

CERTAINTY IN UNCERTAIN TIMES:

A Nonprofit's Guide to Risk Management and
Small Business Insurance

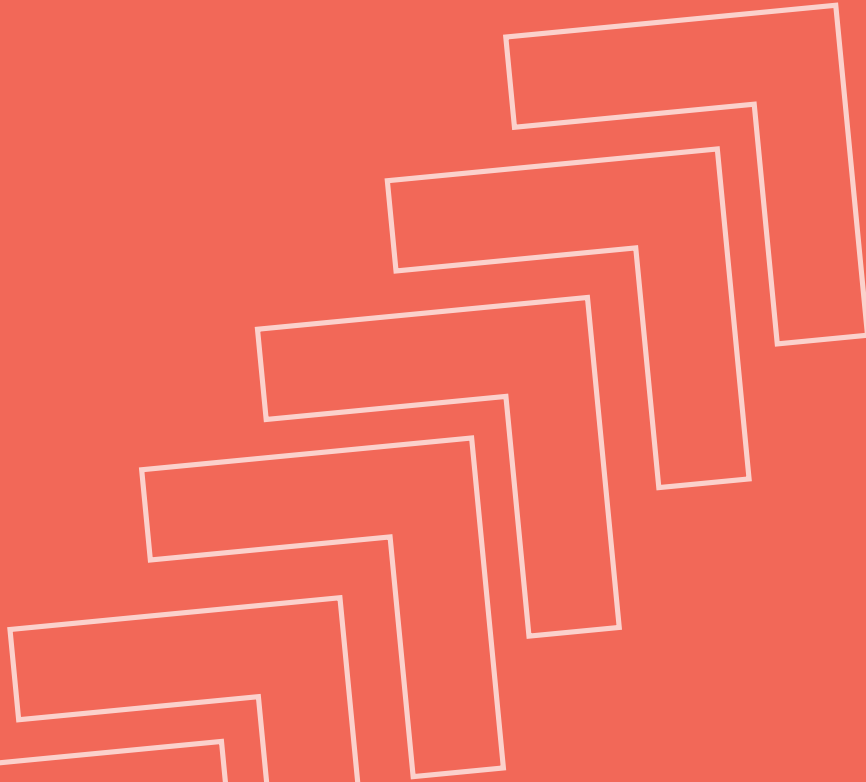




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INTRODUCTION TO NONPROFIT RISKS AND INSURANCE

Whether your **nonprofit organization** specializes in camps, afterschool programs, elderly care, healthcare centers, or other services, you face situations each day that could cause your organization to be sued:

- A patron slips on the floor of a museum.
- A child breaks her arm during an after school fitness camp.
- At a free clinic, a patient accuses his doctor of malpractice.
- A nonprofit's employee claims her employer discriminated against her.



How does it work? When you buy small business insurance, you're signing a contract with your provider. In exchange for a fee (your premium), your provider agrees to pay for lawsuits, property damage, and other expenses that result from covered situations. We'll go over these potential situations in more detail, but for now, be aware that no single policy will cover all the potential losses you could face. But with several key plans in place, you can get pretty darn close.

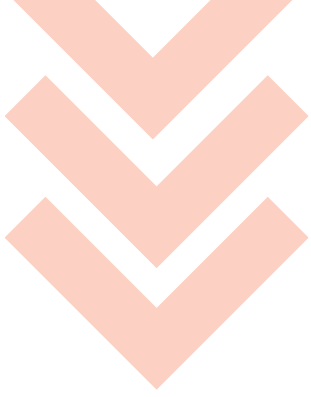
Before we get into the nitty-gritty, let's go over some basic insurance terms that we'll use throughout this guide:

It only takes one accident, oversight, or misunderstanding to trigger liability lawsuits. And the costs of a lawsuit are often so high that they force a nonprofit out of business. For instance, a **report by Insurance Journal** states the typical cost of a lawsuit against a nonprofit's board of directors is around **\$500,000**. What small nonprofit can afford to pay half a million dollars out of pocket?

It's not only lawsuits you have to worry about, either. Consider the damages a storm or other destructive event could cause. If a windstorm wrecked your building, you'd be on the hook for construction expenses and other property damage – a bill steep enough to ensure **40 percent** of businesses **never reopen** after a disaster.

The good news is adequate nonprofit insurance can help your organization survive unforeseen lawsuits and disasters.

- **Policy.** An agreement between you and the insurance company. It lists the situations your insurance covers and how much coverage you receive.
- **Premium.** The amount you pay on a yearly or monthly basis for your insurance.
- **Claim.** An official statement you file with your insurance provider to collect benefits. Claims are triggered by lawsuits or covered losses. They require you to call your insurance agent and / or submit documentation about the situation. The term "claim" can refer to both the process of receiving money from the insurance company and the actual event covered by your insurance.



- **Policy limit.** Policies have a maximum yearly limit, which caps the amount of money you can receive from your insurer. For instance, your General Liability Insurance may have a \$2 million limit, which means it will pay for lawsuits until the total cost of all claims reaches \$2 million for that year. Some policies also have a per-occurrence limit. This limits the amount of money you can collect for any one claim. A General Liability Insurance policy may have a \$1 million per-occurrence limit, but a \$2 million yearly (or aggregate) limit. This policy pays for lawsuits that cost up to \$1 million dollars and pays for multiple lawsuits until the total cost reaches \$2 million.
- **Deductible.** The amount you have to pay for covered events before receiving insurance benefits. For instance, say a Property Insurance policy has a \$5,000 deductible. That means you'd pay for any stolen or damaged property out of pocket until the cost was greater than \$5,000. At that point, your insurance would kick in.

Because navigating the world of risks and insurance can be tricky, let's approach it in a practical way. In this guide, you'll find out how to...

- Identify risks your nonprofit may face.
- Choose insurance policies that make sense for your organization.
- Manage your risks with prevention strategies and adequate insurance coverage.

Read on for tips that help you anticipate risks and protect your nonprofit (and your finances).



\$500,000 = average cost of a D&O lawsuit for a nonprofit.



of small businesses never reopen after a disaster.

CHAPTER 1

UNDERSTANDING YOUR NONPROFIT'S RISKS



PART 1: WHAT IS A LIABILITY?

“**Liability**” is one of those words that both for-profit and not-for-profit organizations hear all the time. But what exactly does it mean?

A liability is your legal responsibility for people, property, and other situations. A nonprofit that maintains an office is responsible for making sure no one is injured on its property. An organization that supplies grief counseling is responsible for the quality of the therapy it offers. When an organization fails to meet its responsibility – whether it’s by creating an unsafe environment or delivering unsatisfactory services – it can be sued.

But those aren’t the only situations that can lead to a lawsuit. One of the reasons the term “liability” can be confusing is because it applies to so many situations. For example...

- Your management can be liable for its financial decisions.
- Your organization can be liable for its employees’ errors.
- Your organization can be liable for injuries others suffer on its premises.

Basically, any time someone can be sued for making a mistake or not preventing a mistake, you’re dealing with “liabilities.”

Which Liabilities Do Nonprofits Face?

Here are some common liabilities that most nonprofit businesses may encounter:



- **Liability for third-party bodily injuries.**

When a deliveryman falls down your stairs and dislocates his shoulder, you can be held liable for medical expenses.

You might be thinking, *Isn’t it the deliveryman’s fault for falling down the stairs?* Maybe. But the law doesn’t treat it that way. When people get injured on your property, you can be held responsible for creating an environment where the accident occurred.

