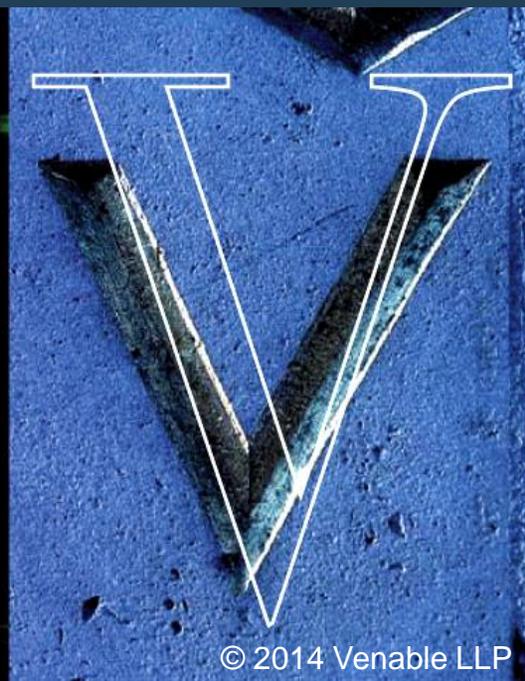
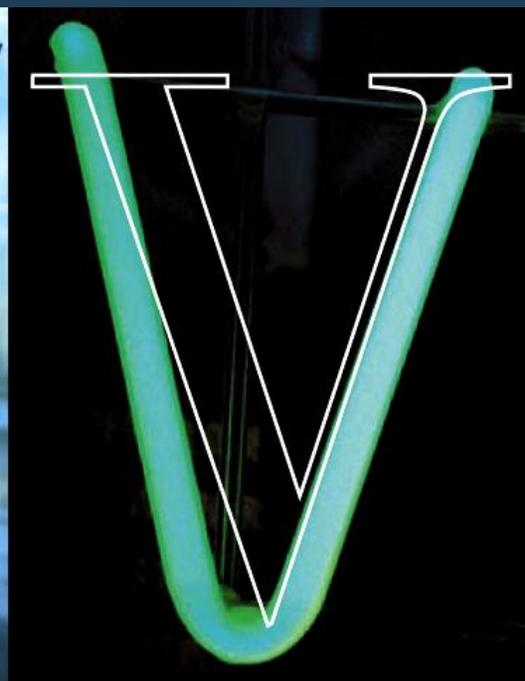
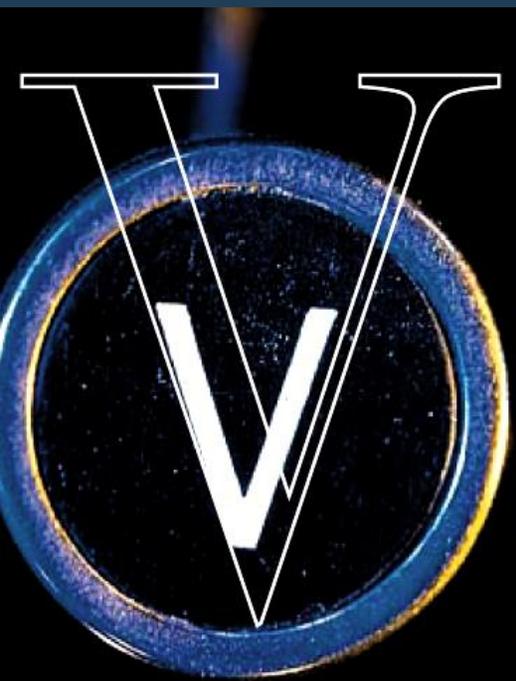


## *Second Annual Nonprofit Executive Summit:*

Bringing Nonprofit Leaders Together to Discuss Legal, Finance, Tax, and Operational Issues Impacting the Sector

Thursday, October 2, 2014  
Venable LLP  
Washington, DC





# CAE Credit Information

**\*Please note that CAE credit is only available to registered participants of the live program.**

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# Nonprofit Executive Summit Agenda

- Panel 1.**    **Fraud and Embezzlement: The Executive Team's Role in Detecting, Reporting, and Preventing Fraud**
  
- Panel 2.**    **Executive Employment Contracts: Getting Compliant and Creative**
  
- Keynote.**    **Midterm Landscape 2014**
  
- Panel 3.**    **Nonprofit Tax Issues: Where the IRS Is Today, and Where Congress Is Headed**
  
- Panel 4.**    **Best Practices for Enhancing the Nonprofit Governance Model**



*PANEL 1*

**Fraud and Embezzlement:  
The Executive Team's Role in Detecting,  
Reporting, and Preventing Fraud**



*Moderator*



*Jeffrey S. Tenenbaum, Esq.*  
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Chair, Nonprofit Organizations Practice  
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*Mary Pat Flaherty*  
Investigative Reporter  
The Washington Post



*William H. Devaney, Esq.*  
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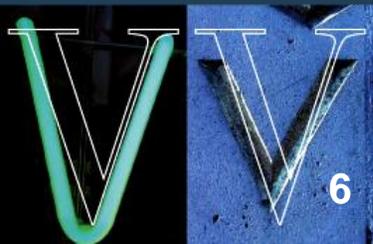


*Marion A. Hecht, CPA*  
Principal  
Fraud & Forensic Investigations  
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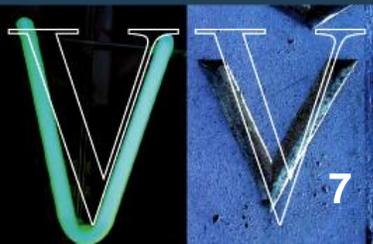
# Recent Examples of Nonprofit Fraud and Embezzlement





# Self, Inc.

- SELF, Inc. is a Philadelphia-based nonprofit organization that operates nine homeless shelters in the city.
- In August 2014, two former SELF executives were charged with theft stemming from allegations that they charged over \$350,000 to the organization's credit cards, spending the money on luxury items such as shoes and electronics, hotel stays and dining at the Four Seasons, and frequent trips to the Caribbean.
- Both former executives claim they reimbursed SELF, but prosecutors estimate they returned a pittance of what they spent (if they returned anything at all).
- The alleged embezzlement scheme began in 2005 and continued until 2010, just after both executives were fired.





# American Legacy Foundation

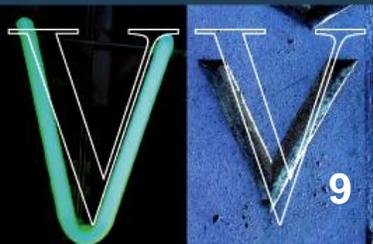
- In 2013, Sen. Charles Grassley (R-Iowa) opened an investigation into the American Legacy Foundation, a nonprofit dedicated to educating the public about the dangers of smoking.
- The investigation was spurred by a *Washington Post* report that the foundation had suffered an estimated \$3.4 million loss as a result of alleged embezzlement by a former IT specialist.
  - According to the *Washington Post*, the IT specialist generated 255 invoices for computer equipment sold to the foundation from 1999 to 2007, 75 percent of which were fraudulent.
  - When a whistleblower came forward (after his concerns were ignored years earlier), the foundation hired forensic examiners and notified the board of directors.
  - The U.S. Attorney's Office told the *Post* that its investigation had been closed in February 2012...***because the foundation had taken more than three years to report the missing equipment and lacked reliable records.***





# Vassar Brothers Medical Center

In late October 2013, the *Washington Post* reported that Vassar Brothers Medical Center in Poughkeepsie, New York, reported a 2011 loss of \$8.6 million through the "theft" of certain medical devices.





# American Red Cross (NY Chapter)

- On February 27, 2013, the former financial director for a New York chapter of the American Red Cross was sentenced to two to seven years in prison for grand larceny.
- As signatory to the chapter's operating account, the former director obtained an ATM debit card in her name and linked to the chapter's account to make cash withdrawals, sometimes as often as every few days.
- The former director used the money to pay for clothing, her children's tuition, and other personal expenses, embezzling over \$274,000 between 2005 and 2009.
- The missing funds were uncovered by an audit.





## H.O.W. Foundation

- On November 8, 2012, the former executive director of the H.O.W. Foundation, a nonprofit alcohol and drug treatment center in Tulsa, was sentenced to 15 months' imprisonment and ordered to pay over \$1.5 million in restitution for defrauding H.O.W. over the course of eight years.
- The former executive director wrote himself 213 unauthorized checks totaling over \$1.35 million. He also embezzled more than \$200,000 from a thrift store operated by the nonprofit.





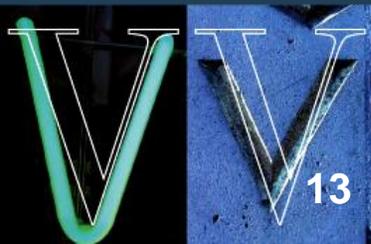
# Global Fund to Fight AIDS, Tuberculosis and Malaria

- In 2012, the Global Fund to Fight Aids, Tuberculosis and Malaria, (based in Geneva) reported to the federal government a misuse of funds or unsubstantiated spending of \$43 million by grant recipients in several countries.
- In a 2013 report, The Global Fund determined that 1.9 percent of Global Fund grants were misspent, fraudulently misappropriated, or inadequately accounted for.



