NONPROFIT ORGANIZATIONS

Update

WINTER 2007

Using Your 990 as a Marketing Tool

The 990 is no longer just a report filed with the IRS that people only see when they come to your office and request it.

With the ease of internet communications, 990s are available to anyone with an internet connection. Guidestar publishes thousands of 990s on its website. Organizations that want to be approved by the Better Business Bureau must post a link to their 990s on their web sites. There are rumors that the IRS is considering requiring organizations to post their 990s on line in the near future.

Who is looking at your 990?

Foundations use 990s to prescreen organizations they invite to submit requests for funding. They are also gathering background information to assist in funding decisions, checking on grantee use of grants, and benchmarking organizations.

Major donors use 990s to research new charities recommended by friends, monitor how past gifts are being used, and research potential beneficiaries for planned or major gifts.

Federal and state agencies look at 990s to gather information about organizations and check on their tax compliance (typically sales and use tax, property tax, and business licensing).

Reporters use 990s as a resource either on a particular organization or for background information on the nonprofit sector. Executive compensation is a hot topic and this information is readily available on the 990.

Watchdog groups, such as Charity Navigator, the Better Business Bureau's Wise Giving Alliance, American Institute of Philanthropy, Wall Watchers, Evangelical Council for Financial Accountability and Worth Magazine's 100 Best Charities, use 990s to ascertain if organizations are in compliance with state and federal laws. They also use an organization's 990 to evaluate its performance and use of best practices.

Organizations use their competitors' 990s to learn about their budget size and allocations, programming focus, funding sources, fundraising and programming costs, staff salaries, and major contractors.

Prospective board members read an organization's 990 to evaluate how well the organization appears to be managed, determine if its financial house is in order, and evaluate the stability of the senior management team. Having a 'feel good' mission statement is no longer sufficient to attract informed, experienced board members – they want to know that they are joining the board of a well run organization.

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WhitefordTaylorPreston LLP

WELCOME

...to Whiteford, Taylor & Preston's **Nonprofit Organizations Update**. This quarterly service of our Nonprofit Organizations Group provides you with practical information about current laws, regulations, and industry news. If you have any suggestions about topics you'd like to see addressed in future issues, please contact Editor Mary Claire Chesshire at mchesshire@wtplaw.com. We look forward to hearing from you.

Employees look at their organization's 990 to find out where the money is going, and are usually interested in the top staff salaries and compensation. Some try to guess the future of their own position and program based on which departments or programs are highlighted in the 990.

Plaintiff's lawyers also use 990s to gather information for litigation. It is a free source of information on the organization's budget, reserves, and compensation levels.

Is your 990 current?

It is possible that more people read the 990 than the annual report and yet much more attention is focused on the presentation in the annual report, from selecting photographs to listing donors by name and giving levels. Organizations miss the marketing opportunity presented by their 990. They focus on the numbers and overlook the text. It is not unusual for an organization to use the same words every year to describe its programs without anyone reading them to make sure they are still an accurate description of the organization's activities.

Take a look at your 990 from last year. Pretend that you know nothing about your organization. What does the information on the 990 tell you about your organization? Is it doing well? Is it growing or continuing to decline? Are there any new and exciting programs? Are there any challenges? After reading through the 990, can you describe what your organization does based on the information you read?

Marketing staff or consultants should be involved in writing the text portions of the 990 to be sure that they not only accurately describe the organization's financial position, but that every opportunity is taken to promote the good work done by the organization and highlight successes and new programs. The IRS is no longer the only audience for the 990; it should meet the needs of the various audiences and present the organization well.

Legal review of your 990

After your accountants prepare your 990 and your marketing team tweaks the language, run it past your attorneys. Issues may be identified in a legal review that can be addressed by adding or changing the way information is presented. They may be able to identify issues that staff and accountants missed, and any discussions between management and attorneys are protected by attorney-client privilege. Attorneys will often look for these red flags: unrelated activity, lobbying activity, relationships with for-profit entities, new lines of business, executive compensation, and payments to top employees and contractors.

