Risk Management for Non-Profits

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RISK MANAGEMENT FOR NON-PROFITS

I. Introduction

A. What is risk management?
   1. Why should non-profits care about risk management?

B. Topics
   1. What is risk management
   2. Types of risk management
   3. How to assess risk
   4. Board, director, staff, and volunteer liability
   5. Organizational risk management
   6. Sarbanes-Oxley for non-profits
   7. Conflict of interest
   8. Intermediate sanctions
   9. Conclusion

C. Sample policies and forms

II. What is Risk Management?

A. Minimizing threats to your organization

B. Anticipating threats (SWOT analysis)

C. Protection against lawsuits/bad media

D. Improving the operations of your organization

E. Saving money

F. Planning

III. Types of Risk Management

A. Government Mandated Risk Management

B. Voluntary
   1. Ethics
   2. Organizational operations
   3. Finances
   4. Governance
   5. Annual audit
   6. Stakeholder analysis

C. Government Mandated
   1. Federal
      a. 990 and IRS reporting
      b. Intermediate Sanctions
   2. State
      a. Fund raising registration with the Attorney General
      b. Annual report to the Annual General
      c. Annual Registration with the Secretary of State

D. Non-Government
   1. Business plans
   2. Strategic and annual planning and review

IV. How to do Risk Management Assessments

A. Four areas
   1. Governance and board activities
   2. Staff-volunteer
   3. Operations
   4. Relations with the public

B. Classify level of risks

C. Prioritize

D. Identify strategies

E. Development and implement plan and time horizon

F. Development assessment tool

G. Other risk management assessments
   1. Mission, relationships, and personal integrity test
   2. Mixing bowl analysis (mission analysis)

V. Board, director, staff, and volunteer liability

A. Board of directors
   1. Duties
      a. fiduciary
      b. loyalty
      c. care
      d. obedience
   2. Standard of conduct
      a. Minn Stat. 317A 251
      b. What is the business judgment rule?
      c. *Janssen v. Best & Flanagan*
         (1) Rule gives deference to corporate directors to make good decisions
   3. Immunity for noncompensated directors, officers, agents, and volunteers *Garry M. Rehn v. Barbard Fischley*, 557 N.W.2d 328(1997) (board immunity if not compensated)
      a. Minn Stat. 317A 257

B. Indemnification
   1. Minn Stat. 317A 521.
      a. Mandatory indemnification for official actions for errors and omissions if acted in good faith and did not take improper personal benefits
   2. Optional indemnification also possible
   3. Could the non-profit indemnify its board for acting negligently? See Minn Stat. 317A 161. subd.21. Could it? What if a board member steals or

commits a crime?

4. If a board member does not prepare for a meeting or does not read material given to her, what has she done wrong? See Minn Stat. 317A 241.
5. You think your non-profit is not acting properly but under pressure at a board meeting, you abstain in a vote. Later you are sued. Are you culpable? Legally or morally? See Minn Stat. 317A 241.

C. Insurance
  1. Who should be insured?

VI. Organizational Risk Management

A. Office Procedures
  1. Money and Signature Authority
  2. HIPPA
  3. Confidentiality issues
  4. Access to records and documents
  5. Orientations

B. Records Management
  1. What records should be protected?
     a. Types of records
        (1) employees
        (2) clients
        (3) board minutes and policies
        (4) financial information
        (5) fund raising records
        (6) medical records
  2. How long should records be protected?
  3. Why should they be protected?
  4. Who is responsible to protect records?
  5. How and where should the records be protected?
     a. On v. off site
     b. Electronic v. hard copy
     c. Backup procedures

VII. Sarbanes-Oxley (SOX) for Non-profits

A. Context of SOX
  1. Enron, Worldcom, and other dot.coms
  2. Lying about debts and accounting
     a. Falsifying reports
     b. Document destruction
     c. Mark to marketing accounting
     d. Phony outside companies
     e. Close relationship with Auditor/Anderson Consulting
        (1) violation of generally accepted accounting practices
     f. Passive board that was not independent

g. CEO lying or passive acquiescence of what is happening with company
h. Dennis Kosalowski toga parties
i. Sarbanes-Oxley Act of 2002

B. Overview of SOX
1. Revitalization of Audit committee
   a. Audit committee has new power to examine the company
   b. Must have disinterested directors (no fees for working for the company besides serving as director)
2. Written code of ethics (have one or explain why not)
3. Certification of statements
   a. The CEO and CFO of each issuer shall prepare a statement to accompany the audit report to certify the "appropriateness of the financial statements and disclosures contained in the periodic report, and that those financial statements and disclosures fairly present, in all material respects, the operations and financial condition of the issuer." A violation of this section must be knowing and intentional to give rise to liability.
4. Stock sales
   a. Prohibits the purchase or sale of stock by officers and directors and other insiders during blackout periods. Any profits resulting from sales in violation of this section "shall inure to and be recoverable by the issuer." If the issuer fails to bring suit or prosecute diligently, a suit to recover such profit may be instituted by "the owner of any security of the issuer."
5. Off-Balance proceedings
   a. Each annual and quarterly financial report . . . shall disclose all material off-balance sheet transactions" and "other relationships" with "unconsolidated entities" that may have a material current or future effect on the financial condition of the issuer.
6. Prohibition of personal loans to executives
   a. National security exchanges must adopt conflict of interest rules
7. Sale on non-audit services
   a. Prohibits auditors from offering certain non-audit services to audit clients. These services include: bookkeeping, information systems design and implementation, appraisals or valuation services, actuarial services, internal audits, management and human resources services, broker/dealer and investment banking services, legal or expert services unrelated to audit services and other services the board determines by rule to be impermissible. Other nonaudit services not banned are allowed if preapproved by the audit committee.
8. Rotation of auditors
   a. The lead audit partner and audit review partner must be rotated every five years on public company engagements.