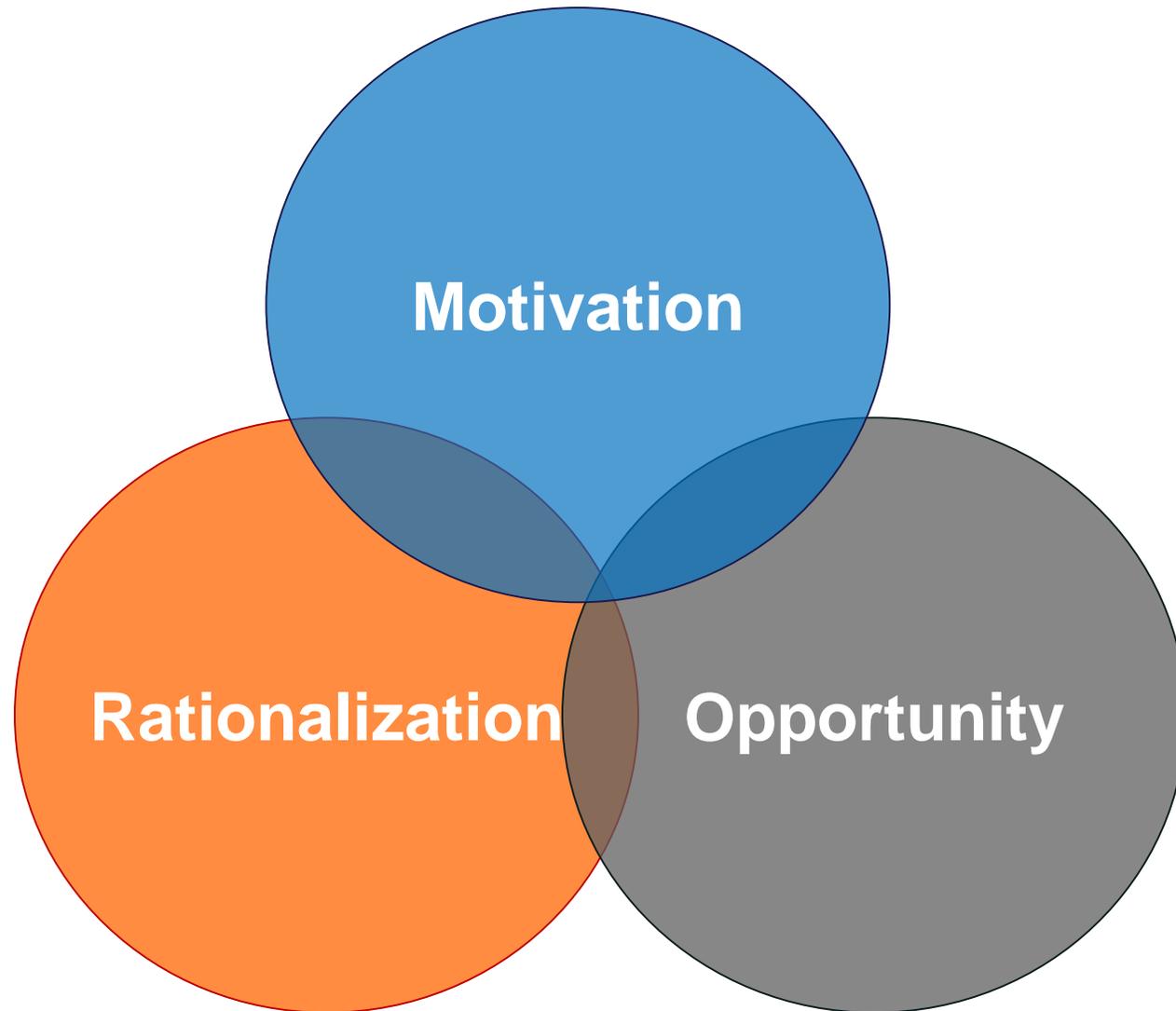


# Why Does Employee Fraud Occur?





# Why Does Employee Fraud Occur?





# Why Does Employee Fraud Occur?

## Motivation

Economic factors such as personal financial distress, substance abuse, gambling, overspending, or other similar addictive behaviors may provide motivation.

## Rationalization

The employee finds a way to rationalize the fraud...perceived injustice in compensation compared to for-profit enterprises, unhappiness over promotions, the idea that they are simply “borrowing” and fully intend to return the assets at a future date, or a belief that the organization doesn’t really need the assets and won’t even realize they are missing.

## Opportunity

The employee has sufficient access to assets and information to believe the fraud can be committed and successfully concealed.



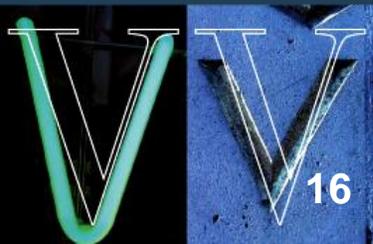


# Why Are Nonprofits Frequently the Victims of Embezzlement?

**Management and board members are often more trusting**

**Fewer stringent financial controls for nonprofits**

**A belief that audits will catch any fraud**





# Controls to Reduce Risk of Fraud



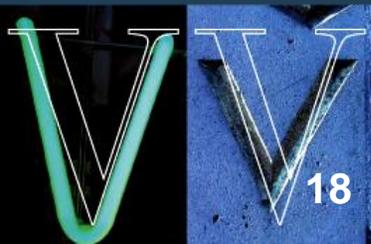


# Set the Tone at the Top

**Management,  
including directors  
and officers, need to  
“set the tone at the top”**

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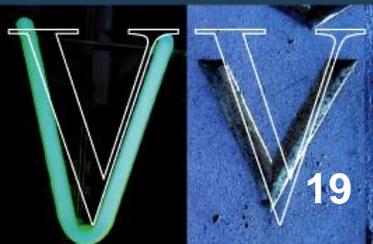
**Management  
must set a good example  
for fair and honest business practices**





# Role of the Board

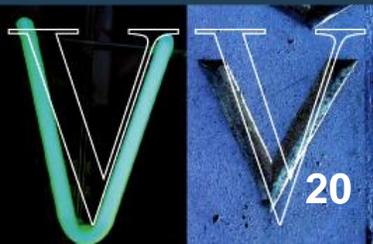
- Boards of directors have a fiduciary duty to ensure
  - Financial decisions are made soundly and legally
  - Individual directors and management always put the organization's financial and business interests ahead of personal financial and business interests
  - The board prudently manages the organization's assets in furtherance of the organization's stated purpose
  
- Business Judgment Rule protects actions taken by board members. However, those actions must be taken in good faith, with the degree of diligence, care, and skill that ordinary prudent people would exercise under similar circumstances.





# Role of the Board

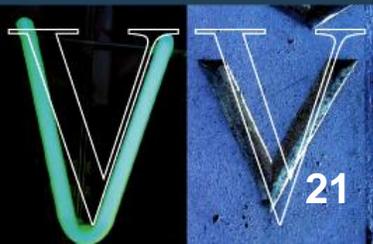
- Satisfying these obligations requires hands-on oversight of management
  - Review financial and other business records
  - Question management
  - Ensure the organization's policies, procedures, and mission are followed
- At least one board member should have relevant financial experience
- At least some board members should not be current or former associates of management. Consider a seasoned lawyer as a board member, as well as members with nonprofit and sector expertise.





# Fraud Risk Assessments

- The purpose of a fraud risk assessment is to identify where fraud may occur within an organization and how it may be perpetrated.
- The assessment process:
  - Define fraud as it pertains to the organization's industry, culture, and tolerance for risk;
  - In collaboration with management and other appropriate employees, identify relevant fraud risks and scenarios
  - Organize fraud brainstorming sessions for selected processes and/or departments
  - Map fraud risks with their mitigating controls and identify control gaps;
  - Measure each fraud risk; and
  - Prioritize fraud risks
- Conduct such assessments on a recurring basis. Risk level/tolerance may change.





# Segregation of Duties

- One individual should not be responsible for an entire financial transaction
  - Record
  - Reconcile
  - Custody of assets
  - Authorization
- Money Coming In: No single individual should be responsible for receiving, depositing, recording, and reconciling the receipt of funds.
- Money Going Out: No single individual should be responsible for authorizing payments, disbursing funds, and reconciling bank statements.
- Not enough staff to segregate these duties? Utilize compensating controls.



# Double Signatures and Authorizations

- Multiple layers of approval make it far more difficult for embezzlers to steal from your organization.
- For expenditures over a pre-determined amount, require two signatures on every check and two authorizations on every cash disbursement.
- Consider having an officer or director be the second signatory or provide authorization for smaller organizations.
- For credit cards, require prior written approval for costs estimated to exceed a certain amount.
- The person using the credit card cannot be the same person approving its use.
- Have a board member or officer review the credit card statements and expense reports of the Executive Director, CFO, CEO, etc.



# Require Backup Documentation

- All check and cash disbursements must be accompanied by an invoice showing that the payment is justified.
- If possible, the invoices or disbursement requests should be authorized by a manager who will not be signing the check.
- Only pay from original invoices.





# Never Pre-Sign Checks

- Many nonprofits do this if the executive director is going on vacation.
- Keep blank checks and signature stamps locked up.





# Purchasing and Fixed Asset Controls

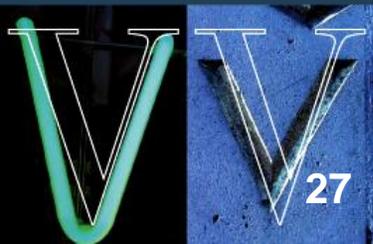
- Fair Bidding Process
  - All contracts over a pre-determined financial threshold should be subject to at least three bids, and approved by a manager uninvolved in the transaction.
  - Large contracts should be reviewed and voted on by the board.
  - Extensive review of related party transactions
  
- Fixed Asset Inventories
  - Conduct a fixed asset inventory review at least once per year to ensure that no equipment (computers, printers, etc.) is missing
  - Record the serial numbers of the equipment and consider engraving an identifying mark on each item in case of theft





# Automated Controls

- Use system-generated reports to detect fraud when it occurs.
- Provide ongoing monitoring and feedback mechanisms (e.g., system-generated e-mails notifying management of exceptions)
- Physical access codes
- System passwords
- Use notification and alert services to alert the organization of possible debits to accounts.
  - Positive pay exceptions notifications
  - Wire notifications (incoming/outgoing)
  - ACH Fraud Filter notifications
  - Balance threshold notifications





# Conduct Background Checks

- Background checks on new employees and volunteers are important. Many organizations skip this basic step.
- The Association of Certified Fraud Examiners reports that 7% of embezzlers have been convicted of a previous crime.
- Background checks can reveal undisclosed criminal records and prior instances of fraud, allowing you to avoid a bad hire in the first place.
- They are also fairly inexpensive and should be made a part of your hiring process.





# Mechanisms for Reporting and Investigating Fraud

- Explain what to do if employees/constituents perceive a fraud threat.
  - Whom to contact
  - How to contact
  - Anonymity
  - Evaluations of reports received
  - Incident responses
- Provide a means of anonymous communication.
- Employees must have the means to contact a board member if something needs to be reported and they do not feel comfortable reporting to management.
- Board members must be prepared to take these reports seriously, keep the reporting employee protected, and contact legal counsel.