- **Liability for damaging someone else’s property.**

Let’s say your organization runs a homecare service that visits elderly people. Visiting someone else’s home means that you could potentially damage their property. Here’s an example: while helping a patient out of bed, your volunteer knocks a glass of water onto the new computer their grandchildren gave them. Though these accidents are sometimes unpreventable, you can still be held responsible for the cost of replacing the damaged property. (General Liability Insurance may cover this liability.)



Any situation that can lead to a lawsuit is considered a “liability.”

- **Digital security liability.** A nonprofit with financial and personal information on its computers and networks can be held responsible for misuse of this data. If a hacker breaks into your NPO's computers, you'd be liable for the cost of credit-monitoring services for the people affected by the breach. (You can protect your organization with [Cyber Liability Insurance](#).)
- **Board members and officers liability.** Financial planning errors or employee conflicts can lead to lawsuits filed against your organization. (Directors and Officers Insurance can help you manage the associated costs.)
- **Professional liability.** No matter what services your nonprofit offers, you can be sued for making errors or failing to deliver an expected result. These lawsuits are more a reflection of a patron's attitude rather than the quality of your work. For example, parents could sue a charter school for making an error on a child's transcript, claiming the oversight was the reason their child was rejected by a college.

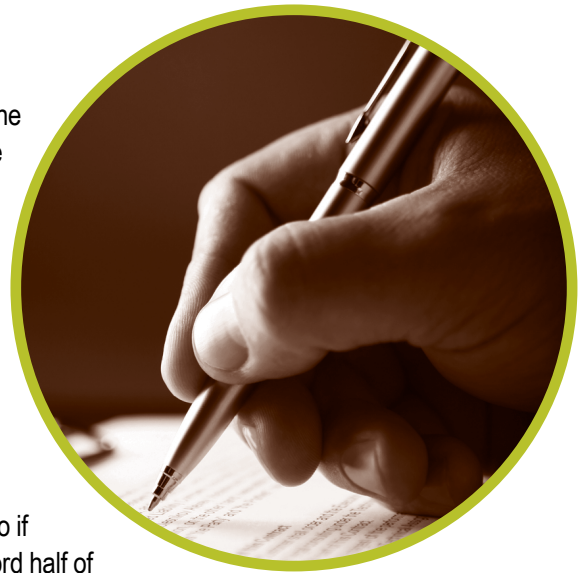
Does the Law Protect Non-Profit and For-Profit Businesses the Same Way?

Though a nonprofit's mission is different than that of a for-profit business, the founders of both types of organizations are protected from lawsuits in the same way. That's because when you started your organization, you "incorporated." Maybe you did this with the help of a lawyer, or perhaps you did it through a legal service website.

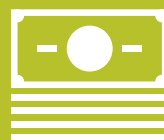
Legally speaking, being a corporation protects your nonprofit in certain ways. Namely, an incorporated organization is legally responsible for its employees' and volunteers' actions. In most cases, you cannot be personally sued for the things you do as part of your organization.

You're also protected from financial responsibility for your organization's debts. So if your nonprofit is sued and found liable for \$1 million in damages but can only afford half of that sum, you won't be personally responsible for repaying the rest of the debt. The organization could file for bankruptcy and / or go out of business, but you won't be on the hook for the remaining \$500,000.

Though a nonprofit is different than a for-profit enterprise, you still have the same legal protection from organizational debts related to liability lawsuits.



501 (c) status comes with unique legal obligations.



Incorporation protects you from financial responsibility for your organization's debts.

PART 2: LIABILITIES UNIQUE TO NON-PROFIT ORGANIZATIONS

Each industry's liabilities vary depending on the services it offers. For nonprofits, their unique liabilities stem from the board's responsibility to maintain the organization's tax-exempt status as a 501(c) organization. That means...

- Board members can't vote on their own compensation.
- Business arrangements can't have conflicts of interest.
- Business deals can't unfairly reward a private party.
- Transactions must be at "arm's length."

If any of these policies is violated, your nonprofit – and specifically your board members – could face a liability lawsuit. Let's take a closer look at these legal obligations.

Board Members Can't Be Involved with Decisions about Their Compensation

If a board member is involved in a decision about their compensation, your nonprofit could lose its tax-exempt status. Here's how this situation often comes up:

Many nonprofits are small organizations with few employees. Frequently, the founder of the organization is an employee who also serves on the board. If the founder is a part of the voting, discussion, or decision-making process about their own salary, then the IRS may consider this a violation of its conflict-of-interest regulations and could revoke the nonprofit's 501(c) status. The organization would lose its tax-exempt status and be responsible for paying back taxes.

Because it was the board's mistake that caused the nonprofit to lose its charity status, donors could sue the organization.

Nonprofits Must Avoid Conflicts of Interest

Nonprofits can't sign contracts with private parties that have a special relationship with people in the organization. If you sign a contract with a company that also donates to you, the IRS could argue that you are unfairly rewarding the company for its contributions.

Here's another example.

The brother-in-law of a member of your board runs a catering business. If you hire him to supply the food for a fundraising event, this could be considered a conflict of interest.

For more information, check out the Center for Nonprofit Excellence's guide "[How to Avoid Conflicts of Interest.](#)"

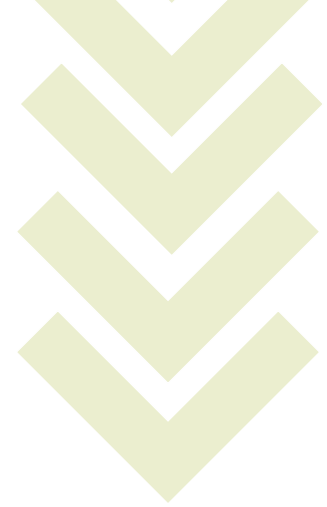


Special Nonprofit Concerns about Compensating Business Partners

Nonprofit organizations have to be careful not to compensate their vendors or employees too much. Doing so could cost an organization its tax-exempt status and lead to a lawsuit alleging the board mismanaged the organization's financial resources.

You may be asking yourself, *Is the law telling me I can't pay my employees well?* But that's not what is going on. You can, of course, compensate your employees fairly. On the other hand, no one should get rich off of your nonprofit (not that you expected that to happen).

The law is in place so that nonprofits are not involved with transactions that unfairly benefit private parties. In practice, this means you can't pay your board members or employees too much money or offer them unreasonable benefits, travel allowances, or housing allowances. Some major nonprofits pay their CEOs a million-dollar salary, but even then, it is usually what someone in a similar position would make at a for-profit company.



How Arm's-Length Transactions Work

The law requires that all of a nonprofit's transactions be conducted at "arm's length." This is another one of those tricky legal terms. In essence, an arm's-length transaction is when neither party can pressure the other into the deal or feel pressured because of a past or potential relationship. This may mean your organization must avoid business deals with donors, family members, and other people involved in your work.

But sometimes these definitions can get blurry – especially in the case of gifts. Here's [an example](#) from The NonProfit Times about an ongoing legal battle involving the definition of an arm's-length transaction:

Johns Hopkins University was given a 150-acre piece of land in rural Maryland by a benefactor named Elizabeth Banks, who also left special instructions before she died for how the land was to be used.

What complicates this issue is that Johns Hopkins actually purchased this land, but for a value far below the market price – just \$5 million for a piece of land worth \$54 million. Johns Hopkins claims that because it purchased the land, it was an arm's-length transaction and it doesn't have to follow Ms. Banks's instructions about the land use. JHU wants to develop the land into commercial property, while Ms. Banks wanted it to be used for academic buildings.

Ms. Banks's family sued Johns Hopkins over its plan to commercially develop the property. Now the courts must decide whether this constitutes an arm's-length transaction or a gift. On the one hand, the university paid for it. On the other hand, the price was far below the land's market value, which could mean it was a gift and Ms. Banks had the right to stipulate how it will be used.