9. Whistleblowers
    a. New protections for whistleblowers

C. Regulation of the Accounting Profession
    1. Public Company Accounting Oversight Board
    2. Creation of a new Five person Board to over see the Accounting Profession (CPAs) and create standards for accounting practices
    3. Conflict of Interest:
        a. Officers cannot have been employed by the company's audit firm during the 1-year period preceding the audit.

D. Criticism of SOX
    1. Section 404 internal controls too costly to implement
    2. Is the cost worth the risk of fraud reduction?
        a. Companies of value of $700 M or more the average cost of compliance is $8.5 M.
        b. Costs of 404 expected to fall by 40% this year as it is implemented
    3. Have accounting firms taken advantage of SOX to push for most extreme reforms?
    4. Hurts small businesses
        a. Too costly
        b. Hurts access to services if paying for audit

E. Sarbanes-Oxley for Non-Profits
    1. Two provisions currently apply to non-profits
        a. Document retention policy and destruction
        b. Whistleblower protections

F. How to Apply SOX to non-profits
    1. Non-profit knowledge of SOX
    2. SOX as future of best practices
    3. What should apply?
        a. Peggy Jackson and Toni Fogarty *Sarbanes Oxley for Non-Profits*

G. SOX and Small Non-profits
    1. Whistleblower and document retention apply
    2. Drafting brief policies
    3. Intern instead of audit committee
    4. Financial training for board
    5. Conflict of interest policy
    6. Code of ethics
    7. Board policies and procedures

H. Other Non-Profit Reforms
    1. California Reforms

VIII. Conflict of Interest

A. What is a conflict of interest?
    1. Personal interest conflicts with professional duties
    2. Abuse of position

3. Abuse of information
4. Special privileges
5. Conflicting loyalties

B. Procedures to address?

1. Bylaws should include a conflict of interest provision (MINN. STAT. 317.A.255)

C. Bylaws must be fair and reasonable *Brennan v. Minneapolis Society for the Blind, Inc.*, 282 N.W. 2d 515 (Minn. 1979).

D. Conflict of interest occurs when:

a. director or family member has transactions with corporation
b. Procedure
(1) full disclosure and 2.3s vote of members or majority of board

E. Sample policies

1. Attorney General's policies
2. Instructions for completing IRS Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code, Appendix A contains a sample conflict of interest policy.

IX. Intermediate Sanctions

A. 2 1.162-7 6 CFR

B. Special tax on excess benefit transactions to a disqualified person

1. Disqualified person is one who can exercise substantial influence over organization during last five years
2. Giving more than fair market value
3. Tax on disqualified person is 25% of excess benefit amount

C. IRS can also impose special tax on those who approve the excess benefit

D. Can show reasonableness by approval of disinterested board without conflict of interest

X. Unrelated Business Income (UBI)

A. Income generated that is unrelated to the exempt purpose is taxable

1. The test
a. An unrelated trade or business that is regularly carried on, the conduct which is not substantially related to the corporation's exempt purpose.
2. Exclusions
a. The 20% rule
b. rents
c. royalties
d. dividends
e. Work done by volunteers
f. Sale of donated items
g. Gain from sale of capital assets
h. Ok with sponsors if no substantial return benefit from use of logo or

relationship.
(1) cannot advertise sponsor's products.
3. UBI
a. Advertising in periodicals, newsletter, program
(1) acknowledgments are ok
4. Consult your accountant

XI. **Accountability**
A. IRS tax form 990
1. File with the AG and make available to the public
B. State annual filing
1. Must register yearly with the state (no fee unless late)
C. Charities can be sued for fraud in fundraising
1. *Illinois ex rel Madigan v. Telemarketing Associates, Inc.*, 123 S.Ct. 1829 (2003)

XII. Political activity
A. Lobbying v. partisan activity
B. §501 (c) (3)
1. "Operated exclusively for religious, charitable, [or other specified] purposes, . . . and *which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or opposition to) any candidate for public office."*
2. Do **not** cross the line or the consequences are loss of tax status
a. *Branch Ministries v. Rossotti*, 211 F.3d 137 (D.C. Ct. App.) (2000)
C. Lobbying and advocacy
1. For a §501 (c) (3) lobbying and advocacy cannot be a substantial part of your organization
2. Can do some lobbying
a. Can spend up to 20% of $500,000 for nonpartisan advocacy issues
b. From $500,000 to $1,000,000 can spend $100,000 + 15% of excess over $500,000.
3. §501 (c) (4) can do more advocacy

XIII. Conclusion
A. The importance of risk management

Risk Management Worksheet

Area of Operation	Risk Identification and Rank	Goal	Who is Responsible?	How is the risk to be addressed?	When(time table)?	Measurement of Success
Governance	1. 2. 3.					
Financial	1. 2. 3.					
Operations	1. 2. 3.					
Staff/ Volunteers	1. 2. 3.					
Public Relations	1. 2. 3.					