpectedly, or a once-popular fundraising event may have run its course, requiring you to seek new sources of income.

Don't ignore risks that are hard to quantify, such as reputation risk. What may seem like a small problem can mushroom if you don't get ahead of it in public. Losing your reputation or the public's trust can be disastrous and has led to the closing of quite a few nonprofits that didn't address the risk quickly enough.

2. Measure & prioritize risks.

Once you've identified the risks facing your organization, ask yourself: Which are the most pressing? Which can cause the greatest damage? Which may get worse if you don't act quickly?

Based on your answers to those questions, list the risks from greatest to least priority. Then do your best to quantify each one. Could the risk affect revenues by 5%, 20%, or 60%? Could the risk make it four, five, or six times harder to attract volunteers? Could it mean a 10%, 15%, or 20% increase in expenses? Quantifying risks in this way will help you decide how much effort you should expend to address each one.

3. Manage the risks you've pinpointed.

Starting with your highest-priority risk, brainstorm ways to deal with each one. There are several ways to manage a risk:

You can transfer the risk to someone else willing to accept it. That's usually done through insurance. Examples: Volunteer insurance manages the accident risks associated with volunteers' work for your organization. Directors' & Officers' (D&O) insurance protects against lawsuits directed at your board. Employment Practices Liability (EPL) insurance guards against employment-related lawsuits such as employees suing for wrongful termination, discrimination, failure to promote, harsh discipline, retaliation, and sexual harassment.

You can control the risk by taking action to minimize its impact.

You can accept the risk. You may acknowledge the existence of a risk and decide to accept it without taking any special effort to control it.

You can avoid the risk. It's far less costly to avoid a risk in the first place than to mitigate it later. A few examples of good risk-avoidance strategies:

- Have good policies. One of your greatest risks is being sued by an employee or former employee. So you need strong human resource policies, including policies forbidding discrimination, sexual harassment, and the like. And it's not enough to have good policies. You need to ask all employees to sign acknowledgments that they understand the policies. Don't do this just at orientation; reinforce your policies frequently.
- Do thorough background checks. You need to screen every potential employee, including volunteers, even if you know the person. Never make exceptions to this rule.
- Be sure you have solid cybersecurity protection and a plan for how to respond if there's a data breach. And, of course, always back up your data.
- Protect your finances by having strong internal controls, a fraud-prevention plan, and a yearly audit.
- Develop a crisis plan so you can leap into action immediately if a disaster occurs. Brainstorm all the possible catastrophes that might befall your organization – not just natural disasters like floods but situations like the death of your CEO, a sudden downturn in the economy, the loss of your major funding source, a criminal act by an employee, and so on. Appoint someone to be your spokesperson with the media if the disaster is reputation-related.
- Provide ongoing training at all levels to educate staff and board members about their legal rights and responsibilities.

> "Of all your legal risks, the most likely is a lawsuit by an employee or former employee."

> "We live in a time of hyper risk."

As part of addressing your risks, develop a risk-management plan. To create your plan, look at each risk and consider the possible ramifications of various responses. Suppose, for example, that you lose government funding for one of your programs. Ask yourself questions such as these:

- Is the program truly needed, or has its time run out? Does it deserve more resources, or would it be better to eliminate it and move on? If it's time to abandon it, what might you develop in its place?
- If it's imperative to continue the program, how will you fund it? What other sources of income can you pursue? Should you start charging service fees to clients? How can you let the public know your need for more support?
- How can you gain feedback from stakeholders to glean their attitudes about how best to manage the risk?

YOU NEED A STRUCTURE FOR MITIGATING POTENTIAL RISKS.

4. Put your plan into action, and monitor it.

Keep an eye on how things are going. Keep scanning the environment for changes that may affect the risk's impact. Be ready to alter your course if conditions change or if the risk itself diminishes or increases. Periodically revisit your plan to be sure it's on track and that the basic assumptions behind it are still valid.

5. Make a record of the outcomes.

Report results to your board and other stakeholders. Keep all your risk information in a risk register. This register will be the one place to find a synopsis of the state of risk for your organization. Below is a sample format of a simple risk register.

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ALWAYS CREATE A RISK REGISTER SUCH AS THIS:

Risk Summary	Impact/ Priority	Risk Owner	Mitigation Plan Summary	Status of Mitigation Plan
Probably new property tax on nonprofit owned properties	$15,000 p/yr	Board & CFO	Advocacy with other nonprofits, expense reductions	Coalition lobbying begun – task force assigned to find expense reductions

Nonprofits have always faced risks. What has changed is the increased number of risks, their magnitude, and their increased speed of onset. The world isn't the same as it was 15 years ago. We now live in a time of hyper risk. Nonprofits that take risk seriously and deal with it professionally have a much better chance of prospering.

Many Risks, Many Responses

Get a handle on your organization's potential risks with articles such as these at NonprofitWorld.org:

Can Your Organization Afford to Lose $100,000? Safeguards Every Nonprofit Needs to Implement (Vol. 30, No. 3)

Avoid Catastrophe by Addressing Cyber Risk (Vol. 33, No. 3)

Use Background Checks to Avoid Legal Pitfalls (Vol. 29, No. 1)

Do You Need D&O/EPL Insurance? (Vol. 27, No. 3)

Volunteer Screening: Changing Trends in Changing Times (Vol. 34, No. 2)

Avoid an Unwanted Auditor's Letter (Vol. 33, No. 3)

How to Write Effective Anti-Bias Policies (Vol. 30, No. 4)

Reduce Your Risk of Occupational Crime (Vol. 32, No. 3)

Six Steps to Good-Reputation Insurance (Vol. 15, No. 1)

Avoid the Selfish Factor: Plan for Succession with Four Simple Rules (Vol. 36, No. 2)

Setting Up a Control System for Your Organization (Vol. 16, No. 3)

From Government Funds to Income Diversity: A Map For The Quest (Vol. 35, No. 4)

Protect Your Resources from Insider Theft (Vol. 20, No. 4)

Don't Go it Alone in a Crisis (Vol. 37, No. 2)

Protecting against Fraud (Vol. 31, No. 5)

The Most Likely Lawsuits–and How to Protect Yourself (Vol. 19, No. 1)

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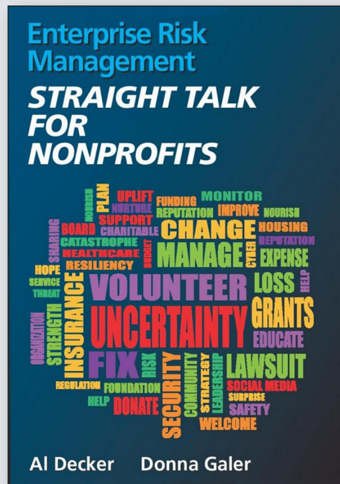
Black Swans, Gray Swans

In the engaging and useful *Enterprise Risk Management: Straight Talk for Nonprofits* (https://www.amazon.com/dp/0578478137), Al Decker and Donna Galer describe how to address the many risks that face your organization. We're all familiar with black swans – improbable, devastating events that no one saw coming. But nonprofits are far more susceptible to gray swans – events that are predictable and preventable. Gray swans have all the devastating effects of black swans, but they're not unexpected, so it's just a matter of taking the time to do something about them before everything falls apart. Examples of gray swans and tactics that will mitigate the risks:



You lose the support of a key funder. ***Prevention Tactic:*** Be sure you have many different sources of funding so you aren't dependent on any one source.

The CEO or other key staffer gets sick, resigns, or dies unexpectedly. ***Prevention Tactic:*** Have a clear, written succession plan. Rotate jobs so everyone has an idea of how to perform roles other than their own.

A trusted staff member has been embezzling for years, putting your organization in financial jeopardy. ***Prevention Tactic:*** Put a good control system in place. Segregate duties by separating the financial functions of custody, authorization, and recordkeeping.

A blog post unfavorable to your organization goes viral. ***Prevention Tactic:*** Designate and train someone in your organization to be your media representative. When bad press occurs, funnel all responses through that person so you'll have a consistent, well-orchestrated response.