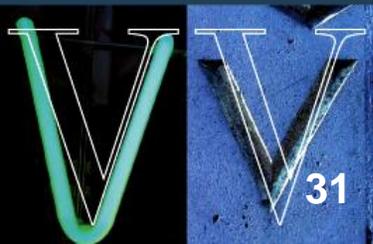
# Effective Compliance Programs

- The best way to prevent embezzlement and to protect an organization is a comprehensive and vigorous compliance program that is more than a mere “paper program.”
- Any effective compliance program will:
  1. Be tailored to the specific organization, so that the controls mitigate the risks inherent in that organization’s business and address any applicable government regulations and industry standards
  2. Include a written corporate code of ethics. The organization’s commitment to ethical behavior should be clearly and concisely communicated to the board, management, and employees. This commitment to the code should be affirmed by all employees on a periodic and ongoing basis.
  3. Be owned by senior management. Management must be proactive. The board must have ultimate oversight and control of the program.
  4. Provide for regular education and training for directors, management, employees, volunteers and staff



# Effective Compliance Programs

- Any effective compliance program will (cont'd):
  5. Be regularly monitored and audited to ensure that it is working
  6. Contain effective means to report violations and concerns, such as whistleblower hotlines or other anonymous reporting mechanisms
  7. Provide meaningful discipline for violation of the policy. A reputation for aggressively investigating fraud can have a strong deterrent effect, while a reputation for ignoring possible fraud is an invitation to commit fraud.
  8. Require that appropriate steps are taken if a crime occurs
  9. Address any control weaknesses uncovered





# What to Do if an Issue Is Discovered

- Selection of investigative team
- Evidence preservation
- Evidence gathering
- Background checks in an investigation
- Interviews
- Reporting
- Remediation

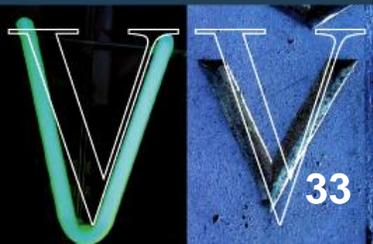




## Nonprofit Fraud...Exposed

FORM 990, PART VI, SECTION A, LINE 5: REGRETTABLY IN LATE APRIL  
WAS DISCOVERED THAT A CSAVR EMPLOYEE HAD ENGAGED IN SIGNIFICANT  
OF EMBEZZLEMENT AND EMPLOYEE THEFT FROM 2003 UNTIL APRIL 201  
DETERMINED THAT THE SAID EMPLOYEE ALLEGEDLY STOLE OVER \$824  
CSAVR.

(Image courtesy of the *Washington Post*)





# Reputational Risk – Best Practices





# Things to Think About

- Professional skepticism
  - It is ok to ask questions to determine responses that do not make sense.
  - Follow up and seek documentation and/or other supporting information.
  - Rule of Two – Always a good idea to run questionable events or transactions by someone.
  - Independent consultation is valuable.
  
- Ostrich attitude
  - Head in the sand – Can hurt the organization’s reputation, sustainability, and economic stability.
  - Instead – Four “I”s: Interview, Intervene, Interpret, Inspect....
  
- Pressures
  - Environment, Economic, Financial, Personal, Organization
  - (Fraud Triangle – Rationalization, Pressure, Opportunity)





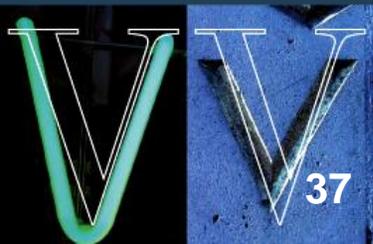
# Things to Think About

- Do you know where your assets are? What about liabilities?
- Big check?
  - Slow down and look beyond the numbers on the check to the issuer.
  - Gifts for no consideration can be “clawed back”.
  - Seek financial information on the donor, look at the footnotes to financial statements.
  - Ask questions.
  - Examples of damages to nonprofits
    - Ponzi schemer gifts that a Receiver will claw back.
    - Bankruptcy Code provides for preference actions against recipients of gifts based on facts and circumstances.
- Entity level controls
  - Employee handbook and code of conduct, regularly reviewed by all employees with signature/date.
  - Anti-fraud controls.



# Preventive Measures and Quick Tips

- Look at checks (front and back)
  - [Checks endorsed to subsequent payee]
- Bank statements should be sent to CEO, accounts reconciled on regular basis
  - [Payees altered and ATM withdrawals not authorized at strange times in the late evening]





# Preventive Measures and Quick Tips

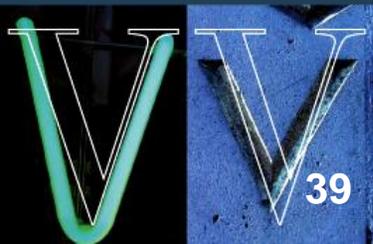
- Credit card abuse
  - Look at the transactions and the purpose of the charges, and determine who has authorization to use the credit cards.
  - Personal expenses NEVER should be charged on a corporate credit card.
  - Document authority.
  - Reimbursement from an employee – why not add --the requested reimbursement is pursuant to our firm policy and is true and complete.
  - Seek advice from HR and potentially counsel before changing firm forms.
  - [Senior executive used company credit card for personal use, travel for relatives, payments to consultants with less than arm's length relationship, additional credit cards paid by firm, among others.]
  - [Look at contracts with board.]





# Internal Controls

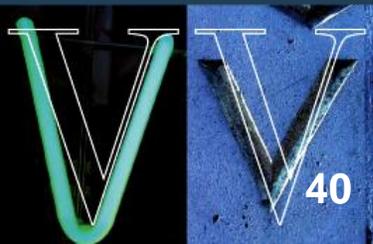
- Vendors
  - Phantom or real? Or, related parties?
  - Do employees have second jobs?
  - Document and look at the possibility of organization funds used for purposes other than the allowed business purpose.
  - [Classic examples include staff as well as management feeling they can rationalize the theft of firm assets for their off duty jobs, among other reasons.]
  
- Process controls
  - Over recording transactions, segregation of duties, approval limits, continuous monitoring, etc.





# Reminder – The Fraud Triangle

- Incentives and pressures
  - What are the incentives and pressures that drive financial performance?
- Opportunities
  - How strong are internal controls, internal audit department, and anonymous reporting programs?
- Rationalization/concealment
  - Character, ethical values, integrity, and how management may justify their actions





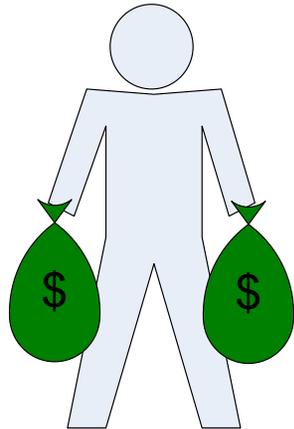
## Reminder - Fraud is defined as:

*“...any intentional act or omission designed to deceive others and resulting in the victim suffering a loss and/or the perpetrator achieving a gain.”*

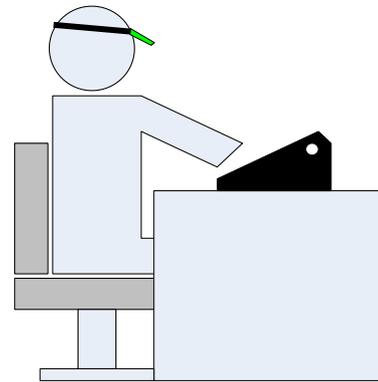
Source: *Managing the Business Risk of Fraud: A Practical Guide*



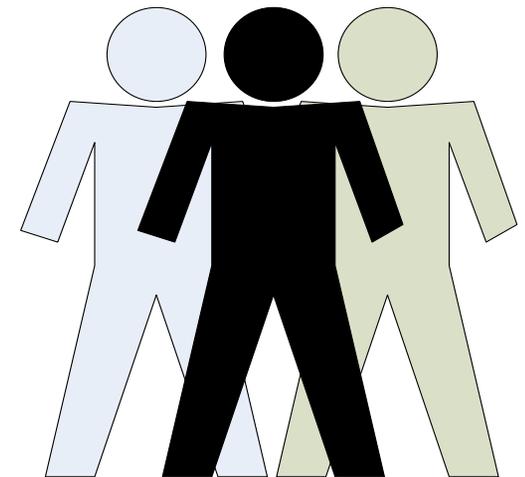
# Reminder – Three Fraud Categories



**Asset  
Misappropriation**



**Financial  
Statement Fraud**

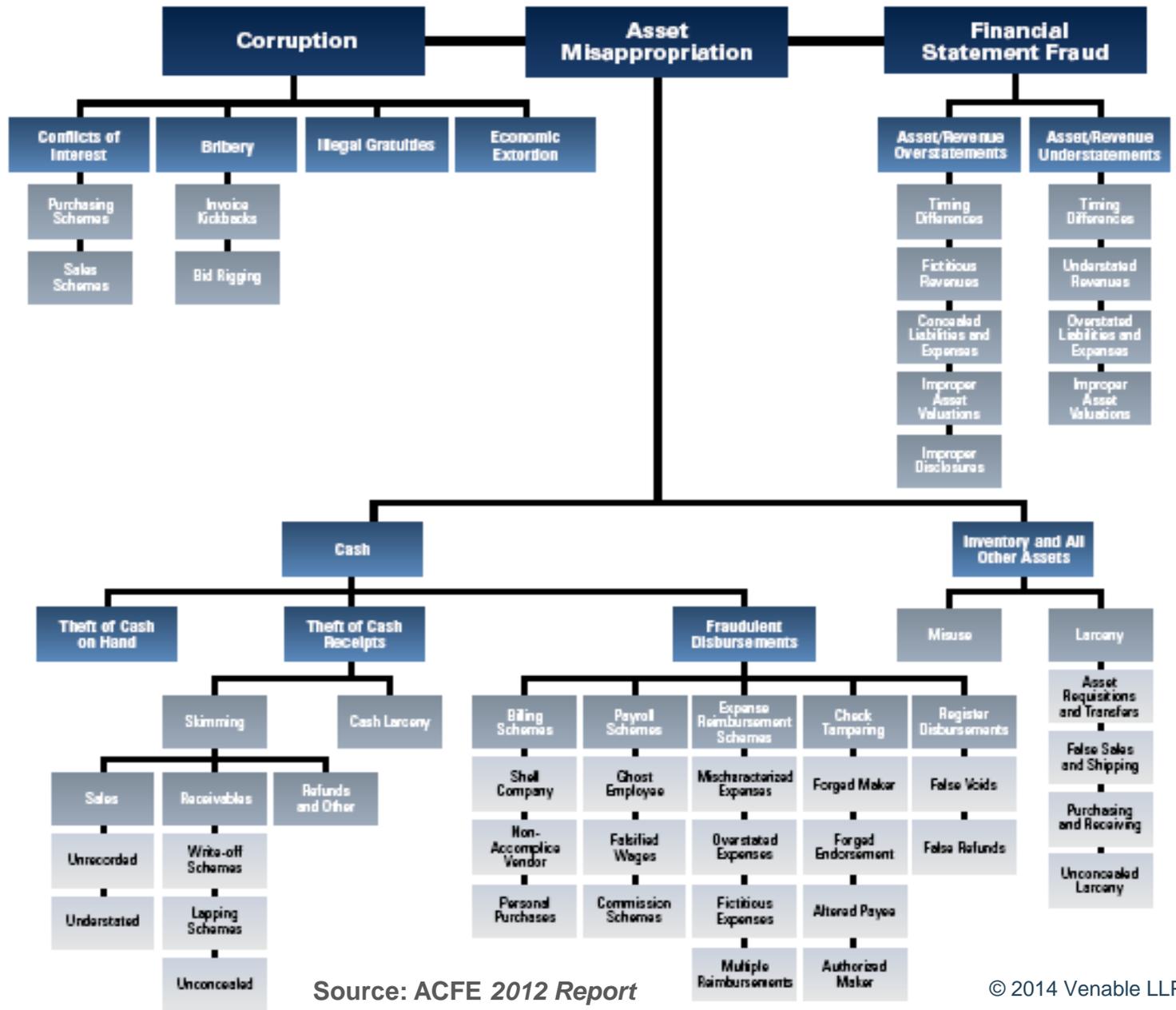


**Corruption**

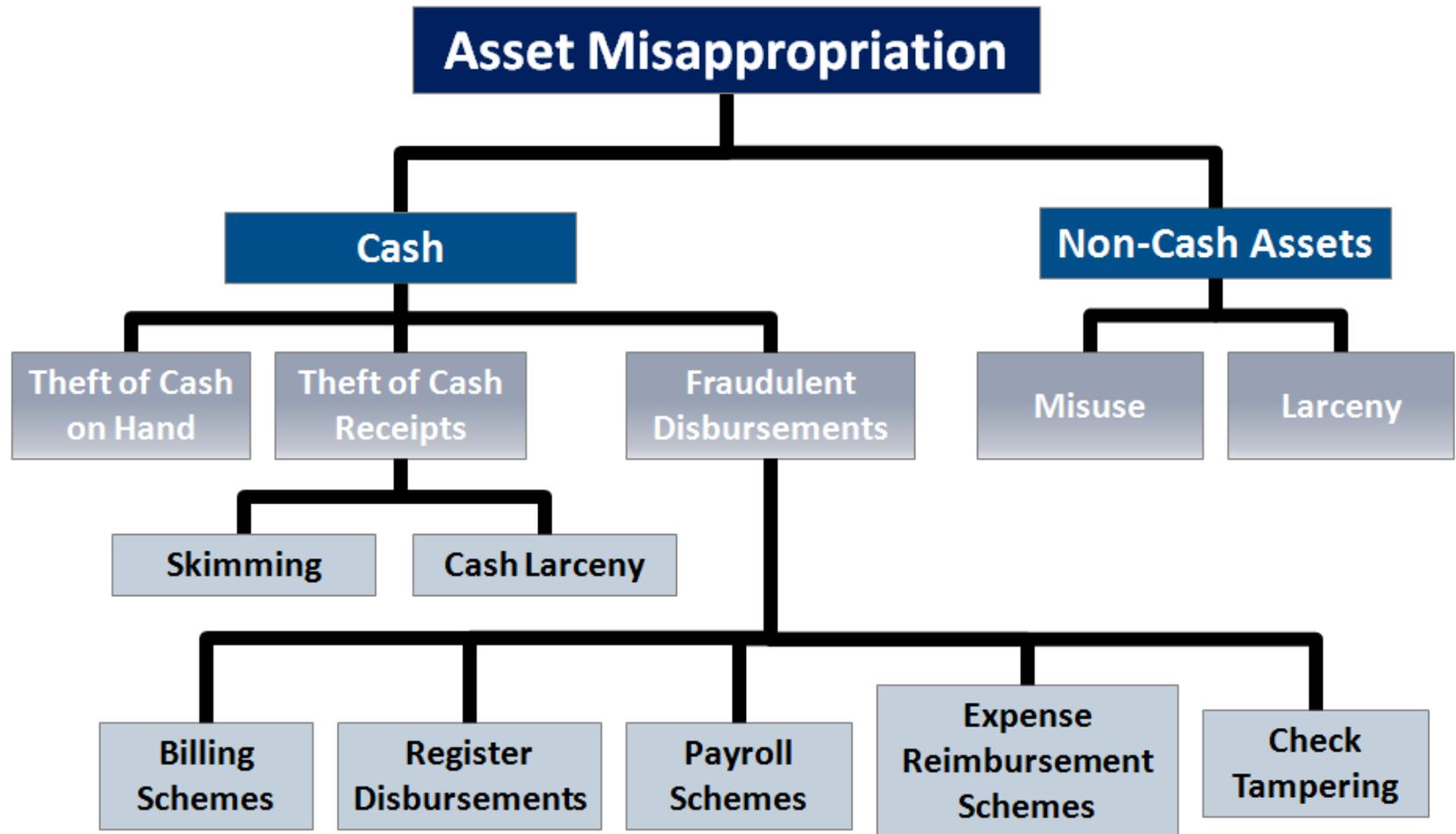




# Uniform Occupational Fraud Classification System

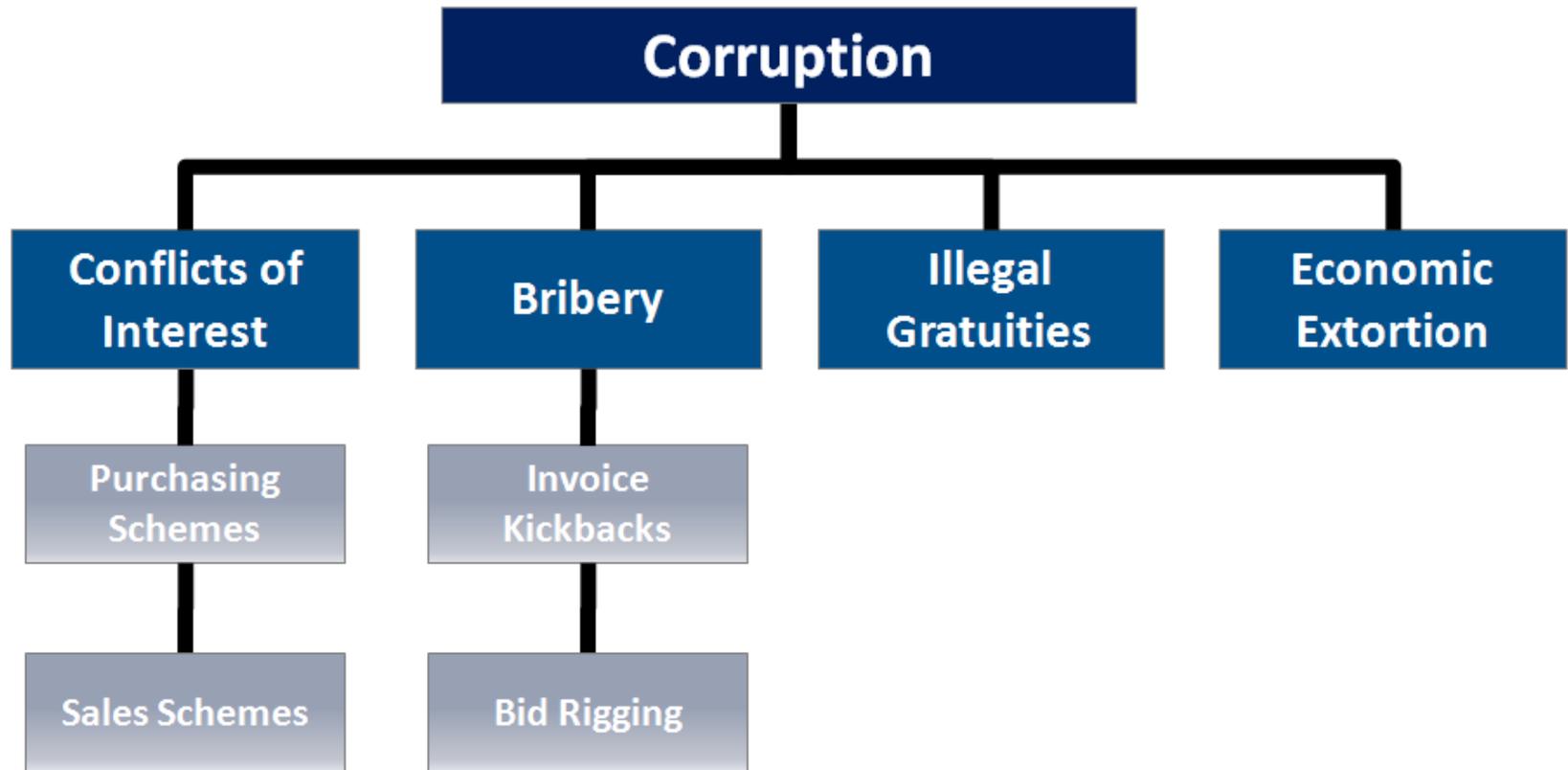


# Asset Misappropriation



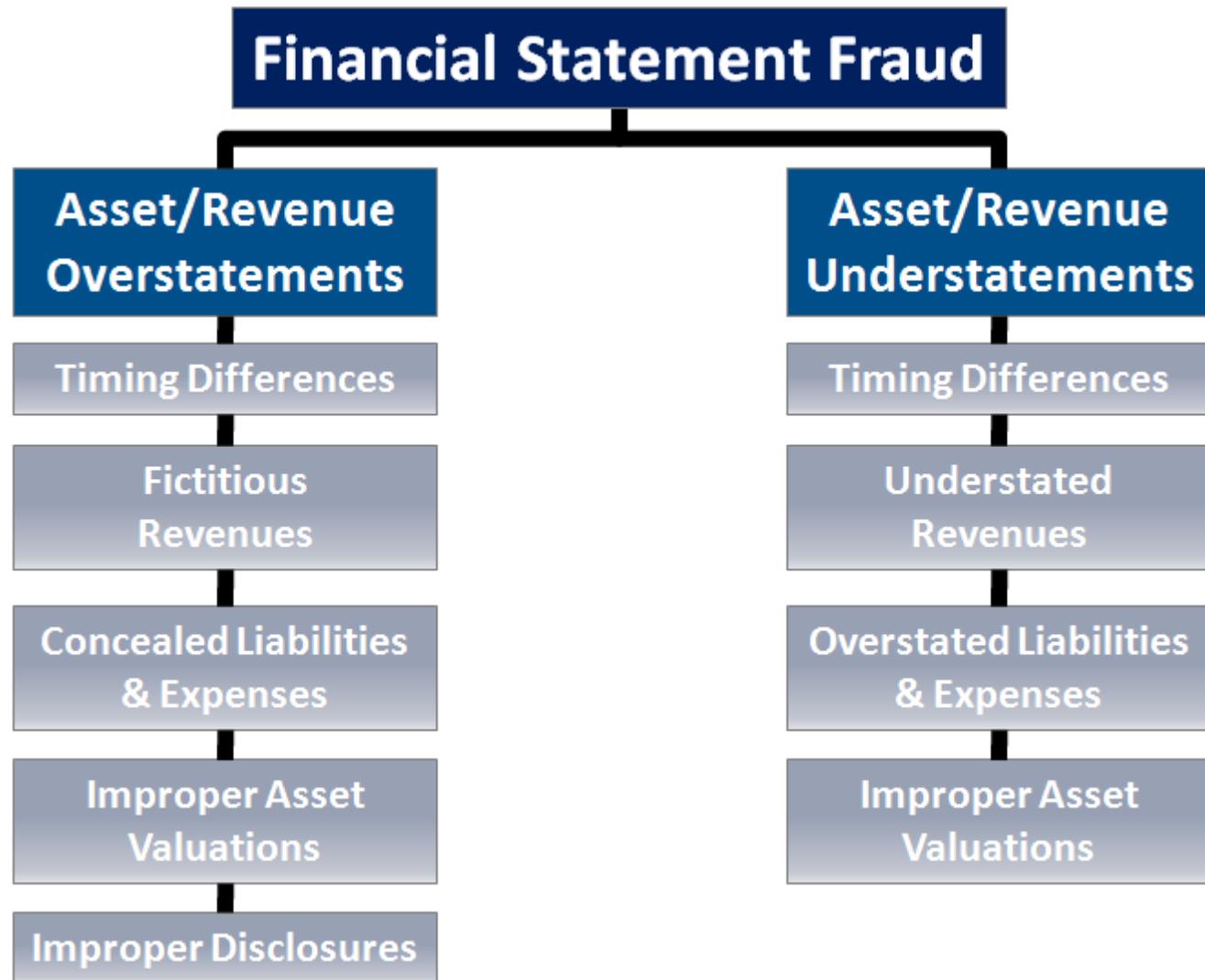


# Corruption





# Financial Statement Fraud



# Categories of Fraud

## Frequency of Fraud by Type





# How Fraud Affects Our Clients

- According to the ACFE's 2012 *Report to the Nations on Occupational Fraud and Abuse*:



**The typical organization loses an estimated 5% of its annual revenues to occupational fraud.**

- Median loss: \$140,000
- Median duration: 18 mo.