Who should sign your 990?

Your 990 should be signed by the chief executive officer or chief operating officer and the treasurer or chief financial officer. This is in keeping with the best practice in the for-profit sector of having tax returns signed by a senior member of management and a senior member of the finance team. It gives assurances to those reading the 990 that the top people in the organization stand behind it.

Conclusion

Organizations should take advantage of the opportunity their 990 presents each year to summarize for a wide audience the achievements of the past year and present plans for the year ahead.

Negotiating Contracts: From Cleaning Crews to Fundraisers

An essential part of your organization's business is negotiating vendor contracts. While the contracts vary in size and importance to your goals, all should be reviewed and analyzed to confirm that your organization is not committing itself to fees, terms, or an unanticipated liability. Although each contract is different, the provisions outlined below may help you minimize your organization's potential liability and better control the terms and fees of your contracts.

Cancellation provisions

One of the most important provisions in any contract is the cancellation provision. Your organization needs to reserve its right to cancel a contract, without penalty, for any reason, especially when you believe that you are not

Q&A

Q **Can a tax-exempt organization's reimbursement of expenses to a director or officer trigger excise taxes under the intermediate sanctions rules?**

A Yes, and the organization's exempt status can be jeopardized if an "insider" (e.g.: director or officer) of a tax-exempt organization [501(c)(3) or 501(c)(4)] receives compensation in excess of the fair value for services performed. In general, as long as an insider's total compensation is reasonable, the receipt of a particular payment or benefit will not be treated as an excess benefit if it is properly reported for income tax purposes.

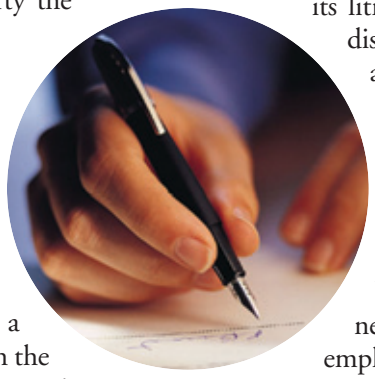
However, with regard to the reimbursement of expenses, the IRS states that it can treat such amounts

receiving the services for which you bargained. A common cancellation clause provides for cancellation after providing the other party with written notice (usually stipulated at 30 days) of intent to cancel.

Be sure to allow for a shorter cancellation notice period (which is typically ten days) in the event that the other party materially breaches your contract, or in other words, fails to perform its primary duties under the contact which may result in injury or liability to your organization. Such a provision usually allows the other party the length of the notice period (ten days) to fix the material breach. The provision should also require the party who intends to cancel the contract to specify the material breach in writing to allow the other party the opportunity to cure the breach.

Term

Understand the length of proposed contract before you sign it. Many contracts are for a one year term, but it is common for parties to agree to a contract that covers a two- to three-year period. A lot can happen within a year; we recommend that most contracts be limited to a one-year term. Doing so provides you with the flexibility to change service providers or negotiate a better deal with your present vendor.



Avoid contracts drafted so they automatically extend for another term if written notice not to renew the contract for another term is not provided to the other party. Such a provision rarely serves a useful function. Rather, it may inadvertently bind your organization into another contract term simply because you forgot to give notice.

Attorneys fees provisions

When signing a contract, one rarely considers future litigation with the other party. But contract language often provides that if either party commences legal action to enforce the terms and conditions of the contract, the prevailing party is entitled to collect from the other party all expenses and reasonable attorneys' fees incurred in connection with such an action.

Avoid these provisions as they provide one party with an unfair advantage if litigation ensues, and contradict the American Rule of jurisprudence that states each litigant pays its own attorneys' fees. If your organization is faced with the possibility of reimbursing the other party for its litigation costs, you may need to settle the dispute for an amount larger than the actual amount in controversy.

