



Readying Your Nonprofit for Recovery: Strategies and Steps for Renewal

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LESLIE GARDNER: Good afternoon. The Association of Corporate Counsel and SmartPros Legal and Ethics welcome you to today's webcast, "Readying Your Nonprofit for Recovery: Strategies and Steps for Renewal."

[The instructions provided here were intended for attendees of the live web cast when it was originally broadcast.]

Our presentation today is going to be moderated by Jim Woehlke. Now, I'll turn it over to Jim. Jim?

JIM WOEHLKE: Thank you Leslie. Welcome to the Association of Corporate Counsel Nonprofit Organization's Committee web cast entitled: Readying Your Nonprofit for Recovery: Strategies and Steps for Renewal.

My name is Jim Woehlke, and I will be the moderator for today's presentation. I am the General Counsel of the New York State Society of CPAs and also the immediate past chair of the ACC Nonprofit Organization's Committee. Our presenters today are with the law firm of Stradley Ronon Stevens & Young, LLP, which is located in Philadelphia, Washington D. C., and numerous other metropolitan areas.

The first panelist is Mark Chopko, who is in Stradley Ronon's Washington D.C. office and is chair of the firm's Nonprofit and Religious Organization's Practice Group. Mark is also one of the founders of the ACC Nonprofit Organization's Committee.

This webcast is being presented through ACC's updated webcast page. Just a reminder, if your question does not get answered during the presentation, answers will be posted by ACC at a later date on the website. If a question occurs to you after the close of this presentation, you can send it to Mr. Chopko at mchopko@stradley.com.

During the course of the webcast, you will see a satisfaction survey on your screen. Please take a moment or two to respond to this survey. It is a very useful tool for ACC to organize and present webcasts that are interesting and informative to ACC members.

In a moment, I will turn over the presentation to Mr. Chopko, who will introduce the other two panelists for today's presentation, but let me first hand the mic back to Leslie Gardner to provide those of you who paid for CLE credit with an important code you will need to qualify for that credit. Leslie?

[The CLE code and instructions provided here were for use only by attendees of the live webcast.]

LESLIE GARDNER: Thank you and now I'll hand the presentation over to Mark Chopko. Mark?

MARK CHOPKO: Thank you, Leslie. Thank you, Jim, and thank all of you for your attendance this afternoon at this webinar. We are pleased at Stradley Ronon to be a part of this project with the Association of Corporate Counsel, and especially the Nonprofit Organization's Committee. We have a long and distinguished record of service to nonprofit and religious clients for more than 80 years.

With me on this broadcast this afternoon is Chris Scarpa, who is a member of the Tax Department and a tax exemption specialist. He's done an awful lot of work in federal, state, and local tax advice for seized partnerships, tax exempt organizations, and so on. He's also, with respect to this client, helped a number of our religious and nonprofit clients deal with restructurings, financial transactions, and other projects brought on by the current recession.

Also joining us is our partner, Mike Roynan, who is the co-chair of the firm's Public Finance Practice Group and a member of our business department. His practice focuses on public corporate real estate based finance, and he served as bond counsel and as counsel to insurer's banks and borrowers in a number of tax-exempt debt financing over the years, and is also a member of the Nonprofit Religious Organization's Practice Group.

What we're going to do this afternoon is talk about the impact of the recession. A lot of people would look at the recession and its impact on it, especially in the nonprofit tax-exempt market, as merely something to be endured, much like a character in a Russian novel. But indeed, we think that it might be an opportunity for our clients and what we try to do is work with our clients to see that it indeed is an opportunity; it's an opportunity for them to take certain steps to position themselves when they emerge on the other side as stronger, better, and more creative.

What we'll do first is set the stage, talk about the impact of the recession, and then talk about some of the impacts that we've seen in our work and raise different questions along the way. Please, as was already indicated, organize your questions, send them, raise your hand, do what you would like to do to make sure that we get the right questions answered from this audience.

We begin with a short note on the impact of recession on nonprofits. We recognize that the nonprofit community consists of very large, but also very small, religious as well as nonreligious services, as well as foundations in a variety of arrays and subject matters of clientele.

For some nonprofits, the recession might yet still not have arrived. Some associations, for example, set their funding trends for their members based on three to five year funding schemes. For those of you who remember, three to five years ago, things were fat for some parts of the economy. And so, the funding trends for this fiscal year may still be reflecting those better years, but that also means that three to five years from now, these organizations, when the rest of the economy is starting to boom again, will still be suffering the effects of the recession.

For others, some of our smaller clients, the recession has brought on lifeline issues. They need foundation funding. They need new sources of income. They need a new way of operating or they simply will not survive.

Some of what we have seen depends on the size obviously, as I've just alluded to, the shape that they're in, their fiscal shape, what their funding looks like, what their members look like, who they serve, the type of industry. Education and health care seem to do well in any economy, but other source of community-based organizations, other nonprofits, are not doing so well. Some communities, as we know, are facing the recession and taking it harder than others.

Some of the implications on the scene that we've seen, again just to set the table, our clients report that they've seen more insurance claims—unemployment insurance claims—medical claims, fidelity claims—reporting losses—disability claims. Whatever the recession has meant downsizing, has meant change, has meant new direction, has meant trying to do more with less—some places doing less with less—all of these stresses result in more impacts on the workforce and more impacts on the bottom line.

We're also seeing, our clients report, squeeze on operational cash flow. The unrestricted monies that they have around are dwindling from time-to-time and so there is pressure to borrow from other accounts, not to divert income streams, but simply to borrow from other accounts that are not suffering the same effects, into operational cash flow for the time being, just again to bridge the nonprofits through this period of time. Others are reporting that they put off purchases; they put off maintenance. All of these things have costs. If you need a new computer system, waiting a year or two may put you very far behind and also increase the buy-in cost when you do have the cash to turn things around. Deferring maintenance on certain things, again you're starting to push, in some instances, operational limits.

Use of volunteers: some of our nonprofits are using more volunteers. But interestingly enough others are saying that because people are out looking for work or that they don't have time or they've been restricted in one job, they've got to maybe look at another part time job, that some of their volunteers have started to drop out. Our clients are reporting both trends, an increase in the use of volunteers instead of employees and a decreased availability of volunteers when they need them.

It presents us with the question: Is this an opportunity? Is this an opportunity for a nonprofit organization to pick the right size? Is it too large; is it too small? Does it have the right structure? Maybe this nonprofit had been just generally incorporated as a general nonprofit, but it's grown more complex over the years. Or maybe this is an opportunity to study mission. Are we doing the things that we're supposed to do? Are we doing what we started out to do? Is this an opportunity to reinvent ourselves? All of these issues are raised in this current cycle.

Before I move on, I'd like my partners to jump in here with any additional comments in the table setting exercise before we move onto the next set of slides.

Let me move onto the question of finance. Michael, do you want to say a few words on this?

MIKE ROYNAN: Sure, certainly this falls within the category of: What opportunities may exist? Given how the historically low interest rates are available in the marketplace currently, it's a good time to consider refinancing your existing debt. While the opportunities for nonprofits to

access the fixed rate debt markets have been restricted, the ability to go into a direct private placement with banks directly has been enhanced tremendously.

If you look at the third bullet point on this slide, it relates to some changes that were made in the American Recovery and Reinvestment Act of 2009, whereby in prior years borrowers were only able to issue \$10 million per year of tax exempt debt, which would be deemed eligible for holding by either banking institutions, where they have relationships typically, and it was limited to particular conduit issuing authorities. It's now been changed to a \$30 million limit measured at the borrower levels. So, the opportunities to go directly to your bank and seek financing through them are greatly enhanced today and are something a lot of organizations could take advantage of by talking with their bankers.

There are also some large organizations that have the ability to look at what their debt portfolio is presently and decide whether they want to try and go back and do what we call "buying back" their bonds. For instance if they have issued 30-year fixed rate bonds at 5% and they are a triple B rated organization, sales of those types of bonds last year were at 6-1/2%. So, the marketplace is moving towards the 6-1/2% rate bonds and doesn't want to hold the 5% rate bonds, you may be able to buy your bonds back at a discount and seize this opportunity to retire some of your debt on a discounted basis. That's some of the highlights of what financing opportunities may exist today.

MARK CHOPKO: Thank you. Once I figure out the technology, we'll just be flying here. Our goal, as I said before, is not just to survive, but to thrive. Our goal is to help our clients see their way through their present situation, to reimagining themselves in a better, more exuberant organization on the other side. Some of the things that we think go into this are these qualities that really go to management, but also to people providing legal services inside and outside.

Question of stewardship, you have to care for what you have. It has to matter what the workforce is. It has to matter what they do. The resources can't be taken for granted and they have to be protected. They have to be marshