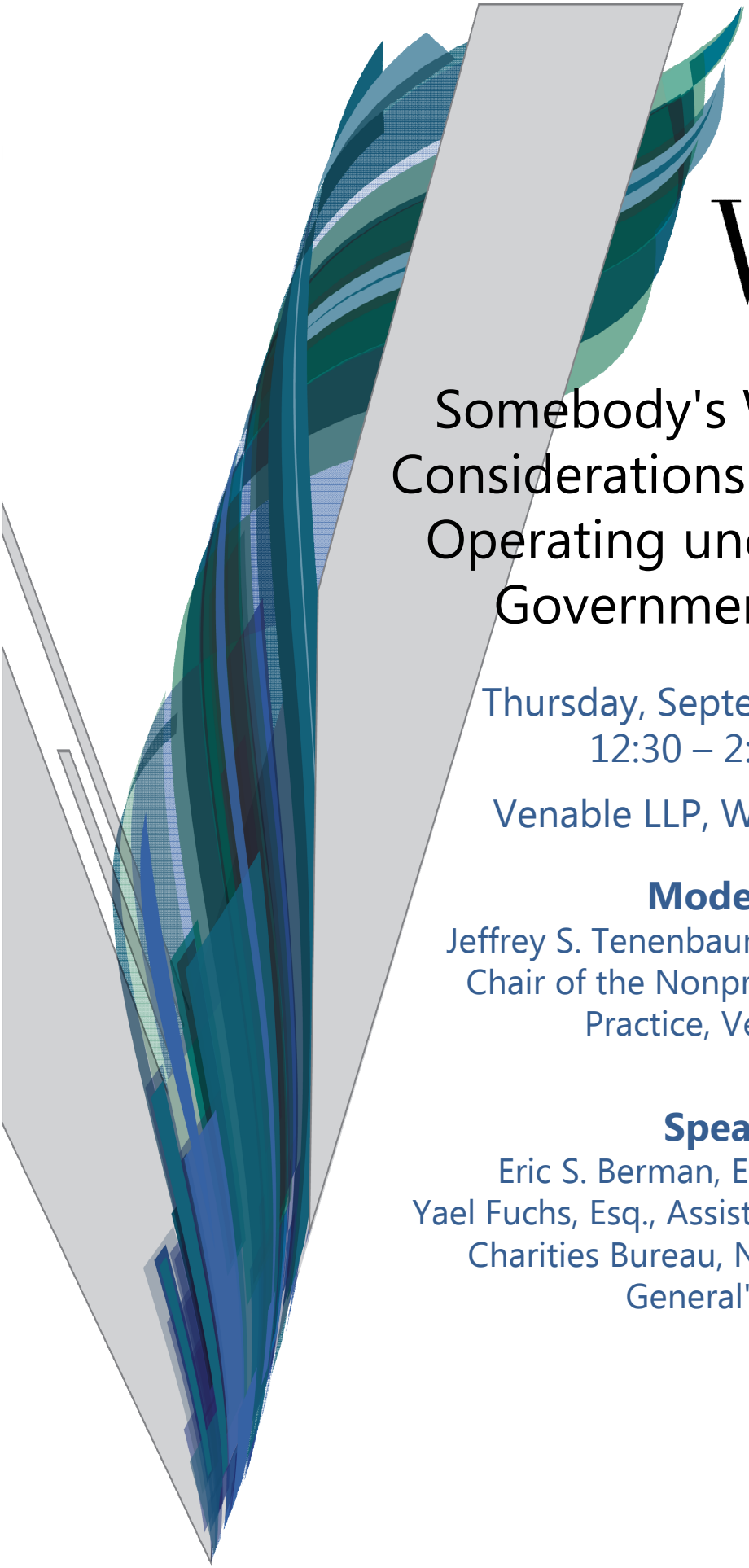


VENABLE® LLP

Somebody's Watching Us: Considerations for Nonprofits Operating under Increased Government Scrutiny

Thursday, September 10, 2015,
12:30 – 2:00pm ET

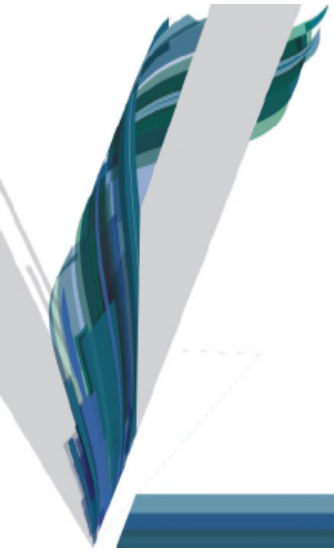
Venable LLP, Washington, DC

Moderator

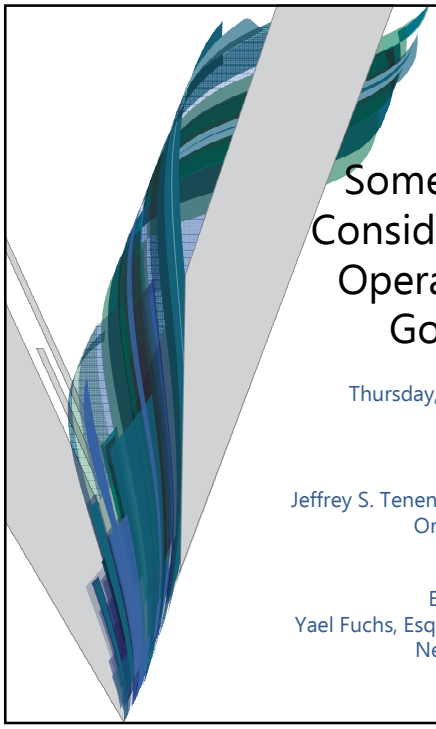
Jeffrey S. Tenenbaum, Esq., Partner and Chair of the Nonprofit Organizations Practice, Venable LLP

Speakers

Eric S. Berman, Esq., Venable LLP
Yael Fuchs, Esq., Assistant Attorney General, Charities Bureau, New York Attorney General's Office



Presentation



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CAE Credit Information

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As a CAE Approved Provider educational program related to the CAE exam content outline, this program may be applied for **1.5 credits** toward your CAE application or renewal professional development requirements.

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Upcoming Venable Nonprofit Events

Register Now

- **October 15, 2015** – Thriving Amid Turmoil and Change: What All Nonprofits Can Learn from Nonprofit Turnarounds
- **November 17, 2015** – The DOL's Proposed Changes to the FLSA White-Collar Exemption Criteria: What Nonprofits Need to Know about the Current Rules, Where Things Are Heading, and How to Avoid Employee Classification Traps and Pitfalls
- **December 10, 2015** – Privacy and Data Security: Best Practices, Common Pitfalls, and Hot Topics for Nonprofits *(details and registration available soon)*

Agenda

- A Regulator's Perspective:
  - The Importance of Internal Controls
  - An Attorney General's Role in Nonprofit Oversight
  - Best Practices in the Face of an Investigation
- An Outside Counsel's Perspective:
  - Increased Scrutiny: the "New Normal"
  - Reducing Risk Before an Investigation
  - Navigating an Investigation (Redux)

Charities Bureau of the Office of
New York Attorney General Eric T. Schneiderman,
at
Somebody's Watching Us: Considerations for Nonprofits Operating under Increased Government Scrutiny

Yael Fuchs, Assistant Attorney General*
Charities Bureau

*All opinions expressed are individual. Nothing shall constitute NYAG endorsement of a particular practice. All expenses paid by NYAG.

5

A/k/a

The FitBit Effect:

Improving Behavior Through Effective Oversight

6

AGs' Oversight Responsibilities

- In New York, regulation and support of New York's nonprofit sector –
  1.2 million employees, 80,000 registered organizations

New York State Attorney General
Eric T. Schneiderman

"OUR JOB AS A REGULATOR ISN'T JUST TO GO OUT AND CATCH BAD GUYS, IT'S ALSO TO HELP THE GOOD GUYS CONDUCT THEIR BUSINESS EFFICIENTLY AND EFFECTIVELY."

7

Goals

- A better understanding of why internal controls are critical (and often mandatory)
- An overview of the AG's role in nonprofit oversight
- Best practices in the event of an investigation

8

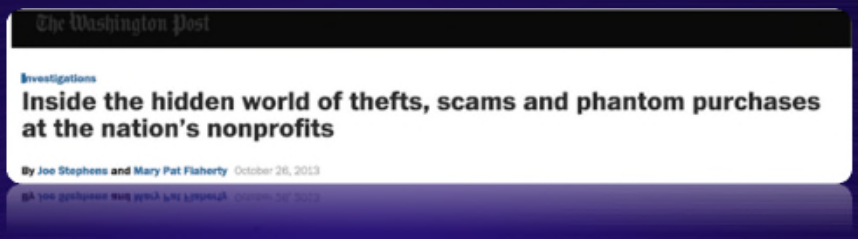
Internal Controls

Policies and procedures that protect the assets of an organization, create reliable financial reporting, promote compliance with laws and regulations, and achieve effective and efficient operations

Source: http://www.charitiesnys.com/pdfs/Charities_Internal_Controls.pdf

9

Internal Control Failures


The Washington Post

Investigations

Inside the hidden world of thefts, scams and phantom purchases at the nation's nonprofits

By Joe Stephens and Mary Pat Flaherty October 26, 2013

- Organizations reporting becoming aware of a "significant diversion of the organization's assets" (990, Part VI, l. 5)
- "Significant diversion" = 5% of total receipts or total assets over $250,000
- More information expected in Schedule O

10

Internal Control Failures

Schedule O excerpts from *Washington Post* database:

The Board of Directors is the oversight group for the Company. It consists of volunteers from various walks of life and includes no members with a financial background. The Board of Directors, we believe, was intended to meet at least once per month. For various reasons this did not always happen. The Board of Directors averaged approximately 8 meetings per year for 2007 and 2008. The minutes of the meetings contained no financial presentation at any meeting. The Board President explained to us that on occasions when

Explanation
A PROGRAM MANAGER ISSUED CHECKS TOTALING APPROXIMATELY $90,000 TO A FICTITIOUS SUBCONTRACTOR FOR ALLEGED HOME REPAIRS AND MOVING SERVICES FOR FAMILIES IN THE KINSHIP CAREGIVER PROGRAM

The agency experienced an extraordinary loss of $161,113 resulting from a cyber-crime in which funds were diverted t

11

NY AG Charities Bureau

- Registration
- Transactions
- Trusts & Estates
- Enforcement

12

AG's Enforcement Function

- Preservation and recovery of charitable assets through public education, investigations, and legal actions

- Cases developed through:
  - Complaints
  - Referrals
  - News/media
  - Filing review
  - Data analysis

13

Types of AG Enforcement Actions

- Informal contact
- Formal investigation

- Assurance of discontinuance
- Civil suit
- Criminal charges

14

Fraudulent Solicitation

- Outliers, but decrease public confidence in the sector

Red Flags:

1. Use of high-cost telemarketers as the primary source of fundraising, for an extended period of time. High fundraising costs are not fraudulent per se.
2. Sound-alike/"warm glow" charities.
3. Extensive use of joint cost allocation and/or gift in kind.

15

Common Issues

- Reporting violations
  - Patterns of deficiencies
  - False reporting
- Related party transactions (self-dealing)
- Use of restricted funds
- Diversion of assets (embezzlement, waste, imprudent investment)

Common cause? Oversight failures.

16

Importance of Governance

What is governance?

The establishment of policies (a/k/a internal controls), and the continuous monitoring of their proper implementation, by members of the governing body of an organization

17

Codification of Compliance Regimes

- Federal Sentencing Guidelines for Organizations – Seven criteria for an "effective compliance program"

1. Standards and procedures to prevent and detect criminal conduct	5. Monitoring, auditing, and whistleblower systems
2. Oversight by high-level personnel	6. Consistent enforcement of compliance standards
3. Due care in delegating substantial discretionary authority	7. Appropriate response to criminal conduct and steps to prevent reoccurrence.
4. Effective communication and training for all levels of employees	

18

Codification of Compliance Regimes: Highlights of the New York Nonprofit Revitalization Act

- Audit committees
- Related party transactions
- Conflict of interest policies
- Whistleblower policies

19

When Bad Things Happen to Good Organizations

- Sometimes bad things happen in well-meaning organizations
  - Embezzlement, insolvency, data breach, public criticism
- Regulators' job to determine what happened, why did it happen, and **how are you going to fix it?**

20

So You're Under Investigation…

What will we ask?

Backward-looking questions:

- Who is in charge of your compliance function?
- Compliance with your reporting obligations?
- Past complaints
- Public-facing representations
- Internal control policies
- Board engagement
- Senior management oversight and compensation

21

So You're Under Investigation…

What will we ask?

Forward-looking questions:

- How are you addressing the problem?
- Appropriate response to whistleblowers
- Identify the nature and scope of the problem
- Isolate the bad behavior
- Get control of your accounts
- Take appropriate disciplinary/legal action
- New policies/procedures

22

So You're Under Investigation…

Additional considerations:

- Candor, transparency to donors, board, regulators
- Internal or external review?
- Document retention

23

Fundamentally…

What are you doing to preserve the value of the organization and continue its mission?

24

Sources/suggested reading

- Charities Bureau website: www.charitiesnys.com
- Charities Bureau guides: http://www.charitiesnys.com/guides_advice_new.jsp
- *Tampa Bay Times*/CNN American's Worst Charities Project. http://www.tampabay.com/topics/specials/worst-charities.page
- *Washington Post* investigation: http://www.washingtonpost.com/investigations/inside-the-hidden-world-of-thefts-scams-and-phantom-purchases-at-the-nations-nonprofits/2013/10/26/825a82ca-0c26-11e3-9941-6711ed662e71_story.html
- Remarks of Hon. Patti B. Saris, Chair U.S. Sentencing Commission at the 12th Annual Compliance & Ethics Institute (2013). http://www.ussc.gov/sites/default/files/pdf/training/organizational-guidelines/selected-articles/Steer-PLI-2003.pdf

25

Conducting Nonprofit Operations under Increased Scrutiny

Eric Berman
Venable, LLP

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A Recent Cautionary Tale

- In May 2015, federal and state regulators announced massive law enforcement action against several charities and their principals.
  - FTC, all 50 State AGs, D.C. AG, Eight Secretaries of State

"This is an historic moment -- the first time that the federal government and the state charity regulators have joined together to present a united front against charity fraud."
-FTC Bureau Director Jessica Rich

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Landscape Constantly Evolving

- Older view: state regulators stretched thin
  - "The infrastructure for monitoring the nonprofit sector is not robust relative to the size, diversity, and growing complexity of the field." (*Nonprofit Quarterly*, Dec. 21, 2004)
- Modern view: look for increased coordination among state regulators and between states and feds
  - E.g., CFA litigation
  - NASCO & NAAG
    - Charities Project/Columbia University
    - Single Portal Filing Project

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Reducing the Risk of an Investigation

Be Proactive (and Thorough)

- Internal compliance audit:
  - Governance documents (bylaws; articles of incorporation)
  - Directors
    - Qualifications
    - Relationships to each other and to officers
    - Length of tenure
  - Written policies and procedures
    - When implemented
    - When revised

Be Proactive (cont'd)

- Meeting minutes
- Regulatory filings and 990s
- Donor-facing materials
  - Scripts, donation receipts, reminder cards
- Fundraising sources
  - Diversity
  - Telemarketing contracts
- Vendors
  - Fundraisers, auditors
- Past complaints or inquiries

Be Proactive (cont'd)

"This is not to say that a nonprofit organization may not compensate its employees at a market rate….Just as a nonprofit hospital may pay $5 million for a new MRI machine that costs $5 million, it may pay $400,000 a year to hire a radiologist when the going rate for a radiologist is $400,000 a year."

Spencer v. World Vision, Inc., 633 F.3d 723, 734 (9th Cir. 2010)

- Dig deeper into:
  - Program services
  - Executive compensation
    - GIK and joint cost allocation issues

Navigating an Investigation

Operational Considerations

- Document hold
- Briefing the Board
  - Who? How often?
- Communicating with staff
- HR issues
- Continuing/discontinuing operations
- Insurance coverage

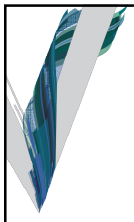
Strategic Considerations

- Who is investigating?
  - Scope shapes response
  - Likelihood of referral/coordination
- States can, and do, share information
- When might FTC get involved?
- First Amendment offers protection, but see fraud exception

> The attorney general may enter into reciprocal agreements with a like authority of any other state or states for the purpose of exchanging information made available to the attorney general or to such other like authority. *Minn. Rev. Stat. 309.60*

Additional Strategic Considerations

- Nonprofit's goals
  - Executives' goals
- Regulators' stance
  - First offer is worst offer
- Advocacy
- PR/Crisis Management
  - Government has home-microphone advantage



Questions?

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To view an index of Venable's articles and presentations or upcoming programs on nonprofit legal topics, see www.Venable.com/nonprofits/publications or www.Venable.com/nonprofits/events.

To view recordings of Venable's nonprofit programs on our YouTube channel, see www.YouTube.com/user/VenableNonprofits or www.Venable.com/nonprofits/recordings.

Follow @NonprofitLaw on Twitter for timely posts with nonprofit legal articles, alerts, upcoming and recorded speaking presentations, and relevant nonprofit news and commentary.

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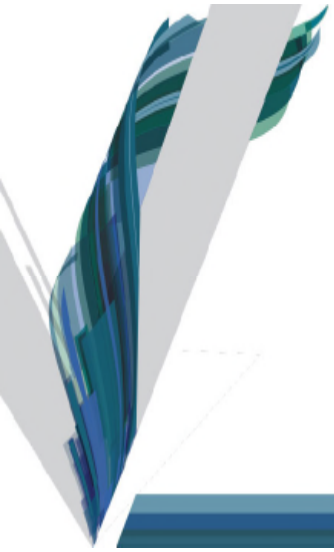

Speaker Biographies

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Jeffrey S. Tenenbaum

Partner

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Jeffrey Tenenbaum chairs Venable's Nonprofit Organizations Practice Group. He is one of the nation's leading nonprofit attorneys, and also is a highly accomplished author, lecturer, and commentator on nonprofit legal matters. Based in the firm's Washington, DC office, Mr. Tenenbaum counsels his clients on the broad array of legal issues affecting charities, foundations, trade and professional associations, think tanks, advocacy groups, and other nonprofit organizations, and regularly represents clients before Congress, federal and state regulatory agencies, and in connection with governmental investigations, enforcement actions, litigation, and in dealing with the media. He also has served as an expert witness in several court cases on nonprofit legal issues.

Mr. Tenenbaum was the 2006 recipient of the American Bar Association's Outstanding Nonprofit Lawyer of the Year Award, and was an inaugural (2004) recipient of the *Washington Business Journal*'s Top Washington Lawyers Award. He was one of only seven "Leading Lawyers" in the Not-for-Profit category in the prestigious 2012 *Legal 500* rankings, one of only eight in the 2013 rankings, one of only nine in the 2014 rankings, and also one of only 10 in the 2015 rankings. Mr. Tenenbaum was recognized in 2013 as a Top Rated Lawyer in Tax Law by *The American Lawyer* and *Corporate Counsel*. He was the 2015 recipient of the New York Society of Association Executives' Outstanding Associate Member Award, the 2004 recipient of The Center for Association Leadership's Chairman's Award, and the 1997 recipient of the Greater Washington Society of Association Executives' Chairman's Award. Mr. Tenenbaum was listed in the 2012-16 editions of *The Best Lawyers in America* for Non-Profit/Charities Law, and was selected for inclusion in the 2014 and 2015 editions of *Washington DC Super Lawyers* in the Nonprofit Organizations category. In 2011, he was named as one of Washington, DC's "Legal Elite" by *SmartCEO Magazine*. He was a 2008-09 Fellow of the Bar Association of the District of Columbia and is AV Peer-Review Rated by *Martindale-Hubbell*. Mr. Tenenbaum started his career in the nonprofit community by serving as Legal Section manager at the American Society of Association Executives, following several years working on Capitol Hill as a legislative assistant.

AREAS OF PRACTICE

Tax and Wealth Planning
Antitrust
Political Law
Business Transactions Tax
Tax Controversies and Litigation
Tax Policy
Tax-Exempt Organizations
Wealth Planning
Regulatory

INDUSTRIES

Nonprofit Organizations and Associations
Financial Services

GOVERNMENT EXPERIENCE

Legislative Aide, United States House of Representatives

BAR ADMISSIONS

District of Columbia

EDUCATION

J.D., Catholic University of America, Columbus School of Law, 1996

B.A., Political Science, University

REPRESENTATIVE CLIENTS

AARP
Air Conditioning Contractors of America
Airlines for America
American Academy of Physician Assistants
American Alliance of Museums
American Association for the Advancement of Science
American Bar Association
American Bureau of Shipping
American Cancer Society
American College of Radiology

of Pennsylvania, 1990

MEMBERSHIPS

American Society of Association Executives

New York Society of Association Executives

American Friends of Yahad in Unum
American Institute of Architects
American Institute of Certified Public Accountants
American Red Cross
American Society for Microbiology
American Society of Anesthesiologists
American Society of Association Executives
America's Health Insurance Plans
Association for Healthcare Philanthropy
Association for Talent Development
Association of Clinical Research Professionals
Association of Corporate Counsel
Association of Fundraising Professionals
Association of Global Automakers
Association of Private Sector Colleges and Universities
Auto Care Association
Biotechnology Industry Organization
Brookings Institution
Carbon War Room
The College Board
CompTIA
Council on Foundations
CropLife America
Cruise Lines International Association
Design-Build Institute of America
Endocrine Society
Erin Brockovich Foundation
Ethics Resource Center
Foundation for the Malcolm Baldrige National Quality Award
Gerontological Society of America
Global Impact
Goodwill Industries International
Graduate Management Admission Council
Habitat for Humanity International
Homeownership Preservation Foundation
Human Rights Campaign
Independent Insurance Agents and Brokers of America
Institute of International Education
International Association of Fire Chiefs
International Sleep Products Association
Jazz at Lincoln Center
LeadingAge
Lincoln Center for the Performing Arts
Lions Club International
March of Dimes
ment'or BKB Foundation
Money Management International
National Association for the Education of Young Children
National Association of Chain Drug Stores
National Association of City and County Health Officials
National Association of College and University Attorneys
National Association of Manufacturers
National Association of Music Merchants
National Athletic Trainers' Association
National Board of Medical Examiners
National Coalition for Cancer Survivorship
National Coffee Association
National Council of Architectural Registration Boards
National Council of La Raza
National Defense Industrial Association
National Fallen Firefighters Foundation
National Fish and Wildlife Foundation
National Propane Gas Association
National Quality Forum
National Retail Federation
National Student Clearinghouse

The Nature Conservancy
NeighborWorks America
NTCA - The Rural Broadband Association
Peterson Institute for International Economics
Professional Liability Underwriting Society
Project Management Institute
Public Health Accreditation Board
Public Relations Society of America
Recording Industry Association of America
Romance Writers of America
Telecommunications Industry Association
Trust for Architectural Easements
The Tyra Banks TZONE Foundation
U.S. Chamber of Commerce
United Nations High Commissioner for Refugees
United States Tennis Association
University of California
Volunteers of America
Water Environment Federation

HONORS

Recipient, New York Society of Association Executives' Outstanding Associate Member Award, 2015

Recognized as "Leading Lawyer" in *Legal 500*, Not-For-Profit, 2012-15

Listed in *The Best Lawyers in America* for Non-Profit/Charities Law (Woodward/White, Inc.), 2012-16

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Washington DC's Legal Elite, *SmartCEO Magazine*, 2011

Fellow, Bar Association of the District of Columbia, 2008-09

Recipient, American Bar Association Outstanding Nonprofit Lawyer of the Year Award, 2006

Recipient, *Washington Business Journal* Top Washington Lawyers Award, 2004

Recipient, The Center for Association Leadership Chairman's Award, 2004

Recipient, Greater Washington Society of Association Executives Chairman's Award, 1997

Legal Section Manager / Government Affairs Issues Analyst, American Society of Association Executives, 1993-95

AV® Peer-Review Rated by *Martindale-Hubbell*

Listed in *Who's Who in American Law* and *Who's Who in America*, 2005-present editions

ACTIVITIES

Mr. Tenenbaum is an active participant in the nonprofit community who currently serves on the Editorial Advisory Board of the American Society of Association Executives' *Association Law & Policy* legal journal, the Advisory Panel of Wiley/Jossey-Bass' *Nonprofit Business Advisor* newsletter, and the ASAE Public Policy Committee. He previously served as Chairman of the *AL&P* Editorial Advisory Board and has served on the ASAE Legal Section Council, the ASAE Association Management Company Accreditation Commission, the GWSAE Foundation Board of Trustees, the GWSAE Government and Public Affairs Advisory Council, the Federal City Club Foundation Board of Directors, and the Editorial Advisory Board of Aspen's *Nonprofit Tax & Financial Strategies* newsletter.

PUBLICATIONS

Mr. Tenenbaum is the author of the book, *Association Tax Compliance Guide*, now in its second edition, published by the American Society of Association Executives. He also is a contributor to numerous ASAE books, including *Professional Practices in Association Management*, *Association Law Compendium*, *The Power of Partnership*, *Essentials of the Profession Learning System*, *Generating and Managing Nondues Revenue in Associations*, and several Information Background Kits. In addition, he is a contributor to *Exposed: A Legal Field Guide for Nonprofit Executives*, published by the Nonprofit Risk Management Center. Mr. Tenenbaum is a frequent author on nonprofit legal topics, having written or co-written more than 700 articles.

SPEAKING ENGAGEMENTS

Mr. Tenenbaum is a frequent lecturer on nonprofit legal topics, having delivered over 700 speaking presentations. He served on the faculty of the ASAE Virtual Law School, and is a regular commentator on nonprofit legal issues for *NBC News*, *The New York Times*, *The Wall Street Journal*, *The Washington Post*, *Los Angeles Times*, *The Washington Times*, *The Baltimore Sun*, *ESPN.com*, *Washington Business Journal*, *Legal Times*, *Association Trends*, *CEO Update*, *Forbes Magazine, The Chronicle of Philanthropy, The NonProfit Times* and other periodicals. He also has been interviewed on nonprofit legal topics on Fox 5 television's (Washington, DC) morning news program, Voice of America Business Radio, Nonprofit Spark Radio, and The Inner Loop Radio.

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our people

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Eric Berman's client service primarily involves counseling, regulatory advocacy, and litigation defense in the areas of consumer protection and antitrust. He represents large companies, trade associations, tax-exempt organizations, and closely held businesses before both the consumer protection and competition bureaus of the Federal Trade Commission ("FTC"), the Department of Justice's Antitrust Division ("DOJ"), and the state attorneys' general.

As part of Venable's highly regarded advertising practice, Mr. Berman advises national retailers, manufacturers, nonprofits, fundraisers, telemarketers, financial services firms, and dietary supplement sellers on how to reduce risk associated with their advertising claims, marketing practices, and business operations. His practice increasingly focuses on helping organizations navigate complex and sometimes multi-faceted law enforcement investigations by federal and state regulators. Recently, Mr. Berman was lead defense counsel to multiple parties in the first consumer protection lawsuit ever filed by the FTC, all 50 state attorneys general, and the District of Columbia.

Mr. Berman is also an experienced antitrust attorney who has represented merging parties and third parties in complex merger reviews before the FTC, DOJ, and foreign competition authorities. He has also defended market-leading firms in complex litigation brought under Section 1 of the Sherman Act. Mr. Berman maintains a broad-based counseling practice in which he advises companies and associations about the antitrust risks associated with a range of business issues, and he has experience conducting internal investigations and implementing compliance programs for antitrust-sensitive firms.

AREAS OF PRACTICE

Regulatory

Antitrust

Advertising and Marketing

Class Action Defense

Mergers and Acquisitions

Investigations and White Collar Defense

State Attorneys General

Tax-Exempt Organizations

INDUSTRIES

Consumer Products and Services

Dietary Supplements, Cosmetics and Functional Foods

Nonprofit Organizations and Associations

BAR ADMISSIONS

District of Columbia

New York

EDUCATION

J.D., George Washington University Law School, 2002

B.S., Cornell University, 1999

SIGNIFICANT MATTERS

Consumer Protection and Advertising

- Lead counsel to multiple nonprofits and their principals in sweeping FTC and 50-state litigation;
- Co-lead counsel to national charitable organization during pendency of state attorney general investigation;
- Co-lead counsel for dietary supplement marketer in FTC false advertising investigation of weight loss claims;
- Advertising counsel to leading home products retailer;
- Lead counsel for window manufacturer in FTC industry sweep of energy efficiency claims;
- Lead counsel for building and home materials seller in FTC action involving insulation performance claims; continue to serve as general FTC compliance and unfair competition counsel;
- Co-lead counsel to UK-based conglomerate against attempted injunction lawsuit

MEMBERSHIPS

ABA, Section of Antitrust Law

DC Bar Association, Antitrust and Consumer Law Section

DRI, Program Chair, Antitrust & Consumer Protection Group

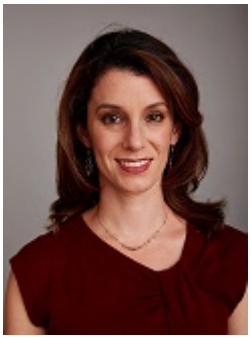
filed by FTC's Northwest Regional office involving debt collection activities.

Antitrust – Mergers, Litigation and Counseling

- Represented third party in major FTC merger challenge in the foodservice distribution industry;
- Advising multiple companies on compliance issues and information exchanges;
- Reviewed and updated global antitrust compliance program for market leading merchant and manufacturer;
- Advised pediatric physicians' association on antitrust issues relating to formation of children's hospital;
- Defended major consumer electronics company in price-fixing litigation brought by private plaintiffs; led defense of related *parens patriae* actions brought by State Attorneys General;
- Represented acquiring and acquired firms before U.S. and foreign competition authorities in the antitrust review of multiple large-scale transactions.

SPEAKING ENGAGEMENTS

- October 7, 2015, "Complex Litigation Against Nonprofits in the Consumer-Protection Context: A War on Multiple Fronts" at the 2015 DRI Annual Meeting
- September 30, 2015, "Protecting Your Brand From Online Fraud, Infringement & Other Emerging Threats" at the Search Marketing Expo – East
- September 10, 2015, "Somebody's Watching Us: Considerations for Nonprofits Operating Under Increased Government Scrutiny" for Nonprofit Luncheon Program Hosted by Venable LLP
- August 11, 2015, "State Attorneys General Developments (July 2015)" for the ABA Antitrust Section Consumer Protection Monthly Update
- April 29, 2015, "Is Calling Puff a 'Magic' Dragon Puffing?" for an Advertising Law Symposium Hosted by Venable LLP
- February 19, 2015, "The Sports Report: Sports, Consumer Protection, and Antitrust – A Year in Review" for the American Bar Association
- June 13, 2014, "Understanding Antitrust & Competition Strategies" for The Knowledge Group (webcast)
- February 20, 2013, "Antitrust Basics For Legal Recruitment Professionals" for the Washington Area Legal Recruitment Administrators Association (WALRAA)
- February 23, 2011, "Introduction to U.S. Merger Enforcement" for the Howrey Antitrust Fundamentals Seminar
- February 25, 2009, "Sherman Act Section One" for the Howrey Antitrust Fundamentals Seminar



Yael Fuchs, Esq., Assistant Attorney General, Charities Bureau, New York Attorney General's Office

Yael Fuchs is an Assistant Attorney General in the Enforcement Section of the Charities Bureau of the Office of the New York State Attorney General. Yael conducts and oversees investigations and litigation of violations of New York laws governing not-for-profits and their agents, including breaches of fiduciary duty and fraudulent solicitation. Recent matters include settlements with three Long Island-based charities, their fundraiser, and their accountant, and a special proceeding brought against a Brooklyn-based charity and its accountant. Yael also works on special projects involving not-for-profits, including the OAG's oversight of disaster relief charities after Hurricane Sandy. Yael is also part of the Adjunct Clinical Faculty at Cardozo Law School.

Prior to joining the OAG, Yael was a litigation associate at Paul, Weiss, Rifkind, Wharton & Garrison, where she focused on internal and regulatory investigations, transnational litigation, and pro bono asylum matters. She served as a foreign law clerk at the Supreme Court of Israel, where she provided comparative law advice to Justice Asher Grunis. Yael earned her J.D. from Columbia Law School, where she was a James Kent Scholar and an editor of the *Columbia Human Rights Law Review*. Prior to law school, Yael worked at two Washington DC-based not-for-profits.

Additional Information

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February 19, 2015

A PRIMER ON DETECTING, PREVENTING, AND INVESTIGATING NONPROFIT FRAUD, EMBEZZLEMENT, AND CHARITABLE DIVERSION

AUTHORS

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- A Primer on Detecting, Preventing, and Investigating Nonprofit Fraud, Embezzlement, and Charitable Diversion

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Increasing Scrutiny of Nonprofit Fraud, Embezzlement, and Charitable Diversion

Media Coverage and Recent Examples

On October 26, 2013, *The Washington Post* reported that from 2008 through 2012, more than 1,000 nonprofit organizations disclosed hundreds of millions of dollars in losses attributed to theft, fraud, embezzlement, and other unauthorized uses of organizational funds and assets. According to a study cited by the *Post*, nonprofits and religious organizations suffer one-sixth of all major embezzlements—second only to the financial services industry.

While the numbers are shocking, the underlying reasons for nonprofit susceptibility to fraud and embezzlement are easy to understand. Many nonprofits begin as under-resourced organizations with a focus on mission rather than strong administrative practices. As organizations established for public benefit, nonprofits assume the people who work for them, especially senior management, are trustworthy. Often these factors result in less stringent financial controls than implemented by their for-profit counterparts.

Of course, nonprofit employees are not immune to the vulnerabilities of economic distress, including financial difficulties, overspending, and even gambling. Further, high-level employees and their close associates have significant access to organizational funds and financial records, causing them to believe they can successfully commit the fraud and embezzlement and conceal their conduct from outside scrutiny. Employees may rationalize their unlawful conduct as just compensation for lower salaries or unfair treatment, or as legitimate financial arrangements whereby the employee is simply "borrowing" money from the organization.

Recent examples of nonprofits that have fallen victim to these crimes include:

- In 2012, the Global Fund to Fight Aids, Tuberculosis, and Malaria reported to the federal government a misuse of funds or unsubstantiated spending of $43 million.
- In 2011, the Vassar Brothers Medical Center in Poughkeepsie, New York, reported a loss of $8.6 million through the theft" of certain medical devices.
- From 1999 to 2007, the American Legacy Foundation, a nonprofit dedicated to educating the public about the dangers of smoking, suffered an estimated $3.4 million loss as a result of alleged embezzlement by a former employee.

In light of the disturbing numbers reported by the *Washington Post*, Congress and numerous state attorneys general have pledged to launch investigations, and reportedly, some have. This will likely lead to even greater scrutiny by government regulators. External audits are necessary to ensure that effective financial controls and fraud prevention measures are being followed, but a standard audit is not the method by which nonprofit organizations should expect to detect fraud. The Association of Certified Fraud Examiners (ACFE) reports that less than 4% of frauds are discovered through an audit of external financial statements by an independent accounting firm.

Nonprofits may no longer elect to handle instances of fraud or embezzlement quietly to avoid unwanted attention and embarrassment. As of 2008, a larger nonprofit must publicly disclose any embezzlement or theft exceeding $250,000, 5% of the organization's gross receipts, or 5% of its total assets. A tax-exempt organization whose gross receipts are greater than or equal to $200,000—or whose assets are greater than or equal to $500,000—is subject to additional public disclosure requirements on its IRS

Form 990 concerning the embezzlement or theft.

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ARTICLES

November 7, 2013

PREVENTING FRAUD AND EMBEZZLEMENT IN YOUR NONPROFIT ORGANIZATION

An abbreviated version of this article was published in Nonprofit Quarterly on December 4, 2013.

AUTHORS

Doreen S. Martin
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On October 26, 2013, the ***Washington Post* reported** that from 2008 to 2012, more than 1,000 nonprofit organizations disclosed hundreds of millions in losses attributed to theft, fraud, embezzlement, and other unauthorized uses of funds and organizational assets. According to a study cited by the *Post*, nonprofits and religious organizations suffer one-sixth of all major embezzlements, second only to the financial services industry.

While the numbers are shocking, this trend will not surprise those in the nonprofit world, who have long known that nonprofits are highly susceptible to fraud and embezzlement. Nonprofits are generally established for beneficial purposes and assume that their employees, especially senior management, share the organization's philanthropic mission. As such, nonprofits tend to be more trusting of their employees and have less stringent financial controls than their for-profit counterparts. Thus, they fall prey to embezzlement and other forms of employee fraud at an alarming rate. By way of recent example, as reported by the *Washington Post*:

- From 1999 to 2007, the American Legacy Foundation, a nonprofit dedicated to educating the public about the dangers of smoking, suffered an estimated $3.4 million loss as a result of alleged embezzlement by a former employee.
- In 2012, the Global Fund to Fight Aids, Tuberculosis and Malaria reported to the federal government a misuse of funds or unsubstantiated spending of $43 million.
- In 2011, the Vassar Brothers Medical Center in Poughkeepsie, New York reported a loss of $8.6 million through the "theft" of certain medical devices.

In addition to those incidents reported by the *Washington Post*, a few other recent examples include:

- On February 27, 2013, a 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. The former director embezzled over $274,000 between 2005 and 2009, using the money to pay for clothing, her children's tuition, and other personal expenses.
- On November 8, 2012, the former executive director of the H.O.W. Foundation, a nonprofit alcohol and drug treatment center in Tulsa, Oklahoma, 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 for a total of more than $1.35 million and embezzled more than $200,000 from a thrift store operated by the nonprofit.
- On October 12, 2013, the former CFO of Project Genesis, a Connecticut nonprofit organization that serves adults and children with disabilities, was sentenced to 33 months' imprisonment after embezzling more than $348,000 from the organization over a three-year period. The former CFO stole the organization's funds by keeping terminated employees on the payroll and then transferring their salaries to his personal bank account.

While external audits are necessary and helpful in ensuring that financial controls and fraud prevention measures are being followed and are effective, the standard audit is not designed and should not be relied upon to detect fraud. The Association of Certified Fraud Examiners reports that less than 4% of frauds are discovered as a result of an audit of external financial statements by an independent accounting firm.

Many nonprofits had previously elected to handle instances of fraud or embezzlement quietly in order to avoid unwanted attention and embarrassment. That is no longer an option. In 2008, the Internal Revenue Service implemented additional regulations designed to enable the public to more easily evaluate how

effectively larger nonprofits manage their money. Tax-exempt organizations whose gross receipts are greater than or equal to $200,000, or whose assets are greater than or equal to $500,000, are subject to additional disclosure requirements on their IRS Form 990 concerning embezzlement or theft. Specifically, these organizations are now required to publicly disclose any embezzlement or theft that exceeds $250,000, 5% of the organization's gross receipts, or 5% of its total assets.

Additionally, in light of the disturbing numbers reported by the *Washington Post*, both Congress and numerous state attorneys general have pledged to launch investigations. This will inevitably lead to even greater scrutiny.

This newly found focus on fraud and embezzlement strikes at the heart of an organization's ability to raise funds and affect its mission. As one nonprofit official quoted by the *Washington Post* explained, "[p]eople give their money and expect integrity. And when the integrity goes out the window, it just hurts everybody. It hurts the community, it hurts the organization, everything. It's just tragic."

Nonprofits are not defenseless, however, and there are several proactive steps organizations can and should take immediately (if they are not doing so already) to prevent and detect employee fraud and embezzlement:

Double Signatures, Authorizations and Back-up Documentation
Multiple layers of approval will make it far more difficult for embezzlers to steal from the organization. For expenditures over a predetermined amount, require two signatories on every check and two different signatories on every authorization or payment. Where the professional staff of a nonprofit is too small to effectively implement a double signatory/authorization policy, consider having a (volunteer) officer or director be the second signatory. Similarly, all check requests and requests for cash disbursements should be accompanied by an invoice or other document showing that the payment or disbursement is appropriate. Never pre-sign checks. With credit cards, require prior written approval, again from two individuals, for costs estimated to exceed a certain amount. Require back-up documentation demonstrating the *bona fides* of the expense. And again, the person using the card should not be the same person authorizing its use.

Segregation of Duties
Hand-in-hand with multiple authorizations goes the segregation of duties. At a minimum, different employees should be responsible for authorizing payments, disbursing funds, and reconciling bank statements and reviewing credit card statements. If the nonprofit does not have enough professional staff to effectively segregate duties, a (volunteer) officer or director should be tasked with reconciling the bank statements and reviewing credit card statements. Because embezzlement also can occur when funds are coming into an organization, no single individual should be responsible for receiving, depositing, recording, and reconciling the receipt of funds. By the same token, all contracts should be approved by a manager uninvolved and personally uninterested in the transaction and, wherever possible, larger contracts should be the product of competitive and transparent bidding.

Fixed Asset Inventories
At least annually, the organization should perform a fixed asset inventory to ensure that no equipment or other goods are missing.

Automated Controls
Use electronic notifications to alert more than one senior member of the organization of bank account activity, balance thresholds, positive pay exceptions, and wire notifications.

Background Checks
Background checks on new employees and volunteer leaders can unearth things such as undisclosed criminal records, prior instances of fraud, and heavy debt loads that can make it more likely that an employee or volunteer leader might succumb to fraud. The Association of Certified Fraud Examiners reports that 6% of embezzlers have been convicted of a previous fraud-related offense.

Audits and Board-Level Oversight
The control measures discussed above only work if someone is checking. In addition to management, who should be ensuring that the measures discussed above are followed, nonprofits also should undertake regular external audits to ensure that these measures are effective. Organizations should establish audit committees on their boards of directors, containing at least one person familiar with finance and accounting, who would serve as the primary monitor of these anti-fraud measures. In lieu of an audit committee, smaller nonprofit organizations should consider putting a CPA or other financially knowledgeable person on the board of directors to serve a similar function.

Encourage Whistleblowers
While nonprofits should encourage the reporting of suspected wrongdoing to management or a designated board member, employees must have a means of anonymous communication if they do not feel comfortable reporting to their supervisor or management. Employees may not report theft or mismanagement if they believe that their job is in jeopardy. The board of directors must ensure that these reports are taken seriously, that the reporting employee is protected, and that outside legal counsel is brought in as appropriate.

Strong Compliance Program
The best way to prevent fraud and embezzlement and to protect nonprofits is a comprehensive and vigorous compliance program that must be more than a "mere paper program." An effective compliance program must be tailored to the specific organization, include a written code of ethics, be effectively implemented through periodic training, have real consequences for violations of the policy, have an effective reporting mechanism, and be periodically audited to ensure its effectiveness.

Self-Audits
Bringing in outside expertise – such as CPAs experienced in conducting fraud audits (different from the standard annual financial statement audit) and attorneys experienced in evaluating and enhancing internal controls as well as training staff on best practices – can be a critical tool in both identifying fraud and embezzlement that may be occurring and in shoring up weak controls and other process deficiencies that may make the organization more susceptible to theft.

While there will always be instances where a determined thief manages to beat an organization's controls, the steps suggested above will go a long way toward deterring and preventing embezzlement and other types of fraud at nonprofit organizations.

* * * * *

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VENABLE® LLP

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October 2012

SIGNIFICANT NEW AND HIGHER STANDARDS FOR CAUSE MARKETING: NEW YORK ATTORNEY GENERAL RELEASES REPORT ON "PINK RIBBON" CAMPAIGNS

AUTHORS

Jonathan L. Pompan
Jeffrey S. Tenenbaum

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The New York Attorney General ("NY AG") released a much-anticipated report on "pink ribbon" campaigns, last week. The report, entitled *Five Best Practices for Transparent Cause Marketing* (the "Best Practices"), available **here**, originated from last year's NY AG initiative focused on breast cancer charities (widely covered by Venable; see links below). Although the NY AG initiative was specific to breast cancer charities, the Best Practices are broadly applicable to all cause-marketing efforts and will likely set a new bar by which the activities of companies and charities involved in these types of campaigns will be measured.

Background of Initiative

In October 2011, the NY AG celebrated National Breast Cancer Awareness Month by sending comprehensive questionnaires to at least 40 charities and over 130 companies asking for detailed information on promotions during which the sale of a product or service is advertised to benefit a charitable cause, in this case, breast cancer awareness. These types of promotional efforts that create goodwill for the company and generate income for a charity are commonly known as "cause-marketing" efforts and are classified as "commercial co-ventures" under New York law.[1]

As cause-marketing efforts have grown in popularity, some have to come to question whether consumers are made aware of the relevant information in such promotions and whether the charities are actually receiving the benefits that consumers believe are promised. The NY AG likely had these critiques in mind when it sent out its questionnaire. The questionnaire, which consisted of 19 questions, some with subparts, dove into questions of compliance with the New York Charitable Solicitation Act, such as asking whether the company had a written contract with the charity in place and whether an accounting had been provided to the charity. The questionnaire also comprehensively inquired into the way in which the campaign was advertised to consumers, requesting copies of each "product label, advertisement, announcement, message or other marketing material."

Release of Best Practices

After a year of analyzing responses to the questionnaire on "pink ribbon" and other similar campaigns, on October 18, 2012, the NY AG held a press conference and released the Best Practices. The Best Practices appear to be intended as far-reaching reforms to the way in which some cause-marketing promotions are currently conducted.

The Best Practices go beyond the general "avoid deceptive fundraising practices" standard and offer recommended practices for specific types and forms of cause marketing – from social media free-action programs to one-to-one in-kind donation programs – used by many charitable organizations. This report is by far one of the most significant, if not the most significant, proactive forms of guidance any state Attorney General has ever issued in the area of cause marketing. An overview of the themes found in the specific recommendations of the Best Practices is below.

Expanded Disclosure Requirements

While many states' current regulations for cause marketing require that certain disclosures be given "on all advertising," the NY AG's Best Practices fill in the details and leave little to the discretion of the reasonable person. The list of items for disclosure is noticeably longer than any other state regulations currently require. Specifically, the Best Practices call for the following to be disclosed:

- the specific dollar amount per purchase that will go to the charity;
- the name of the charity;
- the charitable mission if not readily apparent from the name of the charity;
- whether consumer action is required for the charitable donation to be made; and

- the start and end dates of the campaigns.

By comparison, currently most other state statutes expressly require disclosure of (i) the name of the charity, (ii) the amount or percentage per unit that will be donated to the charity, and, sometimes (iii) the dates of the campaign.

Additionally, the Best Practices state that the expanded disclosures should be given on "advertisements, websites, and product packaging;" should be in "clear and prominent format and size;" and should be located "in close proximity" to the text of the advertisement. Depending upon the nature and structure of the campaign, adhering to this guidance may be challenging without additional examples from the NY AG.

Suggestion of "Donation Information" Label

The Best Practices take disclosures a step further in suggesting that each product in the promotion and website used to advertise the promotion showcase a "Donor Information" label which would be similar to a nutrition label on food items and would identify for donors key information about the campaign in a standardized format. While an innovative suggestion, it remains to be seen how proposed information labels and disclosures would be implemented in various advertising formats where space is often at a premium.

Attention to Social Media Campaigns

The Best Practices also push the bounds of current regulation by extending disclosure requirements to certain social media campaigns. While social media advertisements which encourage the purchase of a product or service with the promise of a donation to charity are covered under traditional regulation of cause marketing, free-action programs – such as liking a Facebook page or submitting contact information on a company website to trigger a donation – are not normally covered by the regulatory definition of a "commercial co-venturer." This is because such promotions do not involve the element of a purchase or use of the company's product or service as a prerequisite to the company's donation. As the specific disclosure requirements for commercial co-venturers do not apply to such campaigns, they are usually subject to the more general standard of avoiding "unfair and deceptive" advertising.

The Best Practices state, however, that "companies and charities should be no less vigilant about transparency in social media cause-marketing campaigns than they are in traditional product-based campaigns." This is one of the first times that a regulator has recognized free-action programs in social media to be under the umbrella of cause marketing. The Best Practices go on to recommend that social media cause-marketing programs disclose, at a minimum:

- the amount donated per action;
- the name of the charity that is benefitting;
- the dates of the campaign; and
- the minimum and maximum to be donated.

The Best Practices also recommend implementing a real-time tracking system to cut off the social media campaign when the maximum donation amount is reached or otherwise alert consumers that their action will no longer result in a donation, something that also has not been seen as a requirement in regulatory guidance. For companies and charities used to conducting social media campaigns on a more informal basis, complying with the suggested disclosures will take some careful planning.

Enforcement

In issuing its Best Practices, the NY AG took a unique approach to ensuring that the guidelines are followed, at least in pink ribbon promotions. At the time of the press release, the NY AG announced that the nation's two largest breast cancer charities – Susan G. Komen for the Cure and the Breast Cancer Research Foundation – had both signed off on, and voluntarily agreed to follow, the NY AG Best Practices in all of their cause-marketing endeavors. This effectively means that a large number of companies that want to hold a pink ribbon promotion also will be playing by these new rules.

And while they have not been directly adopted into law, the guidelines contained in the Best Practices could be used by the NY AG and other state regulators to inform such regulators' enforcement of general prohibitions against unfair and deceptive marketing as found in state mini-FTC Acts. If used as benchmarks for advertising standards, the Best Practices could have far-reaching effects on the ways in which charities and companies conduct cause-marketing campaigns.

Conclusion

Overall, the Best Practices reinforce the general legal principles that have always applied to companies

and charities conducting cause-marketing campaigns, but provide additional specific and concrete examples of disclosures to consider. A decision to disregard these standards could lead to a greater risk of investigation and enforcement. For companies considering cause-marketing campaigns, the new breadth of recommended disclosures in the Best Practices may take some planning and creative coordination to ensure compliant campaigns. Ultimately, it is possible and perhaps even likely that the Best Practices will provide a new norm as cause-marketing campaigns continue to generate goodwill for companies and increase revenue for charitable causes.

* * * * *

Venable's prior articles on the NY AG "Pink Ribbon" initiative can be found at:

- **"Charitable Solicitation and Commercial Co-Venturer Red Flags: Insights for Charities and Marketers from the NY Attorney General"**
- **"Nineteen Questions Every Cause-Related Marketer Should be Prepared to Answer"**
- **"Cause-Related Marketing in the Crosshairs: What the New York Attorney General's Breast Cancer Investigation Means for Nonprofits and Their Corporate Supporters"**

* * * * *

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1 New York Executive Law 7-A, Section 171-a(6) defines a "commercial co-venturer" as, "any person who for profit is regularly and primarily engaged in trade or commerce other than in connection with the raising of funds or any other thing of value for a charitable organization and who advertises that the purchase or use of goods, services, entertainment, or any other thing of value will benefit a charitable organization.

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February 28, 2012

NINETEEN QUESTIONS EVERY CAUSE-RELATED MARKETER SHOULD BE PREPARED TO ANSWER: LESSONS FROM THE NY ATTORNEY GENERAL'S INVESTIGATION OF BREAST CANCER CAUSE-RELATED MARKETING

AUTHORS

Jonathan L. Pompan
Jeffrey S. Tenenbaum

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In November 2011, it was widely reported that the New York Attorney General (the "NY AG") had opened an investigation into the cause-related marketing efforts of "pink ribbon" charities. As part of its examination, the NY AG sent comprehensive questionnaires to at least 40 charities and 130 companies asking for detailed information specific to activities in which the sale of a product or service is advertised to benefit a charitable cause. Venable has since obtained a redacted copy of a typical questionnaire sent to companies involved in cause-related marketing related to breast cancer, a version of which appears below.

A cause-related marketer should review these questions (with a more in-depth analysis available **here**) to ensure that adequate answers could be given about a proposed campaign in the event of an investigation by a state regulator such as the NY AG.

Please answer the following questions regarding cause marketing campaign(s) concerning breast cancer conducted by your company and/or any of its subsidiaries, divisions or brands ("your company") at any time since October 1, 2009. For purposes of this questionnaire, cause marketing means any marketing of products or services which states or suggests that a charity or charitable cause will benefit from the purchase or use of the product or service. Please use a separate questionnaire for each cause marketing campaign and add additional pages to the questionnaire if necessary.

1. Name of your company.

2. Please name the charity or charitable cause that is the subject of your responses below.

3. What are the start and end dates for the campaign?

4. If the campaign has not ended, what is the date on which it is expected to end?

5. Identify the product(s) or service(s) used in connection with the campaign. (Attach additional pages if necessary)

6. Identify each method used to advertise or otherwise promote the product or service in connection with the campaign. Check all that apply:

q product packaging
q television
q print media
q email
q Twitter
q in-store advertising
q radio
q website (provide web address)
q Facebook
q other (describe)

7. Does (or did) the campaign require the consumer to take any action, other than making a purchase, in order for the charity or charitable cause to receive a benefit? (for example, mailing in a label or entering a code on a website)

q Yes q No
If Yes, please describe.

8. Please describe any benefit that the campaign stated or suggested would be provided to the charity or charitable cause.

9. Please describe the procedures for calculating the benefit due to the charity or charitable cause.

10. If the campaign stated that a percent or amount of your company's profits or proceeds or other financial measure would be paid to the charity or charitable cause, describe how “profits” and/or “proceeds” or other measure are defined and calculated.

11. Did your company guarantee a minimum contribution to the charity or charitable cause?

q Yes q No
If Yes, what amount was guaranteed?

12. Did your company place a limit (cap) on the amount it would pay to the charity or charitable cause?

q Yes q No
If Yes, what is the amount of the limit (cap)?

13. If there is a limit or cap, are procedures in place for discontinuing the promotion once the limit or cap is reached?

q Yes q No
If Yes, describe the procedures.

14. What are your procedures for disposing of and/or re-labeling remaining products after the termination of the campaign?

15. What is the total value of the contribution or other benefit that your company has provided to charity since the campaign began? List the date and amount of each payment or other benefit. (Attach additional pages if necessary)

16. If any contribution or other benefit has not yet been provided, please state below the date(s) on which such contribution or benefit is expected and the estimated value of such contribution or benefit. (Attach additional pages if necessary)

17. Identify each of your company's products that contained marketing for the campaign, and state the number of such products produced for the campaign and the number sold during the campaign. (Attach additional pages if necessary)

18. Did your company enter into a contract or other written agreement with any charity concerning the campaign?

q Yes q No
If Yes, please attach copies.

19. Have you provided accountings or reports to any charity detailing the amounts due to the charity in connection with the campaign?

q Yes q No
If Yes, please attach copies.

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*For more information, please contact Jonathan Pompan at 202-344-4383 or at **jlpompan@Venable.com**.*

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February 28, 2012

CHARITABLE SOLICITATION AND COMMERCIAL CO-VENTURER RED FLAGS: INSIGHTS FOR CHARITIES AND MARKETERS FROM THE NY ATTORNEY GENERAL

AUTHORS

Jonathan L. Pompan
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A review of the questions (redacted questionnaire available **here**) asked by the NY AG provides a framework for many of the issues that any charity or marketer should consider prior to entering into a cause-related marketing campaign and can help prepare a marketer or charity to respond to similar inquiry by a state regulator.

Overview of Questions in NY AG Questionnaire

Overall, the questionnaire for commercial entities consists of 19 questions, some with subparts. In addition to requiring written responses, several of the questions ask for documentation to be attached, such as contracts and preexisting marketing materials. The instructions provide that a separate questionnaire must be completed for each cause-related marketing campaign conducted by "the company and/or any of its subsidiaries, divisions or brands" since October 1, 2009. These questions make clear that the inquiry is not only related to the marketing of commercial co-ventures, but also go to the heart of best practices in charitable solicitation and partnerships with charities.

Predictably, many of the questions in the NY AG questionnaire track New York law on commercial co-ventures. For example, the questionnaire asks whether a written contract is in place with the charity, a requirement under New York law and in many other states. The questionnaire also asks for a listing of all charities, along with the charity's EIN, that have received a contribution or other benefit under the campaign. The NY AG could presumably use this information to cross-reference whether each charity is itself properly registered to conduct charitable solicitation. Further, the questionnaire asks whether an accounting has been provided to the charity, showing amounts due in connection with the campaign. Under New York law, an accounting is required at the end of each campaign detailing the number of items sold, the amount of each sale, and the amount to be paid to the charity.

In addition, the questionnaire drills down to the details about the marketing efforts of the campaign, asking for a copy of each "product label, advertisement, announcement, message or other marketing material" used to promote the campaign and requiring that the methods used to promote the campaign be identified, including, among others, television, print media, email, Twitter, Facebook, or in-store advertising. These questions recognize that successful cause-related marketing efforts often will be advertised through different mediums and by different parties, all of which must be in compliance with the relevant state statute.

The questionnaire also hits on items for disclosure in a cause-related marketing campaign. For example, the questionnaire asks whether there were any minimum or maximum guarantees regarding the corporation's donation to the charity. Minimum and maximum guarantees are often of interest to state regulators. Another item on the questionnaire asks whether additional action was required for the charity to receive the benefit promised to the charity, such as the consumer taking an action online or mailing in a receipt. Again, if the campaign involves additional action for the benefit to be received by the charity, marketers should consider evaluating whether this has been made clear to the reasonable consumer.

The questionnaire also focuses on the procedures in place for when the campaign is discontinued. Disposal of excess products and relabeling are issues that many marketers and charities might not discuss in the initial planning stages of the campaign, but which arise in many cause-related marketing efforts. Although most state charitable solicitation laws do not contain provisions specific to procedures that must be in place at the end of the campaign, if products with expired co-venture labeling are sold after the period of the campaign, this could be deemed to be deceptive advertising if a reasonable consumer believed that a charitable benefit would result from the purchase.

Finally, the NY AG questionnaire contains questions related to specifics of accounting procedures involved in the commercial co-venture. The questionnaire asks if a representation has been made to the public that a percentage of the proceeds will be given to a charity, and, if so, how profits or proceeds are measured. Although most state laws require only that the amount or percentage of profits or proceeds to be donated are stated in a contract, it is important that the method of calculation and whether such calculation will be made from gross or net income be discussed between the parties.

Conclusion

The recent initiative by the NY AG highlights the increasing focus of state regulators on charitable solicitation in general and cause-related marketing campaigns in particular. As demonstrated by the questionnaire from this initiative, there are many issues which must be discussed when partnering with a charity in a marketing effort. A review of the NY AG questionnaire provides a good starting point for cause-related marketing compliance planning, and along with a consultation of the relevant state laws, can help ensure a successful campaign.

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CAUSE-RELATED MARKETING IN THE CROSSHAIRS: WHAT THE NEW YORK ATTORNEY GENERAL'S BREAST CANCER INVESTIGATION MEANS FOR NONPROFITS AND THEIR CORPORATE SUPPORTERS

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The New York Attorney General has recently crossed into what some consider to be the hallowed ground of charities, by launching an investigation into cause-related marketing of “pink ribbon” charities. In its own recognition of National Breast Cancer Awareness Month, the New York Attorney General’s Office (the “NY AG”) is examining charities and commercial partners that are involved in a cause-related marketing campaign representing that a portion of the sales of a product or service will support breast cancer research or screening. Overall, this initiative highlights the focus of the NY AG in preventing charitable fraud in breast cancer charities. This action also demonstrates that organizations, both charities and marketers, engaging in increasingly popular cause-related marketing campaigns should pay close attention to state regulatory requirements for these activities.

New York’s Recent Investigations

This new initiative is a continuation of the NY AG’s focused effort on breast cancer charities. In June 2011, the NY AG filed a complaint against the Coalition Against Breast Cancer (“CABC”), which was alleged to be nothing more than a sham charity established to benefit its founders. According to the complaint, CABC solicited more than $9.1 million from the public but spent virtually none of it on breast cancer programs. Instead, the founders used the contributions to provide benefits to themselves and their families. In addition, CABC allegedly deceptively advertised an affiliation with the Memorial Sloan-Kettering Cancer Center when, in fact, no such relationship existed. These activities provided the basis for multiple alleged violations of New York's not-for-profit and charitable solicitation laws. A preliminary injunction prohibiting the defendants from, among other things, soliciting or collecting charitable contributions from any person was granted by the court on November 1, 2011, and the case is ongoing.

Additionally, in August 2011, the NY AG secured guilty pleas against the founders of another breast cancer charity, the Coalition for Breast Cancer (“CFBC”), after the NY AG’s office filed an action alleging the defendants operated a phony charity. The complaint alleged the husband and wife founders of CFBC solicited donations for breast cancer programs but instead diverted the money to pay for personal travel expenses, lavish meals, shopping excursions, and their daughter’s sorority dues. As a result of these activities, the husband in this case pled guilty to two felony counts – one of grand larceny and one of scheme to defraud – while the wife pled guilty to one count of falsifying a business record for her role in opening bank accounts for the organization.

In the newest breast cancer charity investigations, the NY AG is spreading its reach to investigate nonprofits as well as for-profit businesses that engage in cause-related marketing. As the first step in its investigation, the AG has sent questionnaires to at least 40 charities and 130 companies. These questionnaires ask for detailed information specific to activities in which the sale of a product or service is advertised to benefit breast cancer causes. The NY AG is likely to use the information gleaned from the questionnaires to assess whether further investigation is needed in specific instances.

New York’s Requirements for Commercial Co-Venturers

New York is typical of many states in that its charitable solicitation laws (specifically, The Solicitation and Collection of Funds for Charitable Purposes Act, N.Y. Executive Law Article 7-A) define a commercial co-venturer, or business that conducts cause-related marketing, and contain specific requirements for a commercial co-venturer. These requirements include having a written contact with the charitable organization and maintaining accurate books and records of activities for three years following the cause-related marketing campaign. Unlike several other states (such as Alabama, Maine, and Massachusetts), New York does not require that the commercial co-venturer register, obtain a license, or file a bond with the Attorney General. New York does specify, however, that any charity with which a

commercial co-venturer contracts must itself be registered.

The New York charitable solicitation laws also mandate that advertising surrounding the cause-related marketing campaign must contain specific disclosures such as the anticipated percentage of the gross proceeds or the dollar amount per purchase that the charity will receive. At the conclusion of the cause-related marketing campaign, the commercial co-venturer also is required to provide an accounting to the charity, including the number of items sold, the amount of each sale, and the amount paid or to be paid to the charity.

Aside from specific requirements for commercial co-venturers, the New York charitable solicitation laws also generally prohibit any person from engaging in a fraudulent or illegal act including "obtaining money or property by means of a false pretense, representation, or promise." Importantly, New York does not require that either intent to defraud or an injury be shown to prove fraud. Therefore, it is very important for those involved in cause-related marketing campaigns to carefully review their advertisements to ensure that all regulatory requirements are met and that the campaign is not represented in a way that could be characterized as misleading or deceptive, such as by not including any maximum donation limits or implying that the money received will be given to a specific program if it is instead used for general purposes.

Recommendations for Marketers Conducting Cause-Related Campaigns

The New York Attorney General's investigation is rather unique in that its reach extends into examination of the activities of for-profit marketers. For many marketers, entering into a cause-related marketing campaign is the company's first venture into charitable solicitation and the regulatory framework surrounding such activities. However, marketers should perform due diligence on potential partners when entering into any new commercial venture. In this case, cause-related marketing efforts should be no different. In fact, because charities are themselves subject to legal and regulatory requirements, the marketer is opening itself to some unique legal and relationship risks in cause-related marking campaigns. For example, one risk may be that the charitable organization is not itself in compliance with applicable charitable solicitation requirements or is found to be a "scam" organization (such as the allegations in the complaints filed this summer by the NY AG against the two breast cancer organizations).

For these reasons, marketers should consider adopting contractual protections in their cause-related marketing agreements. These protections could address such areas as compliance with charitable solicitations laws and the Internal Revenue Code. The marketer also should develop a due diligence and reporting program in order to collect relevant information to confirm the charity's compliance with applicable federal and state laws. Finally, provisions for indemnification of the marketer by the charity for any claim related to the legal or regulatory status of the charitable organization, as well as insurance to cover the indemnity obligation, also should be considered in the agreement with the charity.

Conclusion

The most recent initiative by the NY AG highlights the increasing focus of state regulators on charitable solicitation in general and cause-related marketing campaigns in particular. Both charities and marketers involved in cause-related marketing should pay close attention to state requirements for charitable solicitation and prohibitions against fraudulent advertising. When it comes to accomplishing the mission of consumer protection, no cause, no matter how purportedly noble, is off-limits to scrutiny from state regulators.

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NONPROFIT PARTNERSHIPS: A GUIDE TO THE KEY LEGAL ISSUES AND PITFALLS

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This article uses the term "partnership" as most people would use the word when speaking to one another. When two or more people, or two or more groups of people, pool their resources together and collaborate to achieve a common purpose, it is fair and accurate to call them "partners." From a legal sense, however, the term "partnership" is a term of art—when lawyers describe two entities as "partners," they are speaking about a particular type of legal arrangement. From a lawyer's perspective, a "partnership" is a complex interaction of business law, tax law, and the rules of intellectual property.

Still, for all the legal complexity that often comes with forging partnerships, maintaining them, and amicably parting ways, there are a few basic steps that every nonprofit can take to better understand the law of partnerships. This article lays out some basic terminology, then explains the tax and intellectual property implications involved in forming partnerships. It concludes by highlighting provisions that should be included in every partnership agreement, no matter what the technical form of the relationship.

I. Terminology

Strictly speaking, a "partnership" is an unincorporated business organization created by contract between two or more entities in order to carry out a common enterprise. Each partner contributes money, property, labor, or skill, and expects to share in the profits and losses of the undertaking. Generally speaking, a partnership does not pay income taxes; instead, the individual partners report their share of the partnership's profits or losses on their individual tax returns.

Within this legal definition, there are several categories of partnership, each with its own balance of management rights and personal liability. There are also several forms of cooperation that fall short of the technical definition of "partnership," but are nonetheless advantageous to nonprofits not yet ready to commit to a long-term relationship with another entity.

A. General Partnership

In a general partnership, each partner shares equal rights and responsibilities in connection with the management of the partnership, and any partner has the authority to bind the entire partnership to a legal obligation. Unlike shareholders in a corporation, the members of a general partnership are personally liable for all of the partnership's debts and obligations. That amount of personal liability is often daunting, but it comes with a significant tax advantage: partnership profits are not taxed to the business. Instead, profits *pass through* to the partners, who include the gains on their individual tax returns.

B. Limited Partnership

In a limited partnership, partners are divided into two classes—general partners and limited partners. The personal liability of a limited partner is limited to the amount he or she has actually invested in the partnership; as a trade-off, however, limited partners are not permitted to participate in management decisions. At least one partner in a limited partnership must be a general partner. General partners retain the right to control and manage the limited partnership, but assume full personal liability for the partnership's debts and obligations.

C. Limited Liability Partnership

In a limited liability partnership ("LLP"), all partners may directly participate in the management of the partnership and are granted some protection from the partnership's liability—although the extent of that protection varies from state to state. Some states tax limited liability partnerships as corporations, although they are considered partnerships under federal law. Many states also make the LLP available only to certain professional businesses—*e.g.*, law and accounting firms—and mandate that LLPs

adhere to specific filing requirements.

D. Limited Liability Company

A limited liability company ("LLC") is a relatively new type of business structure created by state statute. Unlike general partnerships, which were developed over time by case law and require no formal documentation for creation, LLCs are created by filing a document (usually referred to as "Articles of Organization") with the state. LLC owners (called "members") are not personally liable for the debts and obligations of the LLC. In most cases, an LLC will be taxed like a general partnership—that is, the LLC itself will not be taxed, and the individual members will report their share of profits and losses on their individual tax returns. An LLC may, however, elect to be taxed as a corporation.

E. Joint Venture

A joint venture is an enterprise jointly undertaken by two or more entities for the limited purpose of carrying out a single transaction or isolated project. Unlike a partnership agreement, which creates a new entity and anticipates a long-term and continuous relationship, a joint venture usually ends once the limited purpose of the joint venture is complete. A joint venture can be structured like a general or limited partnership or an LLC, although LLCs are often preferred because of the additional liability protection and tax advantages. Similarly, joint ventures can be structured with an increasingly overlapping set of commitments between the parties and an eye towards eventually entering a more formal relationship. In any event, a well-structured joint venture will be codified in a written agreement that details the precise obligations and allocation of risk between the parties involved.

In a *whole joint venture*, one or more of the partnering entities contributes all of its assets to the enterprise. Nonprofit organizations more commonly engage in ancillary joint ventures. *Ancillary joint ventures* are essentially small-scale joint ventures—enterprises that do not become the primary purpose of the organizations involved. Organizations typically engage in ancillary joint ventures for a limited duration, and memorialize the terms of their arrangement in a written agreement. For example, nonprofits may enter into an arrangement with another organization to host a convention, publish a newsletter, or provide a series of educational programs. Tax-exempt organizations seeking additional sources of revenue also may enter into ancillary joint ventures with for-profit corporations, as long as doing so furthers the tax-exempt organization's purposes and the tax-exempt organization retains ultimate control over the underlying activity. Nonprofits often create new entities from which to undertake the joint venture. Depending upon the nature of the activity contemplated, such an organization may or may not be eligible for tax-exempt status.

Joint membership programs allow individuals to join two nonprofits typically, for a reduced fee. These initiatives allow the members of one organization to become more familiar with another, and are typically conducted in the context of other jointly-run programs and activities. Again, programs in this vein are designed to bring nonprofits closer together, often as a precursor to a more formal alliance, but allowing the entities to tinker with the arrangement or disengage altogether if circumstances or expectations change.

F. Independent Contractor Relationships

An independent contract relationship is an agreement between two or more entities for the provision of goods or services under the terms specified in the agreement. For the most part, independent contractors are defined by the IRS's "facts and circumstances" test. For instance, if the nonprofit hiring the contractor has the right to control or direct the result of the work, but not the means of accomplishing the work, then this will be a factor in favor of characterizing the arrangement as an independent contractor relationship. Otherwise, the contractor may be treated as an employee of the nonprofit, whose earnings are subject to withholding for employment tax purposes. The employee also may be eligible for employee benefits from the nonprofit, among other significant implications.

G. Commercial Co-Venture

A commercial co-venture (sometimes referred to as a "charitable sales promotion") generally consists of an arrangement between a charitable organization and a for-profit entity that otherwise engages in a trade or business. In most cases, the for-profit entity agrees to promote the sale of a product or service and represents that part of the sales proceeds will benefit a charitable organization or charitable purpose. Commercial co-ventures generally resemble independent contractor relationships more than partnerships, LLCs or joint ventures.

Commercial co-ventures are a relatively new idea, and the body of law addressing them is still developing. Presently, 24 states expressly regulate commercial co-ventures. Although none of these

states require the commercial co-venture to form a separate business entity, many do require that both the for-profit corporation and the charitable organization file a written contract with the state before engaging in any sales or charitable solicitations.

II. Tax Issues for Tax-Exempt Organizations[1]

Because the terms of a partnership often implicate the tax-exempt purposes of an organization, tax-exempt entities must be mindful of the Internal Revenue Code ("IRC") and the conditions of tax-exempt recognition. This section discusses four central tax concepts for nonprofits to consider before signing any partnership agreement: unrelated business income tax, control by the tax-exempt organization, private inurement and private benefit, and compliance with state charitable solicitation laws.

A. Unrelated Business Income Tax

In general, tax-exempt organizations are exempt from federal taxes on income derived from activities that are substantially related to the organization's exempt purpose. A tax-exempt organization may still be subject to unrelated business income tax ("UBIT"). UBIT is a federal income tax imposed on tax-exempt organizations for income derived from a trade or business that is carried on regularly, but is not substantially related to the organization's exempt purposes. This tax is generally imposed at the federal corporate income tax rates.

For the purposes of determining UBIT, an activity is considered a "trade or business" where it is carried on for the production of income from the sale of goods or performance of services. Income from a passive activity—*i.e.*, an activity in which the exempt organization allows another entity to use its assets, for which the organization receives some payment—is not considered a business. The IRC specifically excludes certain types of passive income from UBIT—dividends, interest, annuities, royalties, certain capital gains, and rents from non-debt financed real property. UBIT also does not include income generated from volunteer labor, qualified corporate sponsorship payments, or qualified convention or trade show income.

In determining whether an activity is "regularly carried on," the IRS will examine: (1) the frequency and continuity with which the activity is conducted; and (2) the manner in which it is pursued. These factors will be compared with the same or similar business activity of non-exempt organizations. Discontinuous or periodic activities are generally not considered "regularly carried on," and generally do not result in UBIT.

An activity that is substantially related to an organization's tax-exempt purposes will not be subject to UBIT. A "substantially related" activity contributes directly to the accomplishment of one or more of the organization's exempt purposes. Alone, the need to generate income so that the organization can accomplish other goals is not considered a tax-exempt purpose.

In the context of trade and professional associations, for example, an activity is "substantially related" if it is directed toward the improvement of its members' overall business conditions. Particular services performed to benefit individual members, although often helpful to their individual businesses, usually results in UBIT to the association where those services do not improve the business conditions of the industry overall.

UBIT is even a consideration where a partnership is formed by two otherwise tax-exempt organizations. To the extent that the activities of a partnership do not further the exempt purposes of either organization, income from the partnership may be subject to UBIT. Notably, if two tax-exempt entities form an LLC operated exclusively for exempt purposes and consisting solely of exempt members, the LLC itself may seek exemption under Section 501(c)(3) of the IRC. Accordingly, if such exemption is recognized by the IRS, the income of the LLC would not be subject to tax. In contrast, the IRS will not grant general or limited partnerships exempt status, even if all of the partners thereof are exempt organizations.

Under the UBIT rules, deductions are permitted for expenses that are "directly connected" with the carrying on of the unrelated trade or business. If an organization regularly carries on two or more unrelated business activities, its unrelated business taxable income is the total of gross income from all such activities less the total allowable deductions attributable to such activities.

An organization can jeopardize its tax-exempt status if the gross revenue, net income, and/or staff time devoted to unrelated business activities is "substantial" in relation to the organization's tax-exempt purposes. In an effort to prevent loss of exempt status, many tax-exempt organizations choose to create one or more taxable subsidiaries in which they may house unrelated business activities. Taxable subsidiaries are separate but affiliated organizations. A taxable subsidiary can enter into

partnerships and involve itself in for-profit activities without risking the tax-exempt status of its parent. Moreover, the taxable subsidiary can remit the after-tax profits to its parent as tax-free dividends.

B. Control

In a partnership, a nonprofit organization continues to qualify for tax exemption only to the extent that (1) its participation furthers its exempt purposes and (2) the arrangement permits the organization to act exclusively in its own interests and in the furtherance of those exempt purposes. If a tax-exempt entity cedes "control" of partnership activities to a for-profit entity, the IRS will consider the partnership to serve private aims, not public interests.

In a partnership with a for-profit entity that involves all or substantially all of a tax-exempt organization's assets, the IRS generally requires the tax-exempt organization to retain majority control over the partnership—*e.g.*, a majority vote on the governing board. In a similar arrangement that involves only a portion of the tax-exempt organization's assets, the IRS has approved a structure in which the for-profit and tax-exempt organizations share most management responsibilities but leave the exempt organization in charge of the exempt aspects of the partnership. Even in a partnership consisting solely of tax-exempt organizations, the management of the partnership must remain with tax-exempt organizations and may not be delegated to for-profit entities.

Nonprofits frequently enter into short-term partnerships with for-profit corporations in order to conduct a particular activity. These ventures should not jeopardize the nonprofit's tax-exempt status in most cases—even if the nonprofit does not maintain operational control over the venture—because the nonprofit will still carry on substantial tax-exempt activities.

C. Private Inurement and Private Benefit

In general, organizations recognized as tax exempt under Sections 501(c)(3) and 501(c)(6) of the IRC are prohibited from entering into a transaction that results in "private inurement." Private inurement occurs where a transaction between a tax-exempt organization and an "insider"—*i.e.*, someone with a close relationship with, or an ability to exert substantial influence over, the tax-exempt organization—results in a benefit to the insider that is greater than fair market value. The IRS closely scrutinizes partnerships between tax-exempt organizations and taxable entities to determine whether the activities contravene the prohibitions on private inurement and on excess private benefit (see below).

Private inurement through dealings with tax-exempt organizations can carry with it individual penalties as well. The IRS may levy excise taxes (referred to commonly as "intermediate sanctions") against "disqualified persons" that receive better-than-fair-market-value in transactions with 501(c)(3) and 501(c)(4) organizations. A "disqualified person" is any person who is in a position to exercise substantial influence over the tax-exempt organization, or has been in the past five years. Directors, officers, and the immediate family of directors and officers are all disqualified persons, among others.

501(c)(3) organizations also are prohibited from entering into transactions that result in more-than-incidental "private benefit" to another party, including unrelated third parties. Incidental benefits related to an organization's tax-exempt purposes are not considered private benefits, but the benefits must be both quantitatively and qualitatively incidental. To be quantitatively incidental, the private benefit must be insubstantial when compared to the overall tax-exempt benefit generated by the activity. To be qualitatively incidental, the private benefit must be inextricable from the exempt activity, in that the exempt objectives could not be achieved without necessarily benefitting certain individuals privately.

While the private inurement prohibition and the private benefit doctrine may substantially overlap, the two are distinct requirements which must be independently satisfied.

D. Charitable Solicitation Statutes

Over the last two decades, the vast majority of states and the District of Columbia have enacted and strengthened charitable solicitation statutes, designed to guard against fraudulent or misleading fundraising solicitations. The term "charitable solicitation" generally refers to requests for contributions to a tax-exempt organization or for a charitable purpose. Many state statutes restrict the application of their charitable solicitation statutes to organizations recognized as tax-exempt under Section 501(c)(3); others apply such statutes to all tax-exempt entities. Solicitations may take many forms, including Internet and telephone appeals, special fund-raising events, and direct-mail campaigns. Any partnership that engages in a charitable solicitation must adhere to the state requirements in each state in which such solicitation occurs.

While the specifics of these statutes vary by state, they generally require tax-exempt organizations to register before soliciting contributions from residents of the state. Registration typically involves

providing general information (*e.g.*, name, address, corporate status, purpose, proposed registration activities, tax status, information about officers and directors, etc.) about the tax-exempt organization.

Many states also impose reporting and disclosure requirements. Tax-exempt organizations are typically required to file a report or other financial information with the state on an annual basis. Many states make all or most of these reports and registrations available to the public. Some states also require solicitors to disclose certain information—*e.g.*, the nature of the organization's activities and the amount of a donation actually designated for charitable purposes—at the request of a prospective donor.

As commercial co-ventures have gained popularity, many states have enacted statutes that specifically address and regulate arrangements between non-profit and for-profit entities. Under these statutes, the for-profit partner may be subject to reporting and accounting requirements to both the tax-exempt organization and the state. Alternatively, states may subject the partners of a commercial co-venture to the registration and bonding requirements usually reserved for professional fundraisers and solicitors.

Failure to comply with charitable solicitation statutes may result in sanctions against the tax-exempt organization, including investigations, revocation of registrations, injunctions, and civil and criminal penalties. Because of the variances in state filing requirement, compliance is often burdensome when nonprofit organizations contemplate solicitation programs that will span several states. This burden is somewhat eased by the fact that 35 states and the District of Columbia have agreed to accept a uniform registration form; however, many of these jurisdictions also require state-specific attachments—*e.g.*, a Form 990, audited financial reports, and/or copies of partnership agreements—to complete the charitable organization's registration.

III. Protecting Intellectual Property within Partnerships

The various types of partnerships discussed previously all likely will result in the creation of or involve the use of some form of intellectual property. Perhaps a company and a charity partner together to promote a "green" program on each other's websites. Nonprofits often come together to produce an educational conference, convention or trade show. Several different types of organizations might enter into a partnership to create the definitive publication on best practices in a given field or industry.

These business ventures, and many others, likely involve the development of products or written works, advertising and marketing literature, the sharing of logos and organization names, and/or the use of membership and customer lists to market the program. In addition, business activities like these often require a nonprofit to share its trademarks, trade secrets, and copyrights. All of these things constitute intellectual property. When such intellectual property assets are managed poorly, an organization runs the risk of damaging or diluting its rights in its own intellectual property assets and potentially infringing upon the rights of others. If managed properly, these assets can remain protected even as they are used to accomplish the goals of the business venture.

In short, a rudimentary understanding of the basics of trademark, trade secret, and copyright law can go a long way toward giving an organization the flexibility it needs to successfully launch new partnerships and business activities.

A. Trademark Basics

An organization's name and acronym may be "trademarks" protected by law. By definition, a trademark is any word, phrase, symbol, design, slogan, or tag line (or combination thereof) used by a company, individual or nonprofit to identify the source of a product. A service mark is the same as a trademark except that it identifies the source of a service. A certification mark is a mark used by an authorized third party to indicate that their products or services meet the standards set by the owner of the mark. It is important to note, however, that there are several exceptions that prevent a mark from being a protected trademark under the law, including the fact that the mark is too generic or is a merely descriptive term.

B. Trade Secret Basics

The term "trade secret" is generally defined as information used in a business that provides a competitive advantage to its owner and is maintained in secrecy.[2] Almost any type of information, if truly valuable, not readily known in the industry, and properly protected, may constitute a trade secret. Trade secret information might include (1) business information; (2) customer or member lists and related confidential information; (3) procedures, such as employee selection procedures, business methods, standards and specifications, inventory control, and rotation procedures; (4) financial information; (5) advertising and marketing information; (6) processes and methods of manufacture; (7) designs and specifications; and (8) computer software.

C. Copyright Basics

While they often may not realize it, organizations create and use copyrighted works on a regular basis. Under the federal Copyright Act, a copyright automatically vests in the author of a work as soon as the work is fixed in some tangible medium of expression. Essentially, when any entity puts pen to paper and an original work appears, a copyright exists. The copyright may be owned by a single author, or by two or more contributors who are joint authors or co-authors. A "joint work" is one created by two or more authors who intend their contributions to be merged into a single work. As a matter of law, each co-author of a copyrighted work has an independent right to use and exploit the entire work, but must share the profits equally and provide an accounting to the other co-author.

Organizations frequently miss a key copyright principle: the law treats works created by independent contractors and other non-employees differently than works created by an organization's employees. Materials created by an organization's employees generally are presumed to be the property of the organization, even absent a written copyright transfer or agreement, thus making the organization the owner of the copyright in such works. However, even if an organization has conceived of the idea for a work, supervised its development, and funded its creation, an independent individual (*e.g.*, an independent contractor or any other non-employee) hired to create a work retains the copyright in that work unless he or she explicitly transfers it back to the organization by way of a written agreement. Even articles and graphics used and reused in the regular publications of a nonprofit may remain the intellectual property of their original creators and owners. If the organization wishes to continue to use such a work, it must obtain permission from the copyright owner and may be required to pay a licensing fee.

D. Preventative Measures

To protect and maximize an organization's intellectual property rights and avoid infringing upon the intellectual property rights of others, the organization should take the following preventative steps, either on an ongoing basis or in contemplation of a new business venture:

- **Register copyrights.** Register the content on websites, publications and all other important, original, creative works that are fixed in any print, electronic, audio-visual, or other tangible medium with the U.S. Copyright Office. Although such registration is not required to obtain and maintain a copyright in a work, it is a prerequisite to filing a lawsuit to enforce the rights in such works and it confers other valuable benefits. Copyright registration is generally a simple, inexpensive process that can usually be done without the assistance of legal counsel.
- **Register trademarks.** Organizations should register their name, logos, slogans, certification marks, and all other important marks with the U.S. Patent & Trademark Office. While federal registration of marks is not required to obtain and maintain trademark rights, it can be extremely helpful in enforcing and maintaining them. Trademark registration, although a bit more expensive than obtaining copyright registration, is still an affordable process, particularly when one considers that trademarks and service marks generally protect the actual identity of an organization or its brand(s). As a result, the ability to fully enforce an organization's trademark or service mark rights through registration is paramount.
- **Use copyright and trademark notices.** Use copyright notices (*e.g.*, "© 2011 Venable LLP. All rights reserved.") on and in connection with all creative works published by your organization, and trademark notices on and in connection with all trademarks, service marks, and certification marks owned and used by your organization (*e.g.*, "TM" for non-registered marks and "®" for federally registered marks). While copyright and trademark notices are not required, their effective use can significantly enhance intellectual property rights, including putting others on notice as to their protection and preventing others from asserting the defense of "innocent infringement."
- **Verify ownership and permission to use all intellectual property.** An organization should ensure that it owns all intellectual property or has appropriate permission to use all intellectual property belonging to third parties that appears in its publications, on its website and in any other media, and should maintain and update such permissions on a regular basis. It is notable that, generally speaking, more copyright problems arise in this area than any other. If an organization discovers that it does not own intellectual property that it seeks to use as part of a partnership or business venture, it may be required to obtain permission from and pay a licensing fee to the owner of the work in order to make lawful use of the work.
- **Police use of your intellectual property.** Police the use of your copyrights and trademarks by others and enforce your rights where necessary. Trademark law requires the owner of a trademark or

service mark to take measures to enforce its rights in such trademarks or service marks. An organization may use periodic web searches, outside watch service vendors, or other means to do so. Enforcement does not necessarily involve the filing of a lawsuit.

E. Contractual Protections

It cannot be emphasized enough that organizations entering into a business venture should memorialize their arrangement in a written contract. Among the other issues discussed in this article, a written agreement will ensure that the ownership rights (or at least sufficient license rights) to all intellectual property created under the agreement are apportioned among the business partners as they intend. If ownership of works is not spelled out in an agreement, the default copyright laws discussed above will apply, among others. The following are key issues that partnering organizations should address in their written agreements:

- **Ensure confidentiality—either up-front or in the partnership contract.** Potential business partners should enter into a written confidentiality agreement up-front—while they are ironing out the business terms—to protect the tentative deal, trade secrets, and any other intellectual or proprietary property revealed through the process of negotiations and due diligence investigations. Alternatively, the parties can address confidentiality in the comprehensive written contract that outlines their business venture.

- **Include an intellectual property license.** Any time an organization allows any other individual or entity—be they members, affiliated entities, or business partners—to use its trademark, service marks, name, logos, copyrighted works, other intellectual property, or proprietary information (such as names, addresses, and other contact information contained in its membership or customer directory or list), it is licensing those rights to the other party. The terms and conditions of such a license should be in writing and the writing should include certain provisions regarding the policing of the use of such intellectual property by others.

The license of an organization's intellectual property to the other partner generally should be limited solely to the scope and purpose of the business venture contemplated under the agreement, and should cease immediately upon termination. The owning partner should explicitly retain all key copyright, trademark, patent, and domain name rights created under the agreement; retain its ownership and control of the "look and feel" of any of its content used on a website; retain quality control over the use of any trademark, service mark, name, logo, or other indicator of source of any product or service; restrict the use of its name, logo and membership list; obtain confidentiality and security assurances regarding the use of its customer or membership data and other information; and obtain a warranty by the licensee partner that it will use no infringing or otherwise illegal material in connection with its use of the owning partner's intellectual property.

- **Minimize liability risk through representations and warranties.** An effective contract will include sufficient representations and warranties that each partner's intellectual property, software, website, and other elements that it brings to the venture do not infringe any intellectual property or other rights of third parties, do not violate any applicable laws and regulations, and that each partner will perform as promised.

- **Spell out rights upon termination.** While the parties may intend for their brilliantly-conceived business venture to continue forever, even the best plans end or change. Thus, one of the most important issues to address in advance in the original written contract is what happens to each party's intellectual property assets upon termination. Joint authors who formerly shared all rights, expenses and revenues may want to buy one another out upon termination, or ensure that the other party cannot use or alter their joint work once they part ways. Partner organizations should consider whether derivative works can be created after termination, and if so, to what extent. The key is for partners to think ahead about what assets they expect to keep or to gain, what rights they wish to protect, and how to enforce those rights at and after termination. In certain cases, a written agreement may be required to alter the statutory default provisions that govern ownership rights related to these types of considerations.

- **Maintain agreements with contractors, authors and speakers.** Partnering organizations also should maintain written contracts with any contractors and non-employee authors and speakers utilized under their business plan. If the ownership of works is not spelled out in a written agreement, the default copyright rule generally will apply, *i.e.*, the person who creates the work is the one who owns it, regardless of who conceived of or paid for the work. An exception to that general rule is represented in the work-made-for-hire doctrine. If a work qualifies as a "work-made-for-hire" under the law, the entity commissioning the work is considered its author and is the copyright owner, not the

individual who created the work.[3] This area of the law is complex and many works may not qualify under the word-made-for-hire doctrine (the doctrine is only applicable to certain limited, expressly-defined categories of works). Among other requirements, in order for a work to be considered a work-made-for-hire, a written agreement reflecting such status is necessary.

A written agreement with any non-employees should contain a section that provides that (1) works created pursuant to the agreement are "works-made-for-hire;" (2) to the extent a work is not a work-made-for-hire under the statute, the non-employee author, creator or speaker assigns the copyright to the organization; and (3) in the event that the non-employee will not agree to assign its work to the organization, the non-employee grants the organization a broad, irrevocable, worldwide, royalty-free, and exclusive license to the work in any manner in the future.

IV. Issues to Consider before Signing the Agreement

After considering the relevant tax and intellectual property issues and choosing the appropriate legal structure for the partnership envisioned, a nonprofit's staff must delve into the specific details. No partnership agreement is complete without taking certain matters under consideration:

- **Due Diligence and Quality Control:** Before entering into any partnership agreement, a nonprofit should become familiar with its potential partner. Nonprofit leadership is obligated to exercise due diligence on this front, and nonprofit staff should be prepared to check references and review key legal, financial, corporate, and insurance documents. Avoiding negligence in the selection process—and on an ongoing basis—is key to avoiding liability for the errors and omissions of a partner.
- **Confidentiality:** While not essential, it often is prudent for a nonprofit to enter into a confidentiality agreement with a potential partner *prior* to beginning negotiations over the partnership agreement. Such an agreement can help ensure that the nonprofit will not be damaged or put at a competitive disadvantage by the disclosure or improper use of sensitive information or documents.
- **Intellectual Property:** Engaging in a business venture with another entity almost always involves the use of one another's intellectual property and frequently the creation of new works. Each organization should include a license to its intellectual property that limits the other partner's use of that property solely to the purposes of the partnership. An organization must preserve the right to maintain quality control over any use of its trademarks, service marks, name, logos, or any other indicator of the source of a product or service. Both partners should address who will own any works created by the partnership—both while it exists and after it terminates—as well as the rights to share in revenue related to such works and the right to create derivative works based on such works.
- **Choosing the Right Form:** As discussed above, each form of partnership has its own liability and tax considerations. Be specific. For example, an agreement to enter into a joint venture should state so explicitly. An agreement that represents a limited, one-time arrangement should contain a clause that states that is the intention of the parties that it be a limited, one-time arrangement.
- **Comply with Tax-Exemption Requirements:** As previously noted, tax-exempt organizations have to abide by special tax rules in order to maintain their tax-exempt status. A nonprofit's tax-exempt status is preserved by continuously monitoring the amount of the resources devoted to a partnership that generates unrelated business income, as well as limiting the unrelated business income itself. The agreement should state that the tax-exempt entity, at the very least, maintains control over the tax-exempt purposes and activities of the partnership.
- **Performance Obligations and Performance Standards:** A partnership agreement must be clear about the precise obligations of each partner, and should err on the side of being too specific. Partners should be required to perform with high standards of quality, professionalism and expertise, and the agreement should contemplate adverse consequences for a party that fails to satisfy these standards.
- **Timeline:** Any time constraints should be stated in the agreement. The phrase "time is of the essence" may be used to prevent late performance.
- **Indemnification:** Most partnership agreements contain an indemnification clause. The basic obligation is that if one partner's negligence or misconduct causes another partner to be sued by a third person, then the party at fault is responsible for any expenses resulting from the suit, including judgments, damages, settlements, and attorney's fees and court costs.
- **Antitrust Compliance:** Any provision that fixes prices, limits competition, allows for the exchange of competitively-sensitive information, attempts to set industry standards, restricts membership in a nonprofit, limits access to particular products or services, limits the production of particular products

or services, or attempts to restrict who may do business with whom in an industry, likely is suspect to scrutiny under federal and state antitrust laws. While not necessarily illegal, extreme care and prudence should be exercised. If the agreement implicates any of these—or otherwise limits competition in any way—consult with legal counsel before proceeding.

- **Representations and Warranties:** Every party to a partnership agreement should be willing to make certain basic guarantees (often called representations and warranties)—to respect the rights of third parties, to follow all applicable laws and regulations, to sign the agreement only if actually authorized to do so, and to perform all obligations in good faith and fair dealing. Many partnership agreements also spell out particular consequences for breach of these guarantees.
- **Term, Termination and Transition:** All good partnership agreements contemplate an exit strategy at every stage of the enterprise. A solid agreement will spell out the initial term of the contract, whether and how the term will automatically renew, and when and how the agreement may be terminated. Unless the agreement specifies otherwise, the law generally will permit a partner to assign its rights and obligations under the partnership agreement to any third party, as well as to terminate the agreement at any time for any reason. Nonprofits can avoid costly disputes at the end of a relationship by deciding, up front, which partners will take which assets with them when they leave the partnership, or at least specifying a process for making such determinations.

This list is by no means exclusive. All partnership agreements should be in writing and generally should be reviewed by legal counsel.

* * * * *

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ARTICLES

August 11, 2011

AVOIDING LEGAL PITFALLS IN CAUSE-RELATED MARKETING

AUTHORS

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Marketers are increasingly looking to affiliate with charities in cause-related marketing efforts, such as arrangements in which a charitable donation is built into the cost of purchase of a good or service, to both raise donations and corporate image. After two years of decline, charitable giving as a whole is increasing, according to a recent survey conducted by the *Chronicle of Philanthropy*, and marketers may be even more interested in cause-related marketing campaigns.[1] However, as seen by the recent class-action lawsuit filed against Lady Gaga over charity wristbands for Japanese earthquake victims,[2] good intentions are not enough to prevent scrutiny and legal trouble.

The suit filed against Lady Gaga (whose real name is Stefani Germanotta) alleges that in selling $5 wristbands that say "We Pray for Japan," Lady Gaga violated federal racketeering and consumer protection laws and engaged in unfair and deceptive advertising by stating that "all proceeds go the Japan Tsunami Relief." According to the complaint, a class action filed by an attorney with 1-800-LAW-FIRM (a Michigan-based legal network) on behalf of consumers, this statement was misleading in that it did not account for taxes and shipping fees on its wristbands.[3]

While the legal merits of the claims are yet to be evaluated, this case serves as a reminder for any marketer seeking to enter a cause-related marketing relationship with a charity to pay attention to potential legal issues prior to embarking on a marketing or advertising campaign. Below we highlight a few of the key issues to be considered. We note that this article does not address federal tax requirements and considerations under the Internal Revenue Code, such as the charitable tax deductibility of donations, required charitable contribution notices and disclosures, and the taxability of income earned by the charity, among others. These are very important issues for charities, but are beyond the scope of this article.

Commercial Co-Venturer Registration

Currently, over 20 states regulate "commercial co-ventures," typically defined under state law as "arrangements between a commercial entity under which the commercial entity advertises in a sales or marketing campaign that the purchase or use of its goods or services will benefit a charity or a charitable purpose." While commercial co-venturer relationships come in many shapes and forms, the most common scenario involves a for-profit, taxable business using the name and logo of a charitable organization for the purpose of increasing sales of the for-profit entity's products or services while at the same time increasing revenue to the charity.[4] As their popularity has increased, such arrangements have come under increased regulation and scrutiny.

In some states, the commercial entity – often referred to as the "co-venturer" – is required to register with the state prior to the marketing of the commercial co-venturer relationship and must meet requirements such as posting a bond and filing financial reports with the state. In other states in which registration may or may not be required, specific recordkeeping requirements and/or mandatory contractual terms between the organization and the commercial co-venturer may be imposed. State statutes also may specify required disclosures for advertising the good or service and typically prohibit the commercial entity from making false or misleading statements in connection with a solicitation.

States have been particularly active in enforcing commercial co-venturer statutes and charitable solicitation laws in general. The Attorney General of each state generally holds enforcement power under these statutes and fines for violations can extremely significant. Some of these statutes also contain private rights of action, including, in some cases, allowing plaintiff's lawyers to bring class-action lawsuits on behalf of a large class of consumers, greatly increasing the risk and stakes for the marketers and charities who become targets of those suits. Therefore, it is important that marketers embarking on campaigns with charities consider state regulation of commercial co-ventures and plan for meeting registration, disclosures, filings, and other applicable requirements before launching their

campaigns.

Unfair and Deceptive Practices

In addition to potential state registration requirements, both the Federal Trade Commission Act (the "FTC Act") and state consumer protection statutes (often referred to as "mini-FTC Acts") prohibit unfair and deceptive trade practices, which include misrepresentations of material facts regarding an advertised product or service as well as omissions of information that would be material to a consumer's decision to purchase a product or service.

The FTC and state Attorneys General have collaborated on a number of actions to enforce the FTC Act and mini-FTC Acts against charities and fundraisers alleged to engage in deceptive marketing practices, including in cause-related marketing efforts. For example, the FTC has brought actions against companies alleged to have deceptively offered advertising space under the guise that it would benefit a law enforcement organization,[5] sellers of household goods alleged to have been manufactured by disadvantaged workers,[6] and a company selling children's activity books claiming to benefit children's hospitals.[7]

In one well-known example, the Georgia Attorney General investigated a Yoplait yogurt campaign designed to benefit the Breast Cancer Research Foundation where the company advertised that it would make a contribution for each lid collected without revealing the agreed-to maximum total donation of $100,000.[8] This investigation concluded with General Mills, the company behind the Yoplait campaign, paying an additional $63,000 to the Breast Cancer Research Foundation, representing the amount that would have been donated through the lid collection efforts of Georgia consumers. Although it does not appear one was initiated in this case, Georgia, like several other states, includes a private right of action for persons injured as a result of a violation of its charitable solicitation statute, and also expressly permits class-action lawsuits, adding another level of risk for a cause-related marketing campaign.

As Lady Gaga discovered, claims of certain percentages going to charity often are closely scrutinized. Therefore, marketers entering into ventures with charities should take care to look at their claims from every angle to ensure that, in seeking to increase donations to a charitable cause, consumers are not misled. Marketers also should review and make appropriate disclosures concerning applicable timeframes for campaigns and any contribution caps.

Relationships with Charitable Organizations

Marketers should perform due diligence on potential partners when entering into any new commercial venture, and cause-related marketing efforts should be no different. In fact, because charities are themselves subject to legal and regulatory requirements, the marketer is opening itself to some unique legal and relationship risks in cause-related marking campaigns. For example, one risk may be that the charitable organization is not itself in compliance with applicable charitable solicitation requirements[9] or is found to be a "scam" organization (somewhat rare but not at all unheard of).

For these reasons, marketers should consider adopting contractual protections in their cause-related marketing agreements. These protections could address such areas as compliance with charitable solicitations laws and the Internal Revenue Code. The marketer also should develop a due diligence and reporting program in order to collect relevant information to confirm the charity's compliance with applicable federal and state law. Finally, provisions for indemnification of the marketer by the charity for any claim related to the legal or regulatory status of the charitable organization, as well as insurance to cover the indemnity obligation, also should be considered in the agreement with the charity.

* * * * * *

The rise in popularity of cause-related marketing allows consumers another way to contribute to worthy causes and raise corporate goodwill. While there are certainly some risks involved for marketers, with appropriate attention, these risks are manageable and marketers can take proper precautions to steer clear of legal pitfalls.

* * * * * *

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This article is not intended to provide legal advice or opinion and should not be relied on as such. Legal advice can only be provided in response to a specific fact situation.

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[1] Holly Hall and Heather Joslyn, *Giving's Recovery Lacks Momentum Says Charities*, CHRONICLE OF PHILANTHROPY, June 26, 2011, available at **http://philanthropy.com/article/Outlook-for-Giving-in-2011-Is/128011/**.

[2] *See Lady Gaga Sued Over Japan Earthquake Charity Bracelets*, REUTERS, June 27, 20011, available at **http://www.reuters.com/article/2011/06/27/us-ladygaga-idUSTRE75Q57220110627**.

[3] *See* complaint in *Caitlin Demetsenare v. Stefani Germanotta et. al,* No. 2:11-CV-12753-BAF-LJM (E.D.M.I. 2011).

[4] *See What's in a Nonprofit's Name: Public Trust, Profit and the Potential for Public Deception; A Preliminary Multistate Report on Corporate-Commercial/Nonprofit Product Marketing and Advertising of Commercial Products* (1999), *available at* **http://www.oag.state.ny.us/press/reports/nonprofit/full_text.html**.

[5] *See FTC v. Southwest Marketing Concepts, Inc.*, Civ. No. H-97-1070 (N.D. Tex. 1997).

[6] *See FTC. v. Crooked Oak Investments et al.*, Civ. No. 00-1496 PHX-ROS (D. Ariz. 2000).

[7] *See FTC v. DPS Activity Publishing, Ltd. et al.*, Civ. No. C 03-1078C (W.D. Wash. 2003).

[8] *See* GA Secretary of State press release, available at **http://sos.georgia.gov/pressrel/pr991221.htm**.

[9] In the vast majority of states, the charitable organization is required to register prior to conducting solicitations or having solicitations conducted on its behalf.

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ARTICLES

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NEW LIMITS ON ONLINE MARKETING: THE IMPLICATIONS FOR NONPROFIT ORGANIZATIONS

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Many nonprofit organizations that market online may rely upon recurring charges for enrollment in membership offers, and other subscription programs, as well as online processing of payment transactions. But now, online advertisers, marketers and merchants will have to comply with a new set of requirements under the "Restore Online Shoppers' Confidence Act," S. 3386 (the "Act"). The Act was signed into law by President Obama on December 29, 2010. As a result, nonprofit organizations with online sales – especially ones with third-party marketing relationships or that sell "continuity" programs (*e.g.*, recurring periodic billing) – will need to review their online activities carefully under the new law to ensure compliance.

Overview

The Act was championed by Senator Jay Rockefeller (D-WV) and the Federal Trade Commission (the "FTC") as a means to combat allegedly deceptive online sales tactics that resulted in recurring charges for consumers for membership clubs and other continuity programs. The Act addresses online "data-pass" of billing information to post-transaction sellers, imposes requirements for obtaining billing information, and restricts the use of negative-option marketing. The obligations in the Act are on top of rules that credit card associations and payment processors already have in place relative to online transactions.

Obligations for Online Sellers

The Act imposes three new obligations for online sellers:

1. Post-Transaction Data-Pass Prohibition

The Act prohibits merchants from sharing financial account numbers and "other billing information" used to charge the customer with "third-party sellers" – a seller who markets goods and services online through an initial merchant after a consumer has initiated a transaction. The Act does not specify the types of "other billing information" that will be covered by the law, but does limit the scope to data used to bill consumers. This data-pass prohibition will not apply to information shared by the initial merchant with its corporate subsidiaries or affiliates.

2. Requirements for Internet Transactions Prior to Obtaining Consumer's Billing Information

The Act requires a "third-party seller" – before it obtains a consumer's billing information – to clearly and conspicuously disclose to the consumer all material terms of the transaction including:

- a description of the goods or services being offered;
- the fact that the third party seller is not affiliated with the initial merchant; and
- the cost of the goods or services.

In addition, the third-party must obtain the consumer's express informed consent for the charge by:

- receiving from the consumer the full account number of the account to be charged and the consumer's name and address and means to contact the consumer; and
- requiring the consumer to perform an additional affirmative action, such as clicking on a confirmation button or checking a box that indicates the consumer's consent to be charged.

3. Restrictions on Online Negative Option Marketing

The Act creates specific new requirements for negative option marketing. Negative option marketing is defined as an offer or agreement to sell or provide goods or services where the customer's silence or failure to take an affirmative action to reject goods or services or to cancel the agreement is interpreted by the seller as acceptance of the offer. Before charging a consumer in an Internet-based transaction, negative option marketers must:

- clearly and conspicuously disclose all material terms;
- obtain the consumer's express informed consent to be charged; and
- where there is a recurring charge, provide the consumer with a simple mechanism to stop such charges.

Enforcement

The FTC and state Attorneys General are authorized to bring enforcement actions against violators of the Act. Although, the FTC generally does not have jurisdiction over *bona fide* charitable, educational and similar organizations, it does have jurisdiction over most trade and professional associations. Also, while there is no private cause of action under the Act, private plaintiffs' attorneys may seek through litigation to make the Act's requirements the *de facto* standard for online transactions under state unfair and deceptive trade practices acts that allow for private lawsuits.

* * * * * *

Nonprofit organizations are advised to look carefully at the provisions of the Act, as well as general online advertising and marketing requirements, to determine whether their organizations should make changes in order to comply with the law.

* * * * * *

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ARTICLES

May 1, 2002

CORPORATE SPONSORSHIP: THE FINAL REGULATIONS

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On April 25, 2002, the Internal Revenue Service ("IRS") published final regulations (T.D. 8991) regarding the tax treatment of corporate sponsorship payments received by exempt organization. The release of these final regulations comes almost 10 years after an initial set of regulations were proposed, and almost five years since the enactment of a federal law, the *Taxpayer Relief Act of 1997* (Public Law 105-34, Section 965), that created a statutory safe harbor for sponsorship payments.

The final regulations are not significantly different from proposed regulations released in 2000. Perhaps the most notable change is the final regulations' inclusion of two new examples designed to demonstrate the IRS' position on whether providing an Internet hyperlink from a tax-exempt organization's Web site to a sponsor's Web site would jeopardize the tax-exempt organization's ability to treat a payment as subject to the corporate sponsorship safe harbor.

Background

In the early 1990s, the corporate sponsorship issue arose in connection with monies received by the sponsors of the Mobil Cotton Bowl college football game. The sponsoring organization was a tax-exempt organization that received a considerable payment from the Mobil Corporation. In exchange, the Cotton Bowl became known as the Mobil Cotton Bowl. On audit, the IRS determined that the money received by the Cotton Bowl organizers should be characterized as taxable advertising income, given the considerable exposure that the Mobil Corporation received in return for the payment. This action caused a stir in Washington, D.C. and led to the drafting of the first set of corporate sponsorship proposed regulations in 1993. The regulations were not finalized before the enactment of the 1997 law, which superseded those regulations.

The 1997 law amended the Internal Revenue Code of 1986 (the "Code") to provide that the receipt of "qualified sponsorship payments" by a tax-exempt organization does not constitute the receipt of income from an "unrelated trade or business." In addition, for Code Section 501(c)(3) public support test purposes, "contributions" include "qualified sponsorship payments" in the form of money or property (but not services). The new law created a new section of the Code (Section 513(i)) clarifying that these qualified sponsorship payments will not be considered taxable income to a tax-exempt organization. It is important to note that Code Section 513(i) is a "safe harbor" — if a payment received by an exempt organization does not meet the definition of a qualified sponsorship payment, it is not necessarily taxable income to the organization. Rather, such a payment may qualify for one of numerous exceptions to the unrelated business income tax ("UBIT"), or it might not otherwise meet the definition of what constitutes taxable unrelated business income.

Below is a description of key provisions of the final regulations.

Definition of "Qualified Sponsorship Payment"

A "qualified sponsorship payment" is defined as "any payment [of money, property or services] by any person engaged in a trade or business with respect to which there is no arrangement or expectation that the person will receive any substantial return benefit." In determining whether a payment is a qualified sponsorship payment, it is irrelevant whether the sponsored activity is related or unrelated to the recipient organization's tax-exempt purposes. It also is irrelevant whether the sponsored activity is temporary or permanent.

Definition of "Substantial Return Benefit"

A "substantial return benefit" is defined as any benefit *other than:* (i) goods, services or other benefits of "insubstantial value" (as described below); or (ii) a "use or acknowledgment" (as described below). Good, services or other benefits of "insubstantial value" are those that have an aggregate fair market value of not more than 2% of the amount of the payment. Note that if the fair market value of the benefits

exceeds 2% the entire fair market value (as opposed to the cost) of such benefits, not merely the excess amount, is considered a substantial return benefit.

A substantial return benefit includes:

- advertising (as described below);
- providing facilities, services or other privileges to the sponsor (or persons designated by the sponsor), unless such privileges are of "insubstantial value" (as described above);
- granting the sponsor (or persons designated by the sponsor) an exclusive or non-exclusive right to use an intangible asset (*e.g.,* name, logo, trademark, copyright, patent) of the tax-exempt organization. Note that while payment for providing a sponsor with the right to use such an intangible asset will not constitute a qualified sponsorship payment, it may constitute a tax-free royalty; or
- designating a sponsor as an "exclusive provider" (defined below).

Use or Acknowledgment

As stated above, a substantial return benefit does not include a "use or acknowledgment" of the name or logo (or product lines) of the sponsor's trade or business in connection with the activities of the tax-exempt organization. Use or acknowledgment does not include advertising (as described below), but may include:

- sponsor logos and slogans that do not contain qualitative or comparative descriptions of the sponsor's products, services, facilities, or company;
- a list of the sponsor's locations (*e.g.,* addresses), telephone numbers, facsimile numbers, or Internet addresses;
- value-neutral descriptions (including displays or visual depictions) of the sponsor's product line(s) or services;
- sponsor brand or trade names and product or service listings; and
- designating a sponsor as an "exclusive sponsor" (defined below).

Logos or slogans that are an established part of the sponsor's identity are not considered to contain qualitative or comparative descriptions. Mere display or distribution (whether for free or remuneration) of a sponsor's product by the sponsor or the tax-exempt organization to the general public at a sponsored activity will not be considered an inducement to purchase, sell or use the sponsor's product and thus will not affect the determination as to whether a payment constitutes a qualified sponsorship payment.

Advertising

"Advertising" is defined as any message or other programming material that is broadcast or otherwise transmitted, published, displayed, or distributed, and that promotes or markets any trade or business, or any service, facility or product. Advertising includes:

- messages containing qualitative or comparative language;
- price information or other indications of savings or value;
- an endorsement; or
- an inducement to purchase, sell or use any company, service, facility, or product.

A *single* message that contains both advertising and an acknowledgment is considered advertising. The above rules do not apply to activities conducted by a sponsor on its own (*e.g.,* if a sponsor purchases broadcast time from a television station to advertise its product during commercial breaks in a sponsored program, the tax-exempt organization's activities will not thereby be converted to advertising).

Hyperlinks

The IRS addresses the provision of an Internet hyperlink in two new examples (Examples 11 and 12). In one example, providing an acknowledgment on a tax-exempt organization Web page that includes a link to the sponsor's Internet address (no specification is made as to whether the link in this example is to the sponsor's home page or to some other page on the sponsor's Web site) is determined not to be a substantial return benefit to the sponsor. In the second example, the tax-exempt organization ("X") provides a link to a page on the sponsor's Web site that includes an endorsement by the tax-exempt organization of the sponsor's product. The IRS states that "the endorsement is advertising," and thus "only the payment, if any, that X can demonstrate exceeds the fair market value of the advertising on the … company's Web site is a qualified sponsorship payment." It is interesting to note that the IRS does not affirmatively state that the fair market value of the provision of the hyperlink on the tax-exempt organization's Web site would be considered advertising income to the organization in this example; rather, the example focuses on the value of the benefit conferred through the endorsement.

Exclusivity Arrangements

Exclusive sponsor. An arrangement that acknowledges the sponsor as the exclusive sponsor of a tax-exempt organization's activity, or the exclusive sponsor representing a particular trade, business or industry, generally will not, by itself, result in a substantial return benefit. For example, if in exchange for a payment, a tax-exempt organization announces that its event or activity is sponsored exclusively by the sponsor (and does not provide any advertising or other substantial return benefit to the sponsor), then the sponsor has not received a substantial return benefit.

Exclusive provider. An arrangement that limits the sale, distribution, availability, or use of competing products, services or facilities in connection with a tax-exempt organization's activity generally will result in a substantial return benefit. For example, if in exchange for a payment, a tax-exempt organization agrees to permit only the sponsor's products to be sold in connection with its event or activity, then the sponsor has received a substantial return benefit.

Allocation of Payment

If there is an arrangement or expectation that the sponsor will receive a substantial return benefit with respect to any payment, then only the portion (if any) of the payment that *exceeds* the fair market value of the substantial return benefit (determined on the date the sponsorship arrangement is entered into) will be considered a qualified sponsorship payment. In other words, if, in exchange for a payment to a tax-exempt organization in connection with a sponsored event or activity, the sponsor receives advertising benefits as well as an acknowledgment, then UBIT will be assessed only on the fair market value of the portion allocable to the advertising benefits (subject to the burden of proof described below). However, if the tax-exempt organization fails to establish that the payment exceeds the fair market value of any substantial return benefit, then *no* portion of the payment will constitute a qualified sponsorship payment. The UBIT treatment of any payment (or portion thereof) that does not constitute a qualified sponsorship payment will be determined by application of the standard UBIT rules and exclusions. For example, payments related to a tax-exempt organization's provision of facilities, services or other privileges to the sponsor (or persons designated by the sponsor), advertising, exclusive provider arrangements, a license to use intangible assets of the tax-exempt organization, or other substantial return benefits, will be evaluated separately in determining whether the tax-exempt organization realizes any unrelated business taxable income.

Fair Market Value

The fair market value of any substantial return benefit provided as part of a sponsorship arrangement is the price at which the benefit would be provided between a willing recipient and a willing provider of the benefit, neither being under any compulsion to enter into the arrangement, both having reasonable knowledge of the relevant facts, and without regard to any other aspect of the sponsorship arrangement.

Valuation Date

In general, the fair market value of a substantial return benefit will be determined when the benefit is provided. However, if the parties enter into a binding, written sponsorship agreement, the fair market value of any substantial return benefit provided pursuant to that agreement is determined on the date the parties enter into the agreement. If the parties make a material change to a sponsorship agreement (including an extension or renewal of the agreement, or a more-than-incidental change to the amount of consideration), it is treated as a new sponsorship agreement as of the date the material change is effective.

Anti-Abuse Provision

To the extent necessary to prevent avoidance of the "Allocation of Payment" rule described above, where the tax-exempt organization fails to make a reasonable and good faith valuation of any substantial return benefit, the IRS may determine the portion of a payment allocable to such substantial return benefit and may treat two or more related payments as a single payment.

Written Agreements

The existence of a written sponsorship agreement will not, by itself, cause a payment to fail to constitute a qualified sponsorship payment. The terms of the agreement, not its existence or degree of detail, are relevant to the determination of whether a payment constitutes a qualified sponsorship payment. Similarly, the terms of the agreement, not the title or responsibilities of the individual(s) that negotiate the agreement, will determine whether a payment (or any portion thereof) made pursuant to the agreement constitutes a qualified sponsorship payment.

Contingent Payments

A qualified sponsorship payment does not include any payment the amount of which is contingent, by contract or otherwise, upon the level of attendance at one or more events, broadcast ratings, or other factors indicating the degree of public exposure to the sponsored event or activity. The fact that a payment is contingent upon sponsored events or activities actually being conducted will not, by itself, cause the payment to fail to constitute a qualified sponsorship payment.

Determining Public Support (for 501(c)(3) Organizations)

With respect to 501(c)(3) organizations, qualified sponsorship payments in the form of money or property (but not services) will be treated as "contributions" received by the tax-exempt organization for purposes of determining public support to the organization.

Deductibility of Payments by Sponsors

The fact that a payment constitutes a qualified sponsorship payment that is treated as a contribution to the tax-exempt organization does not determine whether the payment is deductible to the sponsor as a business expense or as a charitable contribution.

Exception for Trade Show Activities and Periodicals

The unrelated business income exception for qualified sponsorship payments does not apply with respect to: (i) payments made in connection with qualified convention and trade show activities (which are governed by a separate exception in the Code); or (ii) income derived from the sale of advertising or acknowledgments in periodicals of tax-exempt organizations. For this purpose, the term "periodical" means regularly scheduled and printed material published by or on behalf of the tax-exempt organization that is not related to and primarily distributed in connection with a specific event conducted by the tax-exempt organization. The IRS clarified that periodicals may include some forms of electronic publication.

Examples

The final regulations issued by the IRS contain 12 detailed examples illustrating the application of the proposed regulations to the sponsorship and related activities of tax-exempt organizations.

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

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**

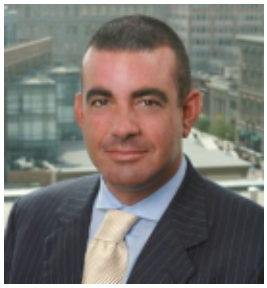
Panel 3. **Nonprofit Tax Issues: Where the IRS Is Today, and Where Congress Is Headed**

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



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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?

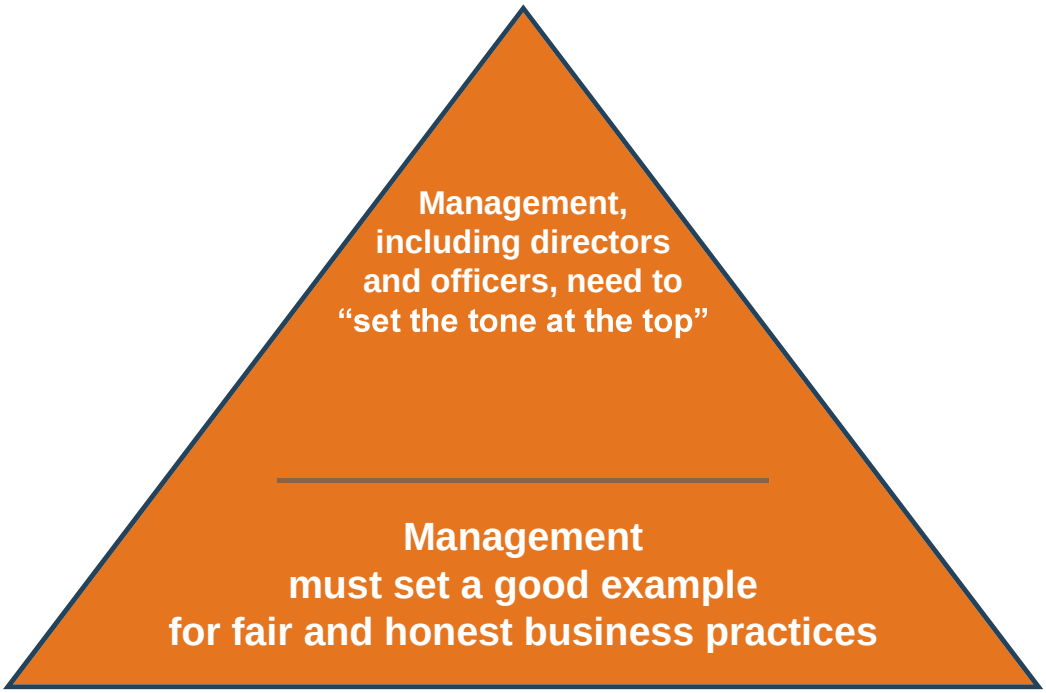
Management and board members are often more trusting

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



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

(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

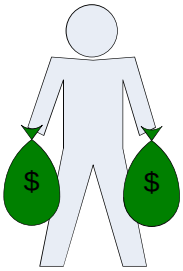
- Incentives and pressures
  - What are the incentives and pressures that drive financial performance?
- Opportunities
  - How strong are internal controls, internal audit department, and anonymous reporting programs?
- Rationalization/concealment
  - Character, ethical values, integrity, and how management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

Reminder - Fraud is defined as:

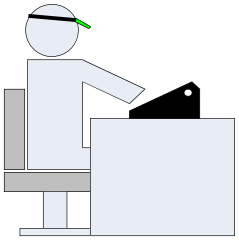
"…any intentional act or omission designed to deceive others and resulting in the victim suffering a loss and/or the perpetrator achieving a gain."

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

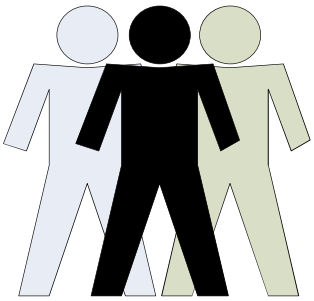
Reminder – Three Fraud Categories



Asset Misappropriation

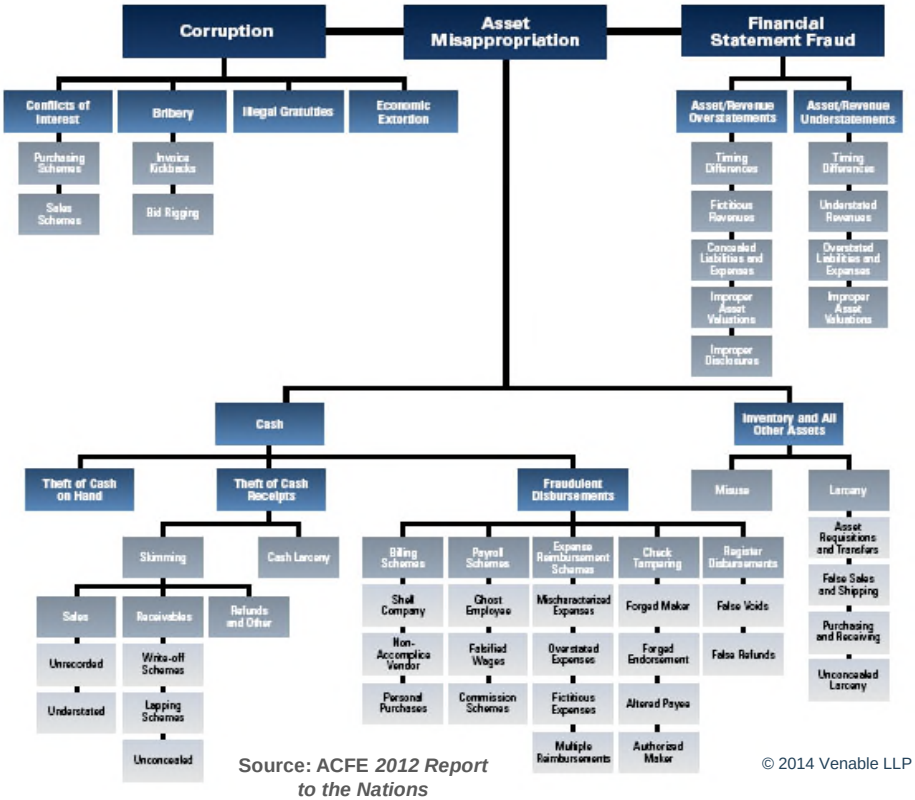


Financial Statement Fraud



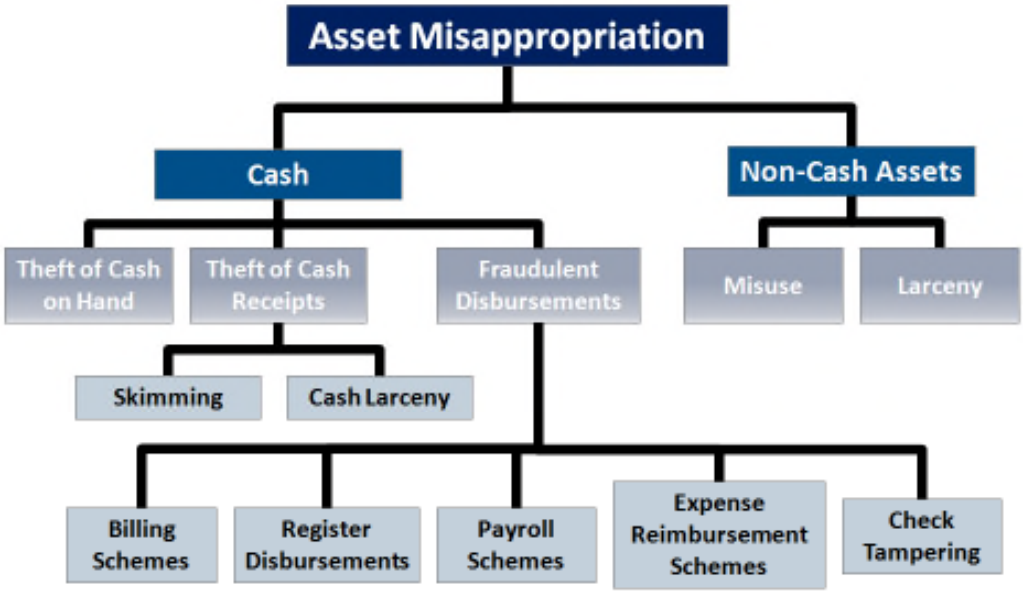
Corruption

Uniform Occupational Fraud Classification System



Source: ACFE *2012 Report to the Nations*

Asset Misappropriation



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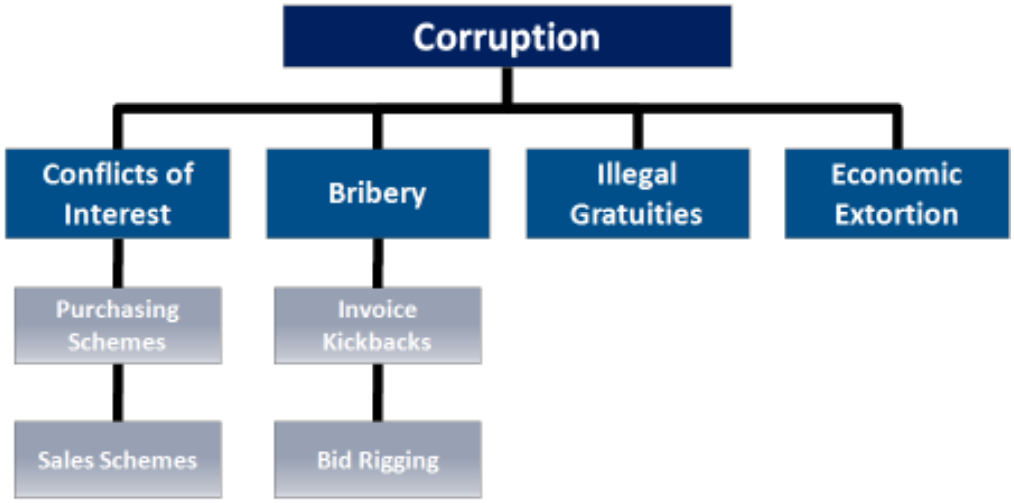
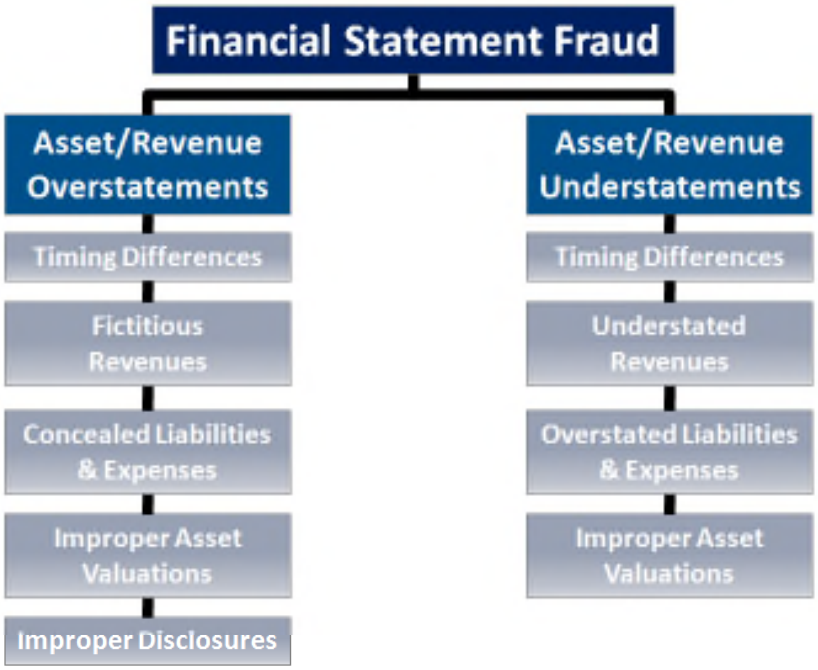
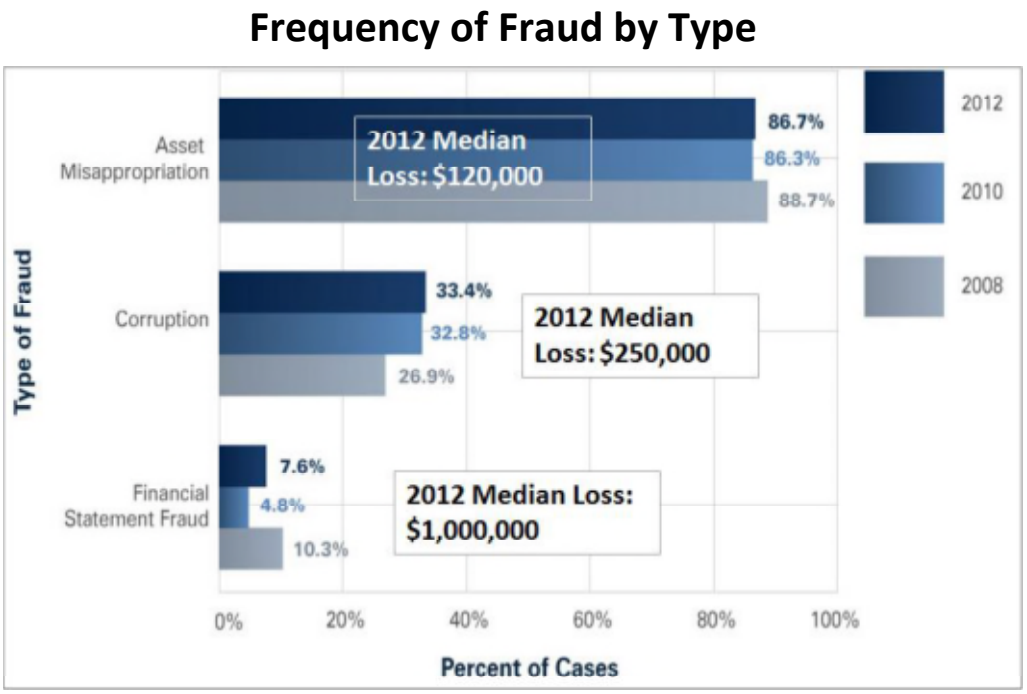


Financial Statement Fraud



Categories of Fraud



How Fraud Affects Our Clients

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

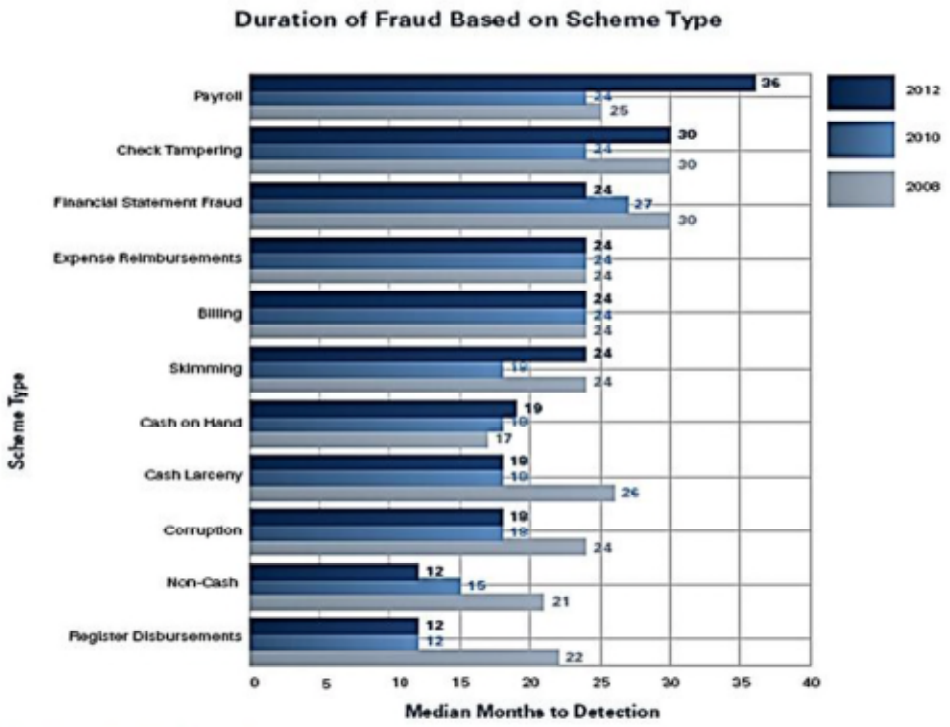
The typical organization loses an estimated <u>5%</u> of its annual revenues to occupational fraud.

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

Victim Organizations

Prevalence by Size of Victim Organization

Gestation Period for Fraud Detection

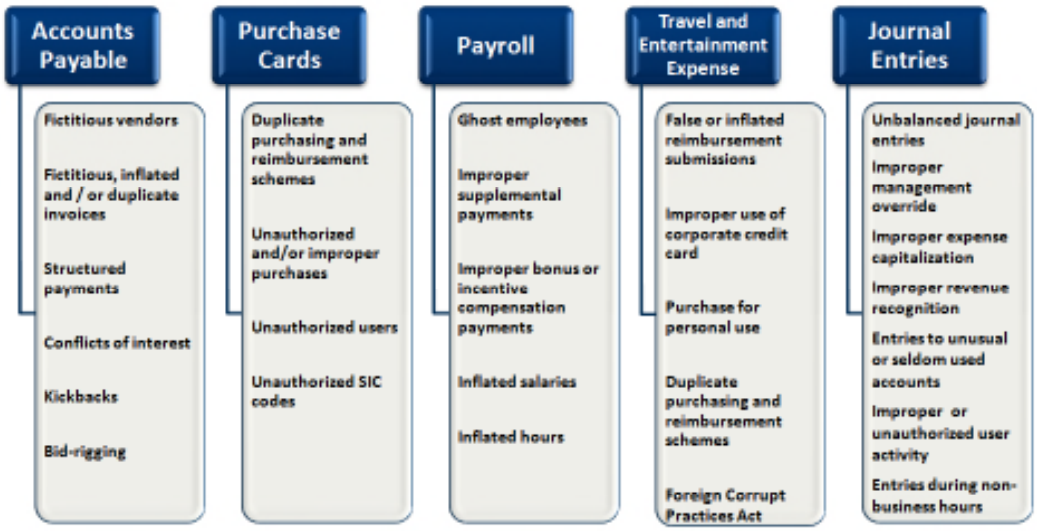


Source: ACFE *2012 Report to the Nations*

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



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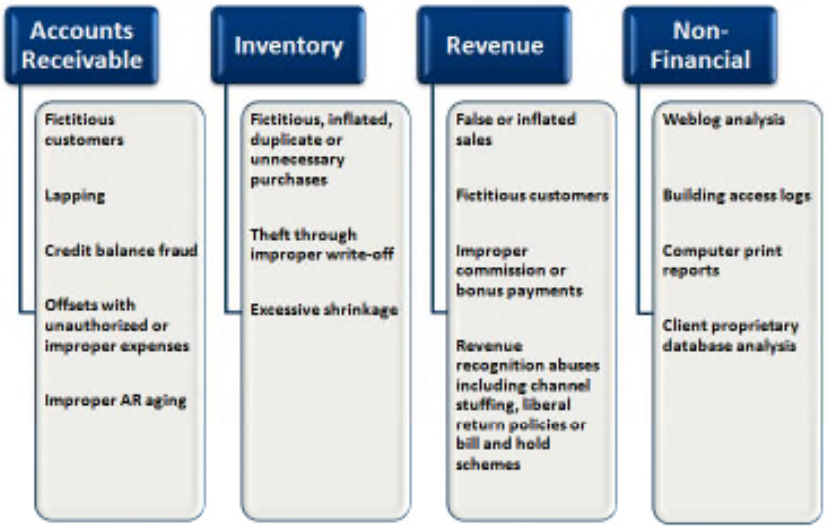

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