This situation is a good example of board liability. Financial planning can quickly lead to legal fiascos that drain your resources and put your plans on hold. Gifts from donors and money left in wills often lead to difficult financial decisions and extra scrutiny, both of which can easily result in a lawsuit against your nonprofit.

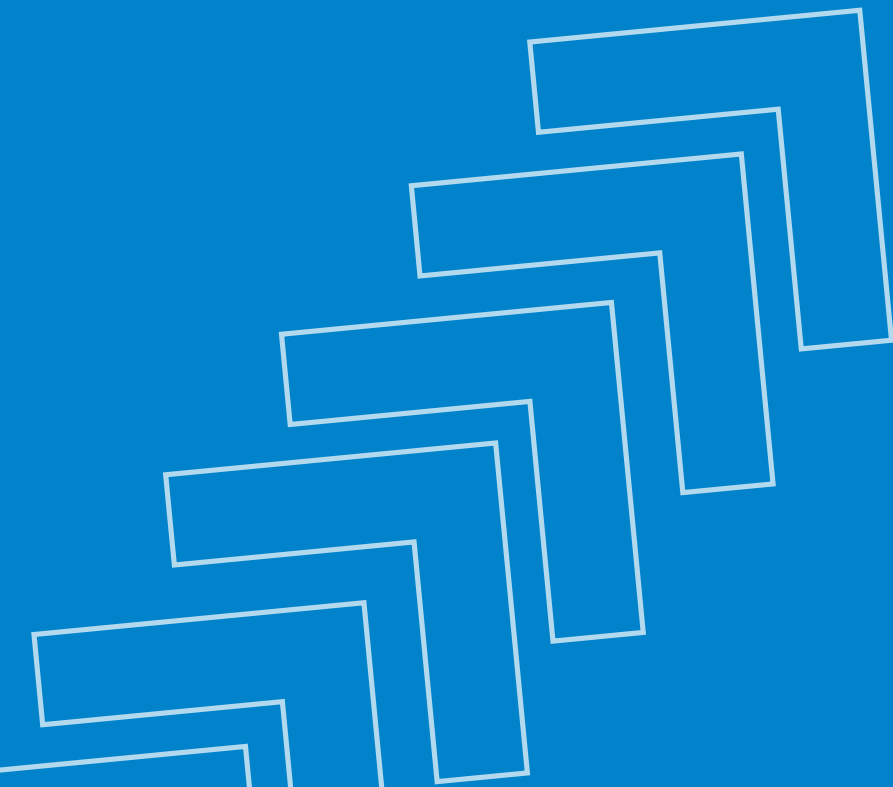
That's why it's essential to have adequate liability insurance in force throughout the life of your organization. The appropriate policy can help your organization pay for legal defense and other court costs arising from board liability claims. In the next chapter, we'll explore some of the insurance policies that can protect your social service organization and its hard-earned funds.



Nonprofits can get into legal trouble if their board members and employees enjoy inflated benefits and salaries.

CHAPTER 2

UNDERSTANDING NONPROFIT INSURANCE COVERAGES



UNDERSTANDING NONPROFIT INSURANCE COVERAGES

Nonprofit insurance can help protect your organization from a variety of sudden, disastrous expenses, including...

- Lawyers' fees.
- Lawsuit expenses.
- Directors / officers liability.
- Property damage and repairs.

When your organization is sued, it could face thousands of dollars in legal expenses, even if it's not found liable for any damages. In fact, a dismissed claim can still run you \$2,000 to \$5,000 in attorneys' fees alone. (Read more about the staggering cost of lawsuits in the U.S. Chamber Institute for Legal Reform's [Tort Liability Costs for Small Business](#) report.)

Nonprofits try to minimize their operating expenses in order to devote the majority of their resources to the services they offer. For most organizations, there's no wiggle room for unexpected legal defense costs.

That's where nonprofit insurance can help. With adequate coverage, you'll have the funds for those sudden costs so you won't have to cut back your services or shut your doors.

Of course, each organization has different insurance needs, but the following policies tend to benefit most nonprofits:

- General Liability Insurance.
- Property Insurance.
- Business Owner's Policy.
- Workers' Compensation Insurance.

In the next couple sections, we'll explore how these policies may help protect your organization.



Even dismissed lawsuits can cost between \$2,000 and \$5,000 in legal defense fees.

PART 1: THE BUILDING BLOCKS OF YOUR NONPROFIT INSURANCE PLAN



General Liability Insurance for Non-Profit Organizations

For many nonprofits, [General Liability Insurance](#) (GL) is the foundation of their insurance coverage. This policy may cover some of the third-party claims all businesses may face, such as injuries that happen on your premises, property damage liability, and advertising injury lawsuits.

Here are a few situations that could trigger your coverage:

- **Premises liability.** A deliveryman slips on the icy sidewalk outside your building while delivering a package to your NPO. He sues your organization for medical expenses.
- **Property damage.** A volunteer leaves her laptop in your office to charge while she passes out water at a 5K you're hosting. A power surge fries her machine and she sues you to replace it.
- **Advertising / personal injury.** A musician files a lawsuit against your NPO, alleging the video on your website uses his copyrighted material without his consent.

For each of these claims, your GL policy may help cover your legal expenses, so long as the lawsuit is brought by a third party (i.e., someone who doesn't work for your NPO). And these costs add up quickly when you consider lawyers' fees, evidence, expert witnesses, docket costs, and damages (if you lose the case).

Damages (or "judgments") can run anywhere from a few thousand to a few million dollars. You may also choose to settle a lawsuit out of court, which would involve both parties' lawyers agreeing on how much you are going to pay the person suing you (i.e., the plaintiff). Luckily, your General Liability Insurance can pay for all these expenses – judgments, settlements, lawyers' fees, and court costs.

You can also add Cyber Liability Insurance to your GL policy so you'll have funds to handle the aftermath of a data breach. For example, if someone hacks into your network and steals your donors' financial information, the policy can help pay for credit-monitoring services, the cost of notifying affected parties about the breach, and PR services to restore your NPO's credibility.

Property Insurance Helps NPOs Survive Storms, Fires, and Other Damage

Your NPO relies on a slew of property and equipment so it can help others. [Property Insurance](#) is designed to help your social service organization protect its assets from unpredictable disasters. It steps in when your organization loses its property because of:

- Theft and vandalism.
- Fire damage.
- Windstorms.
- Power surges and outages.

When one of these covered claims occurs, your insurance company reimburses you for the cost to replace, repair, or restore your property. **You may even be required to carry Property coverage, depending on the terms of your commercial lease agreement.** Even if your landlord insures the real estate, you'd still need to protect the building's contents with your own policy.



Check your lease – you may be required to carry your own Property Insurance.



If you own commercial real estate, you have all the more incentive to safeguard your investment. Your Property policy can cover your building and the equipment inside it, including...

- Offices / garages / workplaces.
- Computer and office equipment.
- Inventory, supplies, and other professional materials.



For example, say you run an after-school athletic camp for middle school kids. You keep an arsenal of sports equipment and other supplies in a garage. If the garage were to burn down, Property Insurance could compensate you for the cost to replace your damaged equipment and repair your storage space.