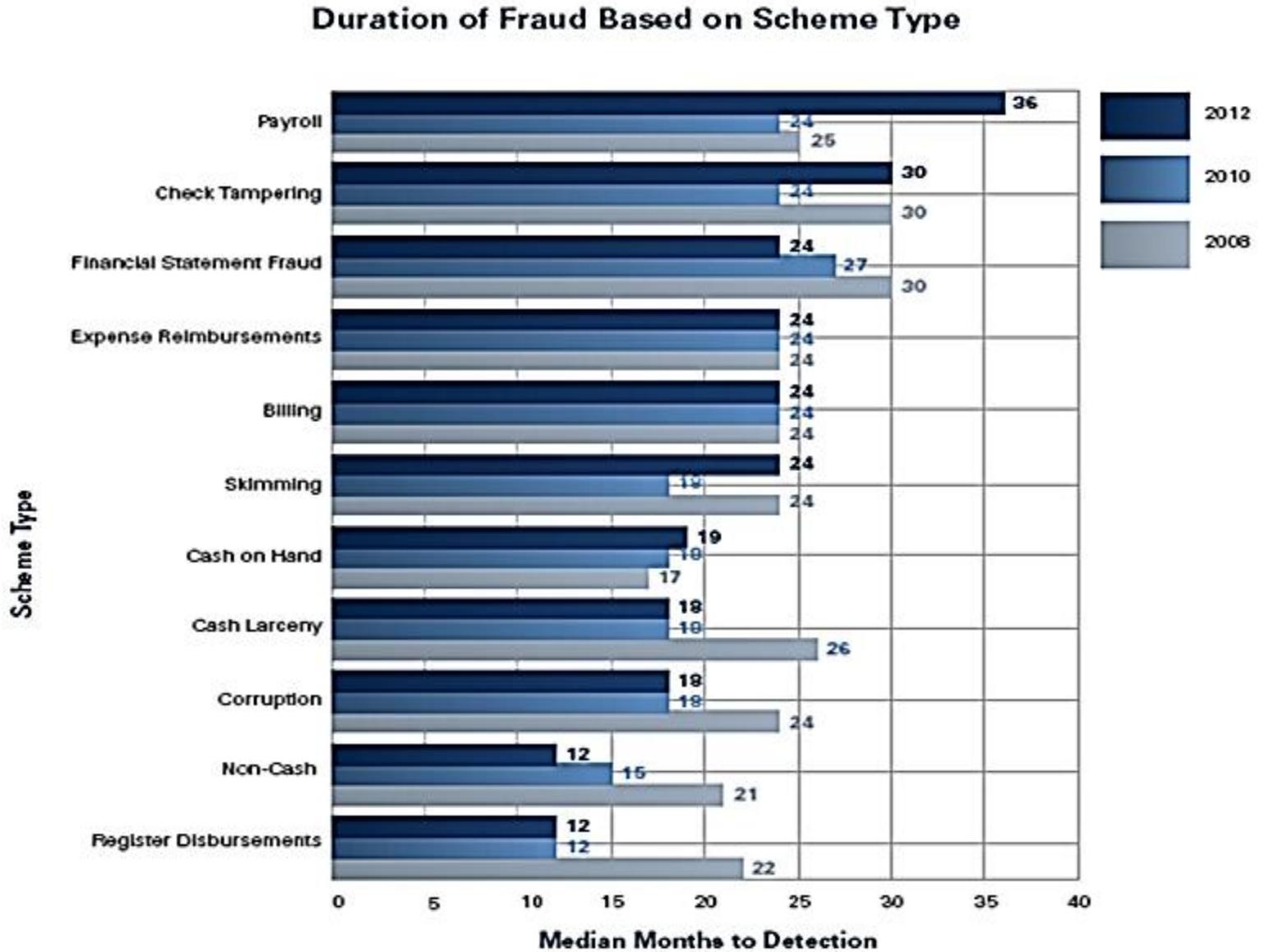
# Victim Organizations

## Prevalence by Size of Victim Organization





# Gestation Period for Fraud Detection



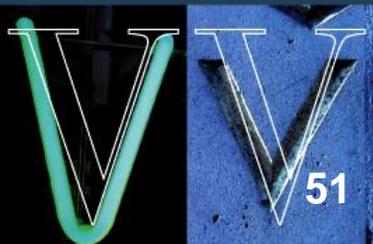
Source: ACFE 2012 Report to the Nations



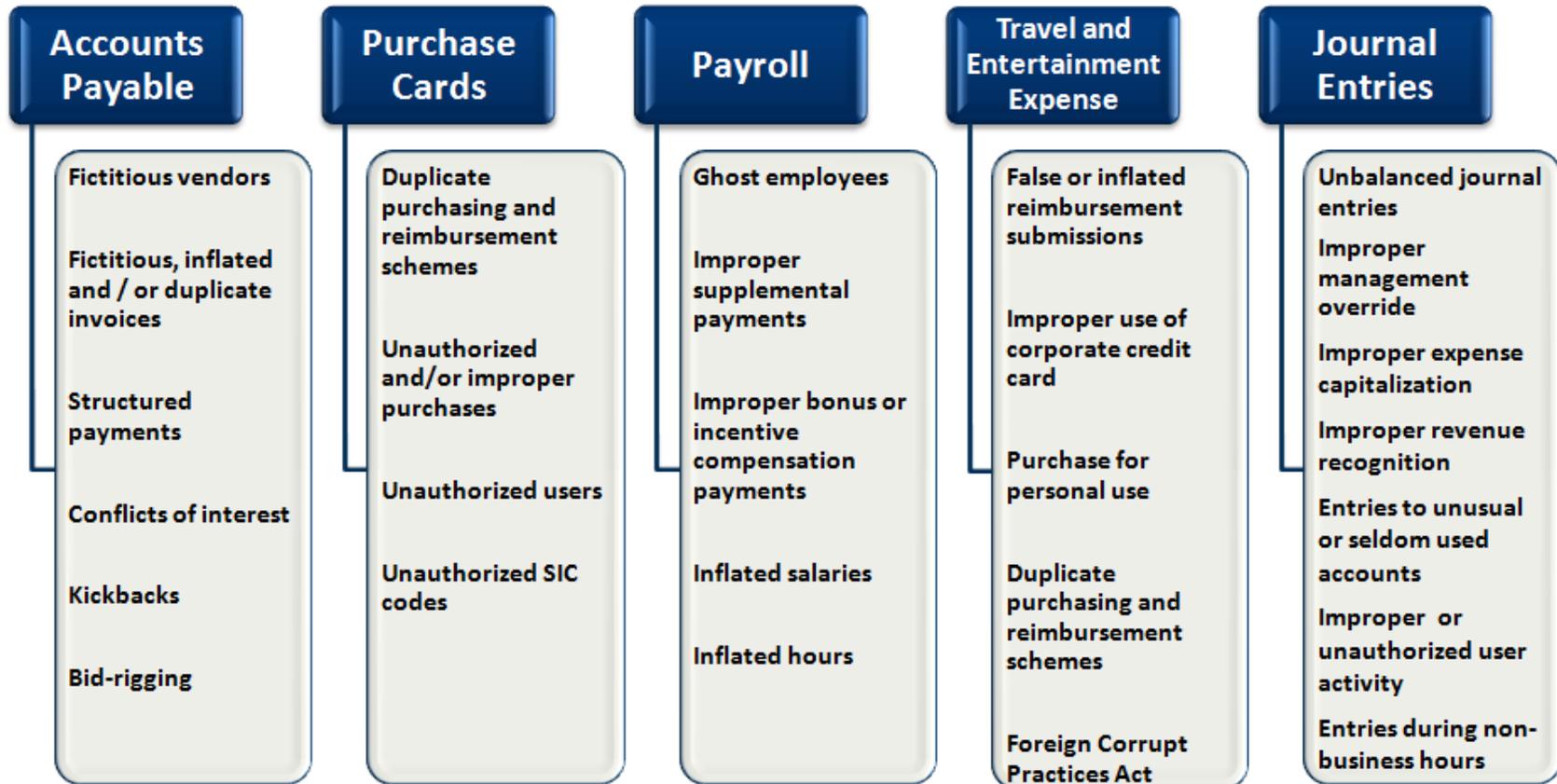


# Forensic Data Analysis

- **Forensic Data Analysis** is the process of gathering, summarizing, comparing, and aggregating existing disparate sets of data that organizations routinely collect in the normal course of business with the goal of detecting anomalies that are traditionally indicative of fraud or other misconduct.
- Can be used in the prevention, detection, or response of fraud or other misconduct
- Provides additional comfort to C-Level executives, audit committees, internal audit departments, and management