Indemnification

A typical contract contains an indemnification provision that requires your organization to indemnify the other party for any damages or for claims brought by other parties resulting from negligent acts of your organization, your employees, or your organization's breach of the contract. While the inclusion of such language is not out of the ordinary, it's important for your organization to even the playing field by making the indemnification clause mutual.

Require the other party to indemnify your organization for any claims for injury or loss by either your organization or a third party that occur as a result of the other

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automatically as "excess benefits" that are subject to excise taxes unless the insider provided proper substantiation of the reimbursed expenses under a reimbursement program that meets business connection, substantiation, and refund requirements (also referred to as an "accountable plan"). According to the IRS, this treatment will be applied regardless of whether the total compensation provided to the insider was reasonable.

Q What's the impact of the Maryland Charitable Solicitations Act/HB 398 legislation passed in 2006?

A The main change is the requirement that most charities soliciting contributions in Maryland obtain a registration letter from the Secretary of State's office before soliciting donations. There is a new expedited appeals process for those charities whose registration applications are not in compliance. The legislation also created a Charitable Giving Information Program comprised of a toll-free hotline, a speaker's bureau, and charitable giving law literature. This program seeks to increase public awareness and encourage questions regarding charitable giving and reporting suspected violations of charitable law. These changes are intended to encourage public confidence in the integrity of charities.

http://www.sos.state.md.us/Charity/Charityhome.htm

party's conduct, its breach of the contract covenants and terms, or its violation of a statute or ordinance.

Keep in mind that the typical indemnification clause triggers a duty to indemnify when litigation commences. Some contracts attempt to significantly limit that duty by triggering the party's duty to indemnify when the party has been adjudged to be liable at trial. Because most litigation settles prior to trial, the duty to indemnify will most likely never be triggered and the other party may be left with no claim for indemnity for its litigation costs.

Force majeure (French for "a superior force")

Force majeure prevents either party from incurring liability if unanticipated acts of nature or people prevent either party from performing its obligations under the contract. Be sure to include language in the provision that provides benchmarks for either party to exercise its right to cancel the contract (e.g., strikes, war, terrorist acts, or weather related events that make it impossible or illegal for parties to travel to the jobsite, or in the organization's reasonable judgment, performance of the contractual obligations will place a party's employees in possible danger).

Limitation of damages

As the title indicates, the limitation of damages provision limits the amount of damages for which a party will be liable to the other, regardless of what happens during the contract period. Typically, the damages are limited to the value of the contract, or in other words, the amount of money to which either party would have been responsible under the contract. The limitation usually applies to all causes of action and claims made by any party against the contracting parties.

The provision should be avoided as it severely limits your organization's ability to be made whole or to be reimbursed for damages or losses incurred as a result of the other party's negligence or breach of the contract. Damages precluded from recovery include lost business, revenue, profits, or goodwill. If a party is qualified to perform the services for which it contracted, it should not be relieved of the consequences caused by its negligence or breach of the contract.

Insurance coverage

To effectively hold a party responsible for its negligence or breach of the contract, your contract must require the parties to maintain adequate insurance coverage for any accidents or injuries that may result during the contract period. Typically, an effective insurance clause will require a party to maintain comprehensive general liability insurance, including contractual liability and liability for personal injury, bodily injury, and property damage.

The coverage should have a limit of liability of not less than $1,000,000 for each occurrence, but the requirement will vary depending upon the breadth of the services provided under the contract and the potential liability for breach or acts of negligence. In some cases, a party may require the other to provide proof of insurance or to add the party as an additional insured to the policy.

Summary

Your organization may want to establish a dollar value for contracts and have legal counsel review all contracts over that set amount. In any event, if you have any questions about the terms of a contract, consult your legal counsel before the contract is signed.

Be on the lookout for our upcoming presentation in Baltimore on using your Form 990 as a marketing tool.

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Understanding the business of nonprofits

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