If you run a home-based NPO, you may be wondering, *But what about Homeowner's or Renter's Insurance?* In short, most of these policies don't cover commercial equipment unless you have the appropriate riders attached to your policy. Even then, you'll get more coverage with a commercial Property policy. (To learn more about the gaps in your Homeowner's policy, check out our infographic "[Is Your Home-Based Business Covered?](#)")

Bundle Insurance and Save: Business Owner's Policies for Nonprofits

Every business is budget-conscious, but nonprofits have to be even more careful with their funds. Many nonprofit managers try to find ways to minimize overhead while maximizing their services and fundraising capabilities. That's why you might be interested in a [Business Owner's Policy](#) (or BOP).

Business Owner's Policies package General Liability Insurance and Property Insurance into one plan at a discounted rate. You receive the same coverage, but for less than you'd pay if you purchased these two policies individually.



However, BOPs aren't available to everyone. Eligibility guidelines vary from one insurance provider to another. Generally, your nonprofit may qualify if it...

- Has an office space or workplace with relatively small square footage.
- Has fewer than 100 employees or less than \$5 million in revenue.
- Doesn't work in a hazardous or high-risk industry.
- Requires no more than 12 months of Business Interruption Insurance.

[Business Interruption Insurance](#) is typically part of your Property Insurance plan. If a covered property loss forces your NPO to halt operations, Business Interruption coverage may help...

- Pay for your organization to move to a temporary office.
- Insure your income.

If you can't make any money because your organization is still reeling from the aftermath of a fire or windstorm, Business Interruption Insurance may cover your normal income, helping you pay salaries, leases, and other costs.





Do Nonprofits and Social Service Organizations Need Workers' Compensation Insurance?

If your organization doesn't have any employees, you probably won't have to purchase [Workers' Compensation Insurance](#) (sometimes also called Workers' Comp or Workman's Comp).

Workers' Comp is a policy that every state in the country (except Texas) requires employers to carry. (Read about your state's laws in our guide "[Workers' Compensation Insurance Laws by State.](#)") As soon as you hire employees, you'll probably need to purchase the policy.

Workers' Compensation Insurance for nonprofits offers coverage for:

- Employees' medical expenses for work injuries or accidents.
- Employees' foregone wages during their recovery.
- Legal expenses if an occupational injury leads to a lawsuit.

Say you run a nonprofit healthcare center, and a nurse slips on a wet floor. She lands hard on her back and breaks her elbow. Workers' Compensation Insurance can help cover her medical care, surgeries, and some lost wages while she recovers.

Now imagine that the nurse decides the clinic was at fault for her injury and refuses her Workers' Comp benefits. She sues, claiming your clinic should have repaired the leak responsible for the slick floor. The clinic could face tens of thousands of dollars in legal fees: lawyers' bills, court costs, and settlements or judgments. Luckily, Workers' Comp may cover these costs, too.

Once you hire employees, be sure to carry the appropriate amount of insurance to comply with your state's Workers' Comp laws. You may even be able to save some money on your policy by you excluding yourself from coverage.



Nearly every state in the U.S. requires employers to carry Workers' Compensation Insurance.

PART 2: HOW NONPROFIT LIABILITY INSURANCE ACCOUNTS FOR YOUR MOST PRESSING RISKS

Now that we've covered a few basic insurance policies, let's delve into the policies that are at the heart of your nonprofit's business protection plan:

- Directors and Officers Insurance.
- Errors and Omissions Insurance.

Why D&O Insurance Is Essential for Nonprofits

[Directors and Officers \(D&O\) Insurance](#) is one of the most important policies for your organization. That's because, according to the [Wyatt Nonprofit Organizational Directors' and Officers' Liability Survey](#), nonprofits spend...

- Between **\$35,000 and \$100,000** on legal fees in a D&O lawsuit.
- A whopping **\$457,000** in settlements or judgments for damages in a D&O suit.

We've already mentioned a few mistakes a nonprofit's board of directors could make. Here's an expanded list of such mistakes, all of which could trigger a D & O lawsuit:

- Salary decisions made without proper arm's-length decision-making processes.
- Salary payments or provision of benefits structured to unfairly benefit an individual.
- Conflict of interest with vendors who are related to the organization.
- Employee harassment.

- Improper termination (and other employment practices liabilities).
- Breach of duty.
- Issuance of misleading or inaccurate statements.
- Mismanagement of funds or other company assets.

Your board doesn't even have to actually do any of these things to be sued. All it takes is an accusation to launch a potentially devastating lawsuit.

Like other insurance policies, nonprofit D&O Insurance helps protect organizations by paying for legal expenses and related costs. But this management liability insurance is particularly important for a nonprofit because its board of directors functions differently than the board of a for-profit company:

1. **Non-profits have to maintain their tax-exempt status.**

The laws are tougher on nonprofit organizations, and small financial management errors could lead to huge costs in tax penalties, audits, or other problems. Simply having a board member vote on certain salary issues could cause your organization to lose its 501(c) status and trigger potential lawsuits.

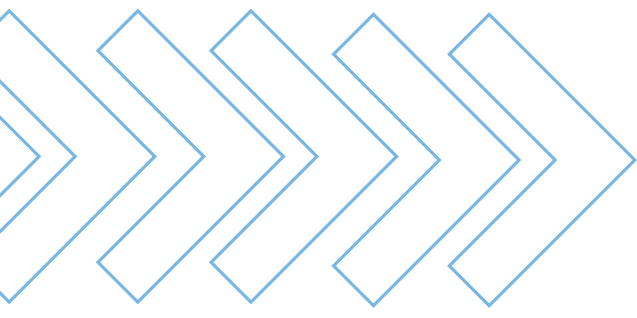
2. **Nonprofit boards are more than just a governing body.**

Your board is an invaluable resource. A well-connected, influential board helps a nonprofit attract important donors, sponsors, and business partners.



\$35,000 to \$100,000 = average cost of legal fees in a D&O lawsuit.

\$457,000 = average judgment / settlement costs in a D&O lawsuit.



Without D&O Insurance, board members must pay for lawsuits with their personal finances.

When an NPO doesn't have Directors and Officers Insurance, **board members are responsible for funding lawsuits with their personal assets.**

Not only is that expensive and inconvenient for board members, but it also prevents you from retaining top talent. One of the most common reasons prospective board members refuse to join a nonprofit organization is because they don't want to take a job that jeopardizes their personal finances.

Directors & Officers Insurance reassures board candidates that your organization can protect them (and their assets) from lawsuits. That way, you can attract influential members to your board. (For more on this issue, read our blog post "[Do I Need D and O Insurance for My Nonprofit?](#)")

Coverage for Professional Liabilities: Errors and Omissions Insurance for Nonprofits



So far, we've discussed how insurance can protect your organization from property damage, general liability lawsuits, workplace accidents, and management liability. Now let's explore the insurance that steps in when you're sued over professional mistakes.

You may be wondering what exactly constitutes a professional mistake. Here are some examples:

- A non-profit clinic treats a patient with medicine they are allergic to.
- A [dog rescue](#) facilitates an adoption but fails to inform the new owners that the pup has kennel cough, which spreads to the family's Pomeranians.
- A [vocational workshop](#) fails to help an attendee get a job – or even an interview.



These are all professional liabilities – situations where a nonprofit allegedly makes oversights or fails to meet an accepted standard of care. In each of these examples, the third party that suffers a financial loss because of your services can sue your organization for damages.

The good news is that [Errors and Omissions Insurance](#) (aka Professional Liability Insurance) can help your NPO avoid an avalanche of debt by covering your legal defense costs and settlements or judgments. In the medical field, this type of coverage is called "malpractice" insurance, but it's important for people in all industries.





You don't have to actually make a mistake to be sued for professional liability, either. These claims are more a reflection of the third party's attitude than the quality of your services. Luckily, E&O may also cover "frivolous" or "meritless" claims. Though you might be sued unfairly, your insurance can still protect you, sparing you from paying a couple thousand dollars in attorneys' fees over nothing.