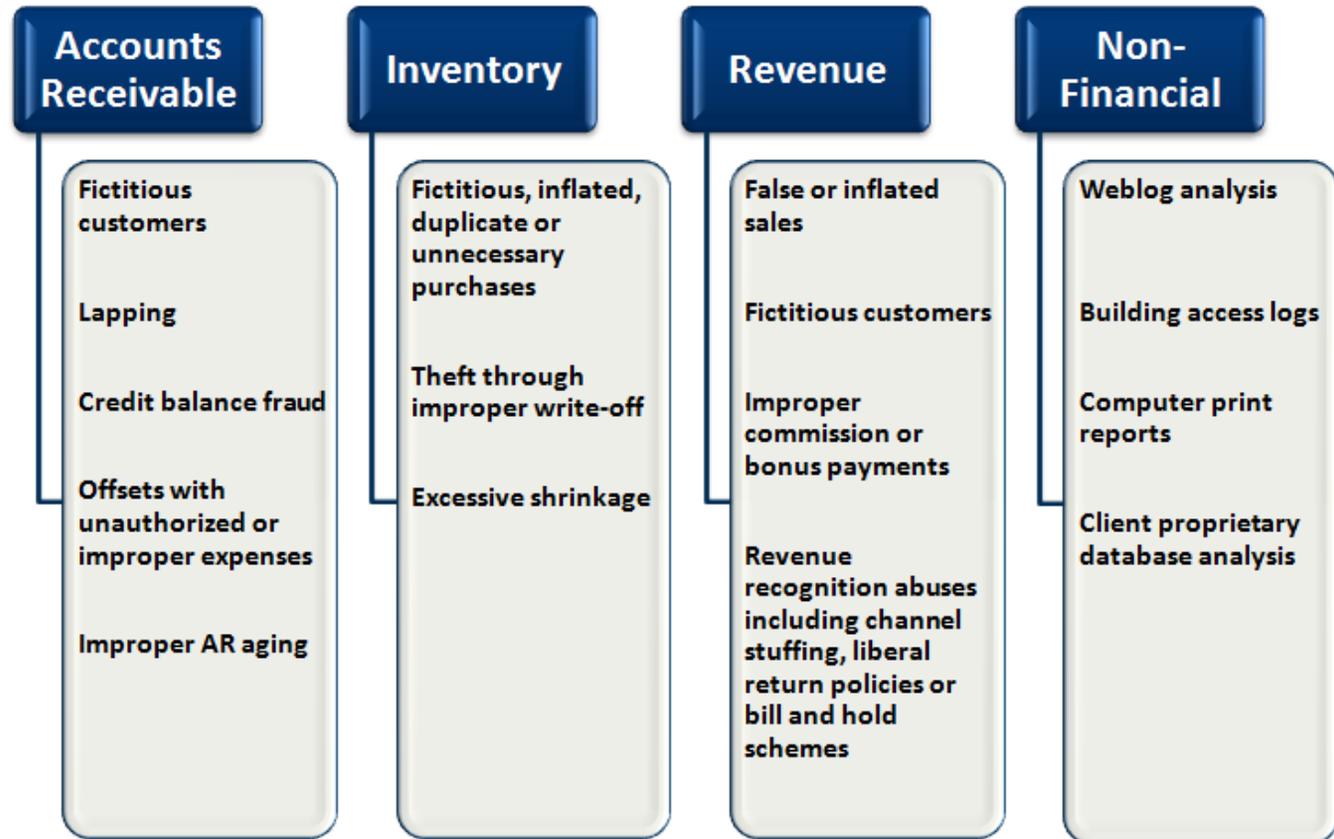


# Types of Fraud and Areas of Analysis



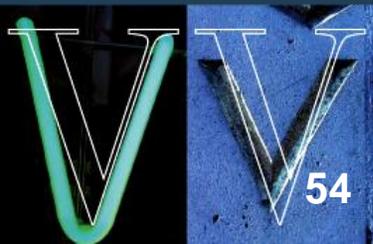


# Types of Fraud and Areas of Analysis





Questions?





# Contact Information

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*PANEL 2*

**Executive Employment Contracts:  
Getting Compliant and Creative**



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*Lawrence D. Sloan, CAE  
President and CEO  
Society of Chemical Manufacturers and Affiliates*





# Offer Letter vs. Formal Contract





# Offer Letter vs. Formal Contract

- Formal contracts provide security to both the executive and the organization.
- Trend: Formal contracts are becoming increasingly common for CEOs. Typical length is 3 to 5 years for both the initial term and contract extension.
- Tip: Be careful with “evergreen” provisions.





# Key Compensation Elements





# Key Compensation Elements

- Whether in an offer letter or formal agreement, the following compensation elements should be addressed in detail:
  - Base salary
  - Incentive compensation/bonus
  - Deferred compensation
  - Perks





# Base Salary

- Not just salary for the initial year but also how salary adjustments will be addressed in future years
  - Automatic increases (cost of living, etc.)
  - Market based (public surveys, compensation consultant, etc.)
- Trend: Common for boards to state that salary will be reviewed annually and adjusted based on performance (organizational and individual) and market movement
- Tip: Review compensation information and salary for prior incumbent (Form 990s) over several years to get a sense of salary levels and annual adjustments.



# Bonus

- Your agreement should detail both the “target” and “maximum” bonus opportunity.
  - Critical for setting expectations
  - With board turnover, it is also important for the understanding to be memorialized/documentated for consistency.
- Trend: With CEO compensation levels rising, association boards want to tie compensation directly to performance.
- Tip: Make sure there is an established performance evaluation process, and that you are involved in setting goals and metrics.





# Deferred Compensation

- Ensuring you have adequate savings to offset retirement costs is critical.
  - Start now rather than waiting until you have a short employment horizon (difficult to accrue ample savings in the last few years)
  - Try to keep the arrangement simple.
- Trend: 457(b) and 457(f) arrangements (detailed on the following slides) are the most common vehicles.
- Tip: Focus the board on the annual dollar amount you desire in deferred comp rather than getting them to commit to a specific income replacement ratio.





# “Nonqualified” Deferred Compensation

- Section 457(b) Plan or Agreement
  - Employee contributions limited to \$17,500 per year (indexed for inflation)
  - Can be fully vested
  - Minimum distribution rules apply beginning at age 70 ½
  - Taxed only when actually distributed
  - No rollover to IRA or qualified plan
  - Can be transferred to §457(b) plan of subsequent, tax-exempt employer





# “Nonqualified” Deferred Compensation

- Section 457(f) Plan or Agreement
  - Contributions—no limit
  - Contributions and earnings must be subject to “substantial risk of forfeiture” for at least two years from date of agreement
  - “Substantial risk of forfeiture” usually means a requirement to perform substantial services until the “substantial risk” lapses (*i.e.*, the vesting date)
  - Vesting date is usually end of contract or anticipated retirement date
  - “Substantial risk” rule not violated if employment terminates before vesting date other than by voluntary resignation (*e.g.*, death, disability, termination by employer)
  - Taxed when vested
  - Can’t extend vesting date
  - Usually distributed when taxed
  - No rollover or transfer to further defer tax
  - May be subject to §409a, if distribution deferred beyond vesting



# Excess Benefit Transactions

- Transaction in which an economic benefit is provided, directly or indirectly, by a 501(c)(3) or 501(c)(4) tax-exempt organization, to or for the use of a disqualified person, where the value of the benefit provided exceeds the value of the consideration received by the organization
- Disqualified person is one in a position to exercise substantial influence over the organization's affairs (includes directors, officers, and key employees)
- Compensation arrangements to disqualified persons must be presumed reasonable and not providing excess benefits



# Excess Benefit Transactions

- Reasonableness of compensation for purposes of determining excess benefits - all compensation provided by a 501(c)(3) or 501(c)(4) organization to a disqualified person in exchange for the performance of services is taken into account:
  - Salary, bonuses, severance, deferred compensation, insurance premium payments, fringe benefits, all non-cash compensation
  
- Excess benefit transactions may result in:
  - Severe sanctions imposed by IRS
  - Revocation of an organization's tax-exempt status
  - Excise taxes (IRC section 4958)





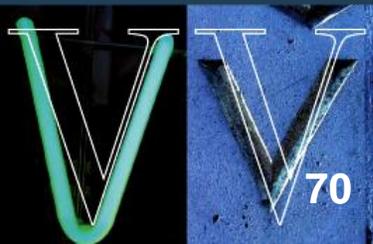
# Excess Benefit Transactions

- Presumption of reasonableness of compensation:
  - Compensation arrangement must be approved in advance by an authorized body of the tax-exempt organization, composed of individuals who do not have a conflict of interest concerning the transaction
  - Prior to making its decision, the authorized body obtained and relied upon appropriate data as to comparability, and
  - The authorized body adequately and timely documented the basis for its determination concurrently with making that determination
- IRS can always refute.
- Recommend organization retain all supporting documentation, including transaction terms, approval date, authorized body members present during debate and approval, the comparability data relied upon, and basis for determination



# Perks

- Common perks and benefits for CEOs:
  - Supplemental insurance
  - Memberships in professional organizations
  - Annual physical exams
- Trend: With increased scrutiny, the prevalence of CEO perks have been declining (e.g., housing, car leases, sabbaticals, social clubs).
- Tip: Focus only on perks that are important to you (i.e., long-term care or business class travel) – otherwise it might be better to negotiate a higher salary.





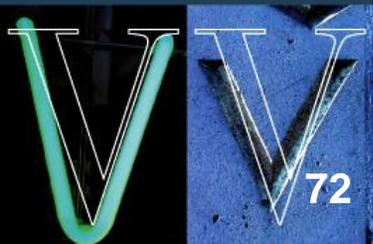
# Other Key Contractual Elements





# Severance

- Discuss severance provision up front while the relationship is strong; understand relationship with “cause” terminations
- Trend: Typically 6 to 12 months of salary
- Tip: Ensure that the severance length is at least as long as any non-compete period. Clarify whether severance is based on base salary or base plus target/pro-rated bonus.





# Restrictive Covenants

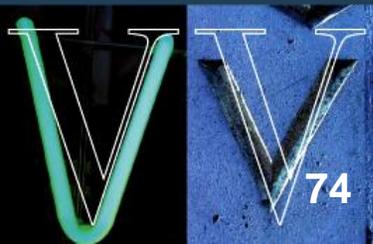
- Confidentiality
- Non-solicitation
  - Employees
  - Members, customers
- “Do Not Compete”
- Limits on outside activities





# Executive Authority and Reporting

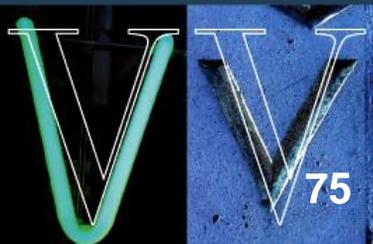
- “Full time and attention”
- Description of responsibilities  
(*a.k.a. The Job Description*)
- Authority over staff
- Report to board or committee
- Annual reviews





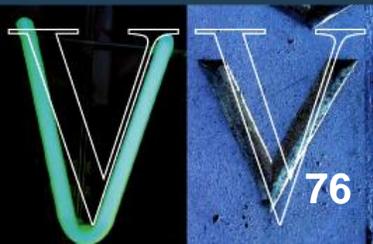
# Term and Termination

- Term, renewal
- Rights to terminate, “cause”
  - Right of executive to terminate for “good reason”
- Payments upon termination
  - Accrued obligations
  - Severance
  - Liability release as a pre-condition
- Return of records and association property
- Dispute resolution – arbitration vs. courts





Questions?