What Is a Claims-Made Policy?

Errors and Omissions and D&O Insurance are both "claims-made" policies. Claims-made policies mean your insurance benefits only kick in if two criteria are met:

- The event that triggered the lawsuit happened while your current policy was in force.
- The lawsuit was filed while the same coverage was active.

Lawsuits can happen years after the event that caused them. For example, your board could be sued over a financial planning mistake three years after it made the error. Sometimes, it takes a while for the consequences of mistakes to emerge.

Many E&O and D&O policies don't cover events that happened before you purchased the policies. What makes things even trickier is that if you switch from one D&O provider to another, your new policy may not cover anything that happened under your old policy.

So what can you do to make sure your nonprofit receives its benefits when it needs them most? Here are your options:

- **Get a policy and stick with it.** Many nonprofits do precisely that. They purchase a policy in the early days of their business. As they grow, they increase their coverage limits, but stay with the same insurance company. This ensures they have no gaps in their coverage.
- **Get a policy with Prior Acts Coverage.** If you switch policies or purchase your first policy years after founding your nonprofit, you can purchase "Prior Acts Coverage." This endorsement covers E&O and D&O lawsuits arising from past issues.

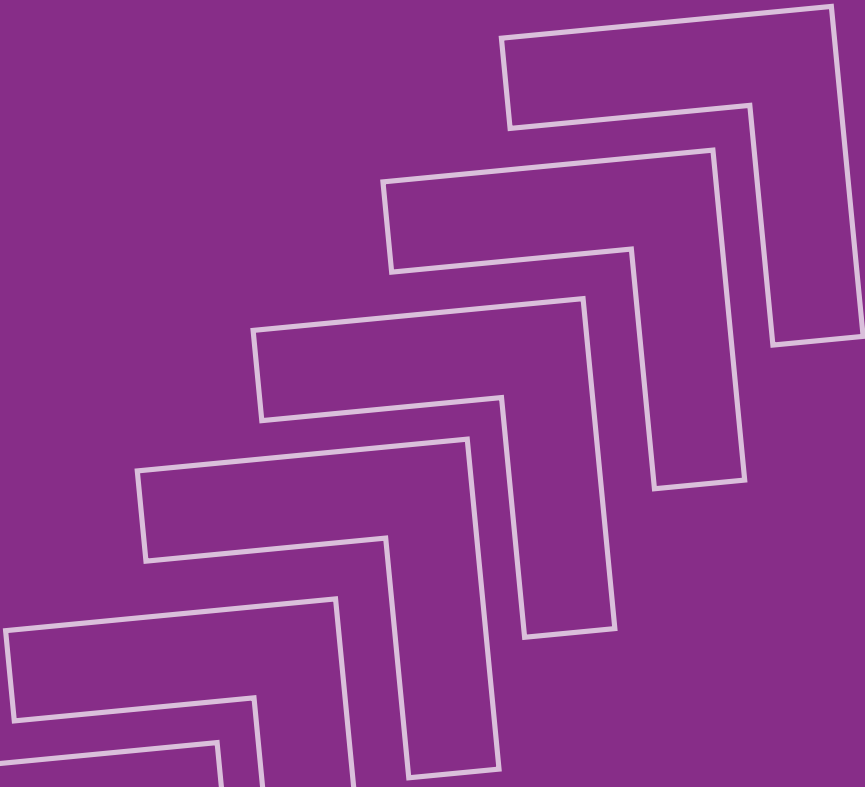
Claims-made policies can be pretty complex, so if you need some help making sense of them, feel free to [talk to an insureon agent](#). You can also learn more about claims-made coverage in our blog post "[What is Claims-Made Insurance Coverage?](#)"



E & O Insurance protects your NPO from both meritless and legitimate lawsuits.

CHAPTER 3

MANAGING YOUR NONPROFIT'S RISKS



MANAGING YOUR NONPROFIT'S RISKS

We've covered the liabilities your NPO may face and the insurance policies that can help your organization survive a number of legal and financial hits. But insurance can't cover every event.

So in addition to purchasing adequate coverage, you should also take steps to manage the risks that you can control. Let's explore some extra risk management concerns so you can solidify your protection plan, safeguard your assets, and cut costs.

What Are Audits and How Can Nonprofits Avoid Them?

Nonprofits don't have to pay federal taxes, but they may have to undergo rigorous (and sometimes costly) audits. "Audit" is a term for an exhaustive examination of your financial records. We'll talk about two types of audits you may experience:

- IRS audits.
- Independent audits.

The IRS chooses to audit organizations from time to time to ensure their tax returns are accurate. If the IRS audits you, you'll need to supply documents and other financial records to prove that everything is in order. That means digging up old bank statements and receipts you've kept in your filing cabinets.

The IRS might audit you for a variety of reasons, such as...

- **Mistakes on your return.** Nonprofits have to file payroll tax returns and IRS Form 990, which thoroughly details your organization's activities, mission, and other information. Any errors on these returns can cause an IRS agent to flag your return.
- **Random selection.** Sometimes the IRS randomly chooses nonprofits to audit – a sort of spot-checking system to verify compliance.

- **Complaints against your nonprofit.** If donors, former employees, or other people file a complaint about your organization, the IRS may choose to look into the allegations and conduct an audit.

Another avenue for audits is through your state's laws. Many states require nonprofits to conduct an annual independent audit of their financials. An independent audit is when you hire a CPA – one who is not connected with your organization – to examine your financial records.

(Find out if your state requires an audit. Read the [National Council of Nonprofits](#) article "[State Law Nonprofit Audit Requirements](#)" for more details.)

Not all states require these audits. Usually, your state audit requirement is tied to the contributions you receive. For instance, in Mississippi, any NPO with more than \$100,000 in contributions for that year is required to undergo an independent audit. If your organization is a smaller nonprofit with donations less than the amount set by your state, it may not have to worry about a state-required audit.



Mistakes on Form 990 could cause the IRS to flag your tax return.



Tips for Avoiding Audits

Audits may reveal financial mistakes, which means they could expose your board to more liability. One financial error can cause your NPO to lose its 501(c) status and pay thousands in taxes. Ultimately, that single oversight can also trigger D&O lawsuits against your board.

How can your nonprofit avoid these costly mistakes on its tax return? Here are some tips to help you avoid an audit:

- **Have a specialist prepare your IRS form 990.** This form lists your financial data and disclosures. It provides the IRS with information about your organization's programs, board members, mission, and activities. The form is long and complicated. It's 12 pages on its own, not including all the supplemental material and schedules you need to attach. Your personal accountant may not be very experienced with nonprofits, which is why you should find a non-profit tax specialist to prepare your filing.
- **Avoid murky business arrangements.** As we mentioned earlier, all your business agreements should be conducted at arm's length. You shouldn't partner with anyone who has a relationship to your board or another conflict of interest. In general, the IRS tends to audit nonprofits that participate in joint ventures with for-profit organizations because nonprofits can't unfairly compensate private parties.

Are Nonprofit Volunteers a Liability?

If there's a theme for this guide, it's that nonprofits have a few more hurdles to clear than other businesses. Your special tax-exempt status requires extra work come tax time and can expose your board to more lawsuits. Another situation that increases your liability is the use of volunteers.

Volunteers are great – don't get us wrong. But from an insurance perspective, volunteers may seem like "wildcards" that bring a whole load of risk with them. Let's take a look at some frequently asked questions about volunteers and how you can ensure your extra help doesn't become a source for lawsuits and losses.