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**KEYNOTE INTRODUCTION**

**James L. Shea, Esq.**  
**Chairman, Venable LLP**

**KEYNOTE PRESENTATION**

**Midterm Landscape 2014**

**Domenico Montanaro**

**Political Editor PBS *NewsHour***



## *Keynote Speaker*



***Domenico Montanaro***  
**Political Editor**  
***PBS NewsHour***



**PANEL 3**

**Nonprofit Tax Issues:  
Where the IRS Is Today,  
and Where Congress Is Headed**



*Moderator*



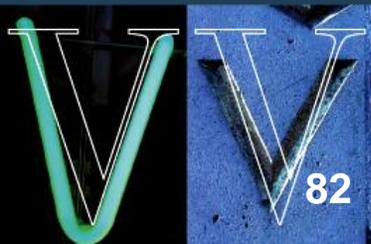
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# IRS Developments





# Lois Lerner

- How it began:
  - The IRS failed to rule on exemption applications filed by organizations that were potentially going to engage in political activities
  - The IRS identified such entities by looking for certain words in the organization's name
  
- What is the result:
  - IRS officials: Individuals were fired, individually named in lawsuits, and Lois Lerner has been called to testify (or not testify) before Congress on numerous occasions
  - New leadership with far less EO specific experience
  - EO Division: Has been attacked for bias, has been attacked for losing and/or destroying emails, and has been portrayed as incompetent and/or corrupt





# Lois Lerner

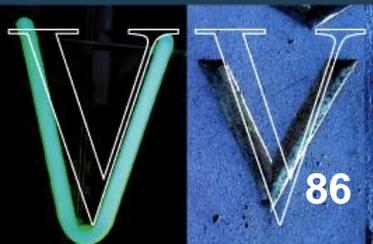
- Problems:
  - A less knowledgeable EO leadership team
  - A more timid EO leadership team
  - A focus on clearing the decks, not reaching the correct results
  
- Opportunities:
  - Less enforcement
  - Lack of follow through on prior enforcement initiatives
  - Focus on clearing the decks





# Religious Organizations

- How it began:
  - The IRS was sued several times in the last few years by organizations seeking for the IRS to engage in greater enforcement initiatives against religious organizations.
  
- What is the result:
  - The IRS and DOJ have announced an increase in enforcement efforts against religious organizations.





# Automatic Revocation

- How it began:
  - As of 2010, organizations that failed to file a Form 990 or Form 990-N for three consecutive years were automatically revoked.
  - The IRS revoked many, many entities that should not have been revoked.
  - The IRS failed to adequately prepare for the impact of applications for reinstatement recognition of exempt status by automatically revoked organizations or establish procedures for correcting erroneous revocations.
  
- What is the result:
  - Significant delays
  - Less thorough reviews of exemption applications
  - Creation of Form 1023-EZ





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# Impact on Exempt Organizations





# Impact of IRS Developments

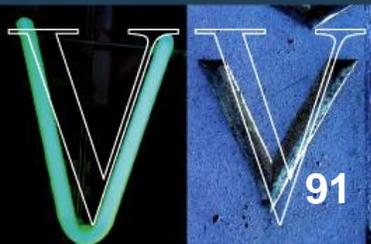
- A lack of published IRS guidance
- Fewer enforcement initiatives
- Less focus on applications for recognition of tax-exempt status
- Enforcement focus on religious organizations





# What Does This Mean for You?

- The IRS is less focused on enforcement now.
  - When looking at potential risks of activities and tax positions, one consideration must be the lack of IRS enforcement.
  - The lack of industrywide programs may mean less lead time prior to an examination.
  
- The IRS review of applications is less involved now.
  - Now is the time to file a Form 1023 or Form 1024.
  
- The IRS has not gone away.
  - Pay attention to public reports about your organization or industry.





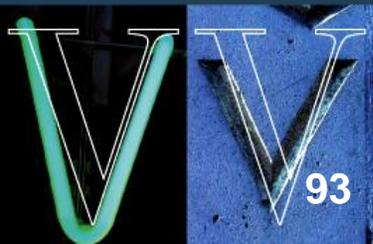
# Current Focus of IRS Enforcement





# Areas of IRS Focus

- Church audits
- Executive compensation
- Political activities
- Unrelated business income
  - Income and expenses allocation
  - NOLs





# Factors Affecting Tax Reform





# Factors Affecting Tax Reform

- FOR
  - Complexity causes errors
  - Complexity impedes collection
  - Complexity is expensive
  
- AGAINST
  - Elections
  - Political will
  - Lowering rates, broadening the base, maintaining revenue neutrality





# Principles of Good Tax Policy

- Equity and Fairness.*  
Similarly situated taxpayers should be taxed similarly.
- Certainty.*  
The tax rules should clearly specify when the tax is to be paid, how it is to be paid, and how the amount to be paid is to be determined.
- Convenience of Payment.*  
A tax should be due at a time or in a manner that is most likely to be convenient for the taxpayer.
- Economy in Collection.*  
The costs to collect a tax should be kept to a minimum for both the government and taxpayers.
- Simplicity.*  
The tax law should be simple so that taxpayers understand the rules and can comply with them correctly and in a cost-efficient manner.
- Neutrality.*  
The effect of the tax law on a taxpayer's decisions as to how to carry out a particular transaction or whether to engage in a transaction should be kept to a minimum.
- Economic Growth and Efficiency.*  
The tax system should not impede or reduce the productive capacity of the economy.
- Transparency and Visibility.*  
Taxpayers should know that a tax exists and how and when it is imposed upon them and others.
- Minimum Tax Gap.*  
A tax should be structured to minimize noncompliance.
- Appropriate Government Revenues.*  
The tax system should enable the government to determine how much tax revenue will likely be collected and when.



AICPA, Guiding Principles for Good Tax Policy: Framework for Evaluating Tax Proposals, 2001; <http://www.aicpa.org/taxreform>.



# Charitable Donation Deduction

- Charitable donations are an itemized deduction
  
- Generally the fair market value of the gift
  - Deduction Rate = Marginal Tax Rate
  - Applies to most gifts of appreciated property
  
- Limitations
  - Cash contributions up to 50% of AGI
  - Capital gain property up to 30% of AGI
  - Pease Limitation





# The Problem

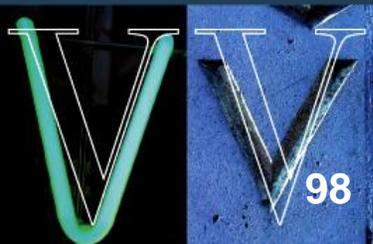
- 3 people donate \$100 to the Save the Whales Foundation
  - Mrs. Bellevue earns \$20,000,000 and owns a mansion. Her donation costs her \$60 after taxes.



- Mr. Maplewood earns \$100,000 and owns a condominium. His donation costs him \$72 after taxes.



- Mrs. Fishtown earns \$20,000 and lives in an apartment. Her donation costs her \$100 after taxes.





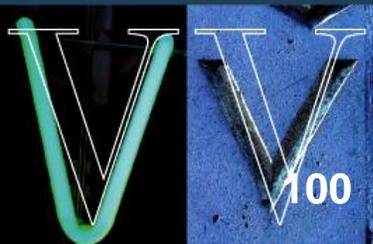
# Nonprofit Reform Proposals





# Previous Proposals

- Reduce the tax benefit for the wealthy
  - Lower the AGI limit
  - Cap the value of the benefit (28%)
  - Hard Dollar Cap (\$25,000)
  - Create a floor
- Increase the tax benefit for the non-wealthy
  - Permit deductions for non-itemizers
  - Permit charitable donations to be withheld/reported on W-2
- Equalize and limit the tax benefit to all
  - Eliminate entirely
  - 12 percent tax credit





# Current Proposals

## Raise the standard deduction

Thresholds	Single	Household
Current Law	\$6,200	\$12,400
Proposed Law	\$11,000	\$22,000

- Only 5% of taxpayers expected to itemize (currently 30%)
- Presumed charitable deduction “baked in”
- Elimination of charitable deduction for many





# Illustration #1

- Household AGI: \$200,000 (28% bracket)
- Rent
- Charitable gifts: \$20,000

## Under current law:

Itemize deductions: Pay \$50,400 in tax

Standard deduction: Pay \$52,528 in tax

## Under proposed law:

Tax is \$49,840 using the standard deduction

- Will the donor give \$20,560?
- Or \$0?

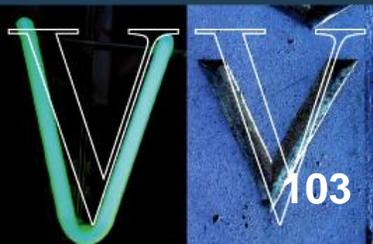




# Current Proposals

## 2% Floor

- Deduction can only be claimed on contributions that exceed 2% of AGI
- Does not affect giving at margin
- Interacts with new standard deduction





## Illustration #2

- Household AGI: \$400,000 (33% bracket)
- Charitable gifts: \$15,000
- Mortgage interest: \$13,000

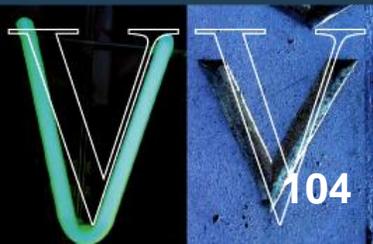
### Under current law:

Itemized deductions

### Proposed law:

Standard deduction of \$22,000

(2% floor is \$8,000, so itemized deductions would only be \$20,000)





## Other Proposals

- Reduce AGI limits on charitable deductions
  - Current law: Cash donations up to 50% of AGI  
Capital gain property donations up to 30% of AGI
  - Proposed law: Cash donations up to 40% of AGI  
Capital gain property donations up to 25% of AGI
- Many noncash gifts would be valued at the donor's basis instead of FMV
- Gifts of real estate would be limited to basis
- Deny any deduction that includes athletic tickets

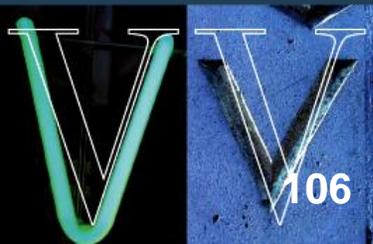




# Timing of Gifts

Current law: Gifts must be made within the tax year.

Proposed law: Gifts must be made prior to the due date (April 15) for the individual's income tax return for the tax year.

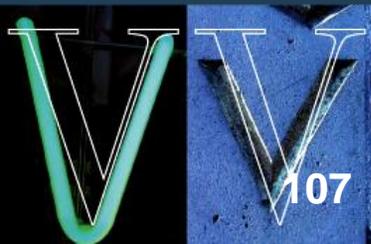




# Executive Compensation

Current law: Organizations may follow the “rebuttable presumption of reasonableness”

Proposed law: 25% excise tax on compensation in excess of \$1 million paid to 5 highest paid employees

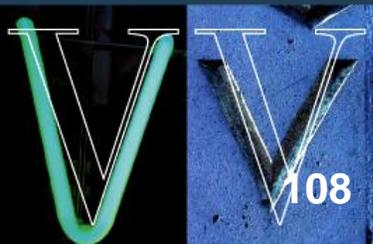




# Endowments

Current law: No excise tax on endowments

Proposed law: 1% excise tax on the net investment income of private colleges and universities with endowments greater than \$100,000 per full-time student

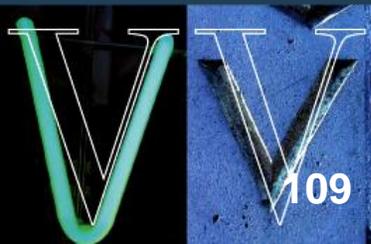




# Royalties

Current law: Income derived from the sale or licensing of a tax exempt organization's name or logo is excluded from unrelated business taxable income.

Proposed law: Name and logo royalties would be subject to UBIT

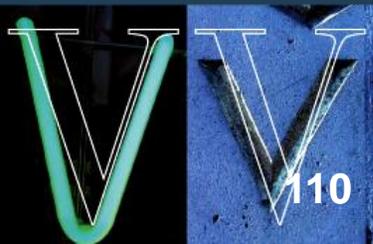




# Sponsorships

Current law: A qualified sponsorship payment (QSP) is not UBI.

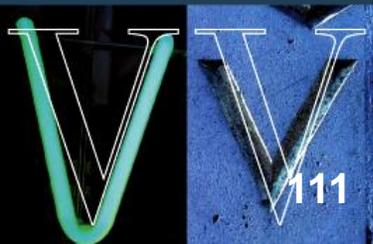
Proposed law: A QSP may not acknowledge the sponsors' products. A QSP greater than \$25,000 may not receive greater benefits than the majority of other sponsors.





## Other Provisions

- Double the late filing penalty for nonprofit information returns.
- Eliminate exemption for Type II and Type III supporting organizations.
- Require that donor-advised funds be distributed within five years.





# UBI Provisions

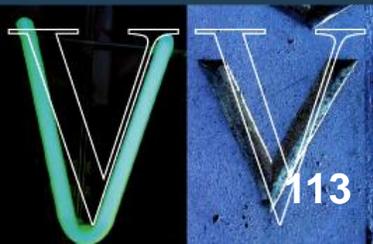
- Research income is UBI unless the results are made freely available to the public.
- Advertising expenses amortized over 10 years
- Losses from one UBI trade or business may not offset gains from another.
- 5% accuracy-related penalty on managers for substantial understatement of UBIT





# UBI Provisions

- Raises the specific deduction from \$1,000 to \$10,000
- Reduces the top tax rate from 35 percent to 25 percent by 2019
- Allows net operating losses to offset only 90 percent of taxable income
- Repeals the alternative minimum tax





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*PANEL 4*

**Best Practices for Enhancing  
the Nonprofit Governance Model**



*Moderator*



***John P. Langan, CPA***  
Managing Partner  
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CliftonLarsonAllen



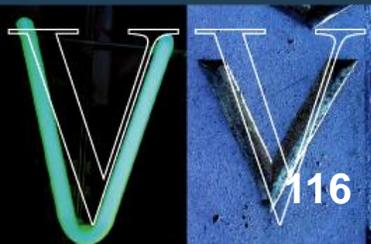
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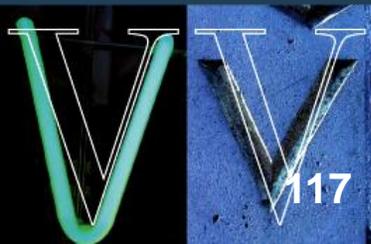


***Sarah Curfman***  
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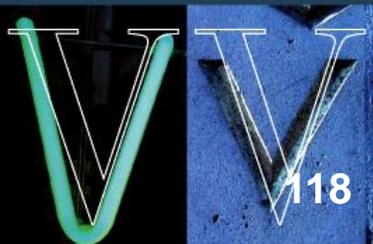
# Legal and Practical Considerations





# Legal and Practical Considerations

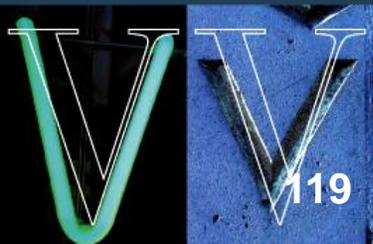
- Governance basics
  - Nonprofit vs. tax-exempt
  - Corporate protection
  
- Nonprofit corporate hierarchy of authority
  - Nonprofit corporate law (statute and common law)
  - Articles of incorporation
  - Bylaws
  - Policies





# Governance Legal Issues

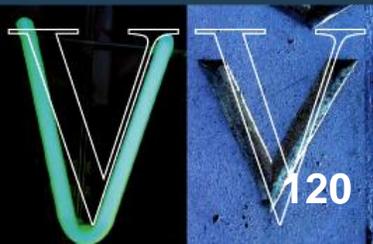
- Board is generally only permitted to act in a meeting (but UWC, telephone meetings)
  
- State of incorporation governs, regardless of location of headquarters (but note foreign corp. filings)





# Governance Hierarchy

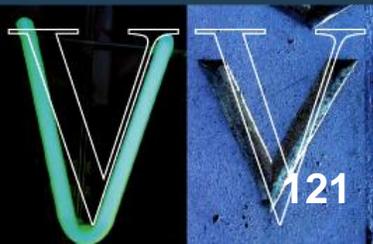
- Board of directors
- Executive committee
- Other committees of the board
- Advisory committees, task forces, etc.
- What about staff?
- What about officers?
- What about individual directors?





# Governance Legal Duties

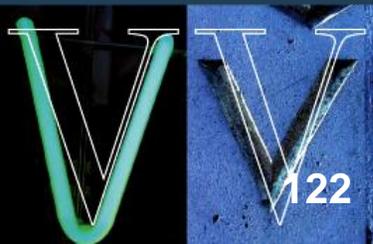
- Duty of Care
- Duty of Loyalty
- Duty of Obedience





# Duty of Care

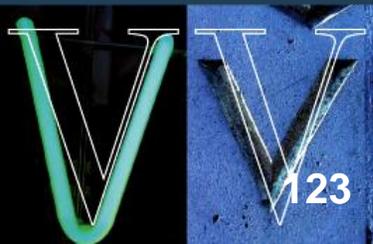
- Duty of care standard is that of “ordinary and reasonable care,” or, what would an ordinarily prudent person do in the same or similar circumstances?
  - Very subjective
  - Tied to reasonableness
  
- Business judgment rule—bad decisions are more easily defended than ignorance





# Compliance with Duty of Care

1. Review all materials provided in advance of meetings.
2. Ask questions.
3. Avoid actions/discussions outside the formal meeting setting.
4. Be familiar with organizational documents (policies, bylaws, articles).
5. Maintain confidentiality.





## Compliance with Duty of Care (cont'd)

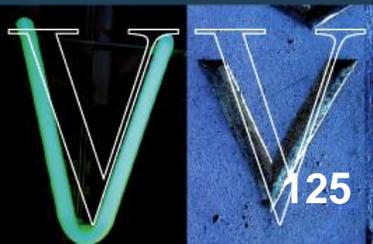
6. Directors may rely on experts when appropriate (but must understand such reliance cannot be absolute).
7. Directors should ascertain that all minutes (particularly recorded votes and attendance) are accurate.
8. Encourage directors to attend meetings regularly, read publications, and be involved.
9. Work with chief elected officer to encourage best practices/compliance with duty of care.





# Compliance with Duty of Loyalty

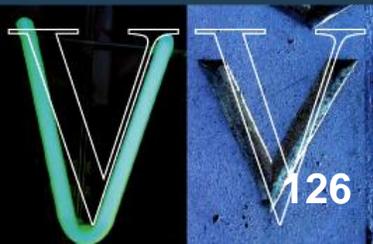
- Keep in mind that the organization's interests come first.
  
- Adhere to conflict of interest policy.
  - Disclose actual, apparent, and potential conflicts of interest through regular disclosure statements (and at each meeting as appropriate).
  - Deliberate as a board or through a committee to determine whether conflict exists.





# Duty of Obedience

- Obedience to nonprofit mission
- Follow terms of articles of incorporation, bylaws, policies, and procedures
- Applicable laws and regulations must be followed





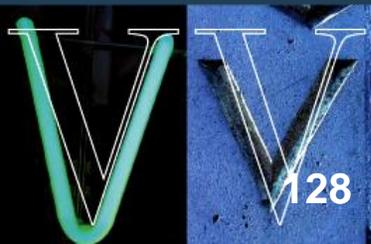
# Policies to Consider and Implement

- Form 990
  - Conflict of interest policy and annual disclosure
  - Record retention
  - Whistleblower
  - Joint ventures
  - Compensation review
  - Form 990 review
  - Auditor selection and review
  
- Others
  - Board member roles and responsibilities
  - Director agreement





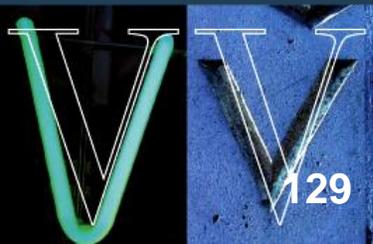
# Case Studies and Examples





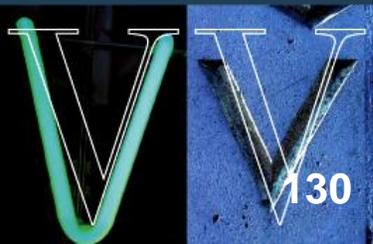
# Discussion and Examples

- Considering the legal framework just discussed, panelists will offer examples of strategies that have been successful in enhancing board governance.





Questions?





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# Thank You!

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