FAQs about NPO Volunteers and Risks

Is my organization liable for injuries my volunteers suffer? Absolutely. If a volunteer gets hurt working for your organization, you can be sued for failing to provide a safe workplace.

If a volunteer damages someone's property or hurts someone, is my NPO liable? Yes. In fact, the [Volunteer Protection Act of 1997 \[PDF\]](#) was enacted specifically so that volunteers can't be sued over mistakes they make while volunteering. The Volunteer Protection Act doesn't absolve your organization from liability, though. In other words, if a volunteer damages someone's property, the property owner won't be able to sue them. The owner will be able to sue your organization.

How concerned should I be about volunteer liabilities?

According to the article "[Safeguarding Volunteers with Effective Risk Management](#)" published in *Nonprofit Quarterly*, more volunteers have been asked to do manual labor or maintenance work since the Great Recession. In our recent economic downturn, nonprofits rely on more volunteers to perform work that their paid staff had done in years past.

Why is this significant? Maintenance and manual labor are some of the most dangerous and "risky" work that people can perform. If you rely on volunteers to do manual labor or specialized jobs, there's a greater chance that your nonprofit will face some kind of liability lawsuit over injuries or errors – or both.

Some states require NPOs to undergo independent audits.



Protect Your Organization from the Risks of Using Volunteers

Let's go over some ways to mitigate the risks of using volunteers:

Screen Your Volunteers

The level of screening you implement will depend on the kind of work your volunteers do. For instance, volunteers working with minors should undergo a background check (which can cost between \$25 and \$50). In fact, state laws may require you to do so. If your volunteers are involved with bookkeeping, you should check their credit background.

Even though you are not hiring them, you should scrutinize volunteers. You might not ask them all the things you would in an employee interview, but a few questions will go a long way.

Ensure Your Volunteers Are Properly Trained

While it may seem obvious that volunteers need training, the implementation is trickier than you'd think. Remember, training is an ongoing thing. Let's say you run an organization like Habitat for Humanity. If you're building a house, you'll need to constantly train people. With a large number of volunteers, that can be hard to keep track of.

That's why documentation is a good idea. Documenting which workers have received which type of training is vital. Equally important is having handbooks, guides, and other documents that back up the face-to-face training your organization does with its volunteers. Emailing guidebooks, waivers, and other materials to volunteers ahead of time can be a smart way to cover your liabilities and streamline your work schedule.

Keep in mind that if a volunteer sues you, it might be your word against theirs unless you have the documentation to back up your story.

Assign Jobs to the Right People

Naturally, you want your most trustworthy and capable people working on your most dangerous jobs. These include things like heavy lifting, maintenance, manual labor, and any work that requires tools.

But what about new volunteers? You may not want to overwhelm them with documentation and training on their first day for fear of scaring them off. Many volunteers want to do something right away and feel they are making a difference, but some jobs aren't safe for those without training. You'll want to find low-risk tasks for less experienced volunteers or pair them with more seasoned volunteers in order to give them experience in a safe way.





Delegate Training

Reward your best volunteers by giving them more responsibility. Let them train new workers. Make sure you outline best practices and show them the key things they'll need to teach effectively.

Conduct Evaluations

Just as important as training, evaluation gives you an opportunity to reinforce the skills, attitudes, and behaviors you want from your volunteers. Tell your volunteers what parts of their work you appreciate the most and point out areas where they could improve.

One helpful resource on volunteer management is the website [Better Impact](#). This site compiles sample documents for everything from volunteer recruitment to screening and waivers.

How Your Nonprofit Can Save Money on Unemployment Taxes

Astonishingly, a recent [study by the Unemployment Services Trust \(UST\)](#) found that **22 percent** of nonprofits are unaware that they can opt out of paying state and federal unemployment taxes. This is a potentially significant cost savings.

What are unemployment taxes? For each paycheck you write, you have to pay a variety of federal and state taxes. One of those taxes is the unemployment tax, which goes into a pool used to pay unemployment benefits. According to the [California Employment Development Department](#), the tax rate can be as high as **6.2 percent of the first \$7,000** of your employee's income (in other words you can pay \$400 to 500 per employee per year).

The good news is that nonprofits don't actually have to pay this tax. Instead, they can opt out, choosing to pay "dollar-for-dollar," which basically means you only pay unemployment taxes when one of your former employees applies for unemployment. This can end up saving your organization a significant amount of money.

If your organization is small and doesn't have any employees, this is something to keep in mind when you plan to make your first hire.



of nonprofits don't know that they can opt out of state and federal unemployment taxes.

CHAPTER 4

PRACTICAL TIPS FOR PURCHASING INSURANCE



PRACTICAL TIPS FOR PURCHASING INSURANCE



What You Need to Know Before You Buy Nonprofit Insurance

If you Google “nonprofit insurance,” you’ll find dozens of companies offering different policies. And even if they offer the same kind of policy (e.g., General Liability), chances are the two contracts will vary wildly in terms of coverage and exclusions. To ensure you find insurance you can count on, you’ll need to do your homework.

Too often, nonprofits will sign up for a policy and not really know what it covers. For many people, insurance is too complicated. Overwhelmed, they throw their hands up, buy a policy that sounds good, and hope they never get sued. But who says you have to settle? After all, buying insurance is an investment in the future of your nonprofit.

You may want to team up with an insurance broker so that you can make informed decisions and find a policy that fits your needs. We’ll talk about the differences between buying through a broker and buying directly from an insurance company in the next section. But for now, let’s look at the common insurance pitfalls you’ll want to avoid so you don’t waste time and money on an ill-fitting insurance plan.

Buyer Beware: Insurance Coverage Red Flags

Watch out for these telltale signs that you shouldn’t do business with a provider or purchase a policy:

The insurer cancels your policy after a claim.

This is a little like the insurer breaking up with your NPO. If you have to file a claim, some insurers will drop your organization after your annual policy is up. They’ll cover that year and pay for your claim, but after that, you’re on your own. It will be a hassle to find new insurance all over again and can be problematic for “claims-made” policies (such as Directors and Officers Insurance or E&O Insurance).

Because E&O and D&O Insurance policies work best when you have the same policy continually, it can be frustrating to lose coverage. When you buy a new policy, you’ll have to find one with Prior Acts Coverage, which can be difficult and more expensive now that you’ve had to file a claim. New insurers may look at your organization’s history and decide that it’s not worth the risk.

Your policy contains a “failure to provide insurance” exclusion.

According to the nonprofit ranking and resource center [Guidestar](#), nearly a **quarter** of nonprofit insurance policies contain this exception. A policy with this exclusion allows an insurer to refuse to cover you for a claim if they can argue that you didn’t buy “enough” insurance. That’s exactly the kind of thing you don’t want in your insurance policy: vague language that an insurance company can use to avoid paying for a major lawsuit.

Your D&O coverage is too limited.

Some insurance companies will not include employment practices coverage with their D&O Insurance. [Employment Practices Liability Insurance](#) (EPLI) can be purchased on its own but is often bundled with Directors and Officers Insurance (and less commonly with an E&O policy). EPLI helps cover lawsuits over harassment and wrongful termination.

Roughly 25% of nonprofit insurance policies have a “failure to provide insurance” exclusion.

The insurance company may tell you that your D&O policy has “employment practices” coverage, but likely, it’s a limited version of EPLI. For example, that page in your policy may only cover sexual harassment issues and not improper termination.

Your insurance company sells you everything online and you never get a chance to talk with someone about your policy.

Online insurance has helped and hurt the industry. On the one hand, you have access to tons of information and providers. That’s fantastic. On the other hand, you may end up with a provider that doesn’t offer you the strongest coverage. Given how confusing the language of insurance can be, it’s easy for nonprofit owners to misinterpret information they find online.

The key to buying insurance online is to find a company whose agents can talk you through policy options. This is important for two reasons:

- Your agent can clear up any confusion you have about your policy.
- You’ll want to work with a company that you can talk to when you need to expand your coverage.

If you buy E&O coverage with a \$1 million limit and find out that a contract you’re about to sign requires \$2 million in coverage, it’s helpful to have an agent’s number to call so you can sort it out quickly.

Bottom line: To make sure you have adequate protection for your nonprofit, work with a knowledgeable insurance agent (like those who work at insureon) who has experience finding coverage for businesses in your industry.



Buying from an Insurance Agent vs. an Insurance Company

We’ve established that insurance can be confusing, but you probably already knew that. One way to simplify the process is to buy insurance through an agent who will act as your translator and guide.

An agent is an independent professional who has an agreement with a variety of insurance companies. They sell policies from, but are not employed by, these companies. When they make a sale, they get paid. That gives them the incentive to find insurance that fits the nonprofit they’re serving.

Agents employed by an insurance company can only sell their company’s insurance and have less incentive to help you find deals or to tailor an insurance policy to meet your needs.

Buying Nonprofit Insurance With an Independent Agent

Here are some other ways agents can make your life easier:

- **Independent insurance agents specialize in certain areas of insurance.** You may find agents who work exclusively with car dealerships or restaurants or nonprofits. You’ll want to work with a company that has agents trained in the needs of nonprofit insurance. Think of it this way: before you buy a used car, you take it to your mechanic. A mechanic’s eye will notice things you don’t and help you determine whether you’re getting a good deal. A broker works the same way. They can use their expertise to tell you what you’re getting from a policy. They’ll check for the pitfalls we mentioned in the previous section and can confidently let you know if the insurance you’re buying makes sense for your organization.



Insurance agents who specialize in nonprofit coverage can help you find tailored policies at competitive rates.



• **Your insurance agent is a living, breathing human.**

When you need your policy changed or you have questions, you won't have to number-punch your way through a phone tree. You can call your very own insurance agent who will explain your policy in plain English.

• **Your broker has connections.** For example, insureon works with top-rated insurance carriers that are known for their reliable coverage, quick payouts, and industry-tailored products. Because we are an independent agency, our agents can find multiple policies from different providers so our clients have options.

Buying Nonprofit Insurance On Your Own

Though an independent agent can simplify and streamline the insurance-buying process, let's say you want to shop around on your own. Here's what you'll have to do to make sure you receive adequate coverage from a reliable carrier:

• **Identify which insurance companies you'll consider.**

Make a list of potential providers, and check out how well these companies rank on A.M. Best's site. A.M. Best's ratings grade insurance companies on the strength of their long-term financial outlook. Financials are especially important to insurance companies because, like banks, insurance companies build up a reserve of money so they can pay for claims. If a company has good credit, it receives an "A" rating. Here's the scale of [A.M. Best's rating system](#). Remember, any company can have a professional-looking website, but if it doesn't offer A-rated insurance, be wary.

SECURE	VULNERABLE
A++, A (Superior)	B, B- (Fair)
A, A- (Excellent)	C++, C+ (Marginal)
B++, B+ (Good)	C, C- (Weak)
	D (Poor)
	E (Under Regulatory Supervision)
	F (In Liquidation)
	S (Suspended)

• **Request quotes from the insurance companies you've identified.** Usually, this involves filling out some online forms and / or talking with captive agents over the phone. Because you're comparison-shopping, you'll need to go through this process with a few different insurance companies. Rinse and repeat. Be sure to get quotes from at least three different companies. Bonus: use the various quotes you receive as negotiation tools when you talk with agents.

• **Compare the benefits and exclusions of your prospective policies.** One way to do this is to make a list of the coverage you want, and check that each insurance policy you consider provides those benefits. As we've discussed, insurance policies can vary tremendously. Two Directors and Officers Insurance policies can offer different coverage for lawsuits, employment practices, and other financial mismanagement claims. In other words, before you even call the insurance company, know exactly what kinds of coverage you want and need. Otherwise, it will be hard to compare policies. The reality, of course, is that every policy is slightly different. Aim to find a policy that offers the best combination of coverage and price.

Bottom line: Buying insurance through an agent saves you time and provides you with a guide to coverage for your company.



Buying nonprofit insurance through an agent can save you time, stress, and money.



How the ACA / Obamacare Healthcare Requirements Affect Small Nonprofits

The Affordable Care Act (aka “Obamacare”) took effect in January 2014. Here are some frequently asked questions (and answers) about this healthcare law that many small nonprofits may have:

- **Do I need to insure my employees?** Only if you have more than 50 fulltime-equivalent employees. If you don't, you won't need to provide health insurance for them.
- **Where can I find more information about coverage options for my employees?** If you want to cover your employees, you can visit the [small-business section of the government's healthcare site](#), which will help you sort through your options.
- **If I don't have coverage now, will I need to buy insurance for myself?** Yes. As of January 2014, all individuals without insurance are required to purchase health insurance for themselves and their families.
- **How much will my new personal insurance cost?** The cost of your healthcare coverage will depend on how many people you need to insure, the plan you choose, where you live, and your income. You can use the [Kaiser Family Foundation's subsidy calculator](#) to get an idea of the potential premium and any subsidies you may be eligible for.
- **What's the minimum amount of coverage I have to purchase?** Plans are tiered into four groups: bronze, silver, gold, and platinum. Bronze is the lowest acceptable coverage level and pays at least 60 percent of the average person's healthcare costs. Plans you purchase through your state's Marketplace will all meet the minimum requirements.
- **What happens if I don't purchase personal health insurance?** If you don't have insurance, you'll have to pay a fee: one percent of your yearly income or \$95 per person (whichever is higher). You will also have to pay \$47.50 per uninsured child. After paying the fine, you still won't have insurance. Fees will increase substantially in 2016.
- **What if I have a lapse in coverage?** The ACA law allows people to have a lapse in their healthcare coverage and will not require people to pay a fine for brief interruptions (up to three months).



The cost of your health insurance depends on the number of people on your plan, your coverage level, your income, and your state's Marketplace exchanges.



When Should a Nonprofit Purchase or Update Insurance Policies?

As your nonprofit grows, its insurance needs will change. The following stages signal that it may be time to purchase or reevaluate your coverages:

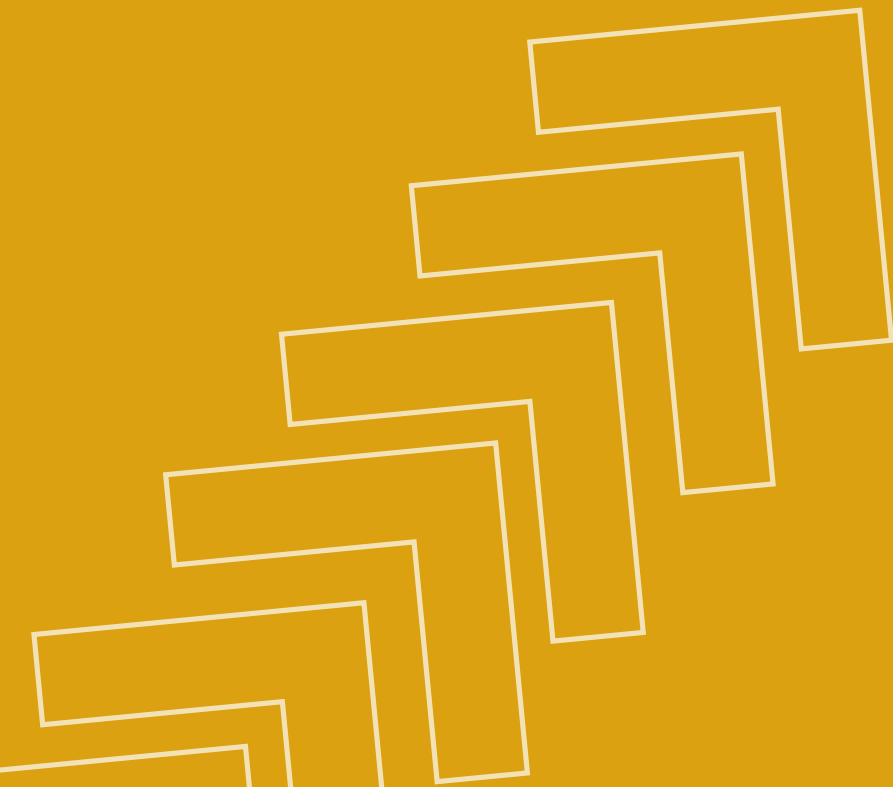
- **You just founded your organization.** It may not be financially feasible to buy insurance immediately, but ideally you should. As we've seen, Errors and Omissions Insurance and D&O coverage work best when they're in place from the beginning. Buying insurance at the start ensures that there are no gaps in your claims-made coverage.
- **You want to attract new board members.** When you pursue new board members, you'll want to purchase D&O Insurance to cover their liabilities. After all, no one wants to take a job that could endanger their personal assets. Adequate D & O coverage ensures that if board members are sued for decisions they made on behalf of your organization, you'll have the funds to pay for their legal defense and litigation costs.
- **You hire employees.** Many organizations start as volunteer-only, but as they grow, they hire some support staff. If your organization adds employees, you may need to purchase Workers' Compensation Insurance in order to comply with your state's regulations. If you already have a policy and you hire additional employees, be sure to let your agent know. They will need to update your policy to cover the new hires.
- **You've just signed a significant contract.** A rental agreement, lease, or other contract might specify that you need to purchase insurance. This is particularly common if you sign a long-term services agreement. Let's say a nursing home signs a contract with a nonprofit to run exercise activities with the patients. The contract may require the NPO to carry a specific amount of Errors and Omissions Insurance.
- **Your NPO buys property, relocates, or opens an office.** If your organization acquires new property or relocates, it will need to reevaluate its Property Insurance coverage. This is also true if you purchase new equipment or other expensive items. If you open up an office, museum, storefront, or other physical space that's open to the public, you'll also want to purchase General Liability Insurance (or increase your current coverage).



When your nonprofit makes a significant change, your coverage needs may change, too.

CHAPTER 5

RESOURCES FOR NONPROFITS



RESOURCES FOR NONPROFITS



Nonprofit Insurance FAQs

Looking for some quick-and-dirty answers? Here's a recap of what we've covered in this guide.

What is a liability?

These are legal responsibilities your organization faces. Accidents, injuries, and failures to fulfill these responsibilities can trigger a lawsuit against your NPO.

What liabilities do nonprofits face?

Liabilities come in all shapes and sizes. You can be liable for employee accidents, injuries that happen at your property, professional mistakes employees or volunteers make, and bad decisions from your board members.

Does the law protect nonprofits and for-profit companies in the same way?

As a corporation, your organization protects you from being personally sued. This corporate status shields you from personal liability the same way it would a for-profit company.

Are there special liabilities that only nonprofits have?

Yes, many. Your board can be sued for mistakes that cause the organization to lose its 501(c) status. Having volunteers also opens you up to more liabilities.

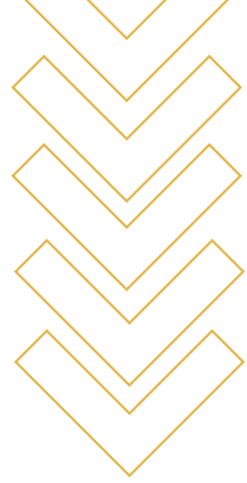
What insurance policies do nonprofits need?

Depending on your budget, the kind of work you do, whether you have any employees, and the kinds of contracts you've signed, you could need a variety of insurance policies. These include Property, General Liability, Directors and Officers, Errors and Omissions, Workers' Comp, and other insurance coverages.

What is an audit and how can nonprofits avoid them?

An audit is an intense process in which you have to supply documentation to back up your tax returns and financial statements. The IRS may audit you from time to time, or you may be required by your state government to undergo independent audits. You can avoid audits by having experienced professionals prepare your tax documents and by avoiding questionable joint ventures with for-profit enterprises.





What risks do volunteers bring to the table?

Because volunteers are protected under the Volunteer Protection Act, your organization assumes their liability (i.e., you can be sued for their actions). Reduce your risk of lawsuits through training, providing manuals and legal documentation, conducting evaluations, and implementing other volunteer management techniques.

What do nonprofits need to know before they buy insurance?

Look for top-rated insurance companies that have agents who specialize in nonprofit insurance. Each insurance policy can have many “customizable” add-ons, so make sure you know what you’re getting in terms of coverage, exclusions, and deductibles.

What’s the difference between buying insurance from an agent and an insurance company?

Agents simplify the purchasing process. The agents at insureon hand-compile insurance quotes based on your risks, allowing you to make a confident decision about your policies. Purchasing directly from an insurance company is more labor-intensive, and it’s harder to know when you’re getting a good deal.

What do nonprofits need to know about the ACA healthcare requirements?

You won’t need to insure your employees if you have fewer than 50. You will have to have health insurance for yourself and your family, and you’re subject to fines if you don’t have adequate coverage.

When should you purchase or update your small business insurance policies?

As your organization expands, changes its services, hires new employees, or signs contracts, you may need to purchase new insurance policies or upgrade your old ones.

Conclusion

As the owner of a nonprofit or social services organization, you help improve the lives of others. And because so many individuals count on your efforts, you need a business protection plan that ensures your organization can survive unexpected setbacks. This includes securing adequate insurance, mitigating your risk of losing your 501(c) status, and properly training your volunteers.

If you have any questions about small business insurance for your nonprofit organization, [an insureon agent](#) will be happy to help.





Quick Resources

[A.M. Best Insurance Provider Ratings Tool](#)

[Center for Nonprofit Excellence's How to Avoid Conflicts of Interest guide \[PDF\]](#)

[Federal Government Healthcare Website for Small Businesses](#)

[Insurance Journal Website](#)

- [“How to Help Small Businesses Avoid Underinsurance and Anticipate the Unexpected”](#)
- [“Nonprofits Especially Need Protection Against D&O Liability Risks”](#)

[insureon's Guide to Business Interruption Insurance \[video\]](#)

[insureon's Workers' Compensation Insurance Laws by the State](#)

[Kaiser Family Foundation's Subsidy Calculator](#)

News Stories and Articles Mentioned in this eBook

- [“Do I need D and O Insurance for My Nonprofit?”](#)
- [“Is Your Home-Based Business Covered?”](#)
- [“Judges Considering If Real Estate Was Transaction Or A Gift”](#)
- [“Nonprofit Directors and Officers Insurance: The Good, the Bad, and the Ugly”](#)
- [“Safeguarding Volunteers with Effective Risk Management”](#)
- [“What is Claims-Made Insurance Coverage?”](#)

[Better Impact Website](#)

[“State Law Nonprofit Audit Requirements”](#)

[“Tort Liability Costs for Small Businesses” \[PDF\]](#)

[Volunteer Protection Act of 1997 \[PDF\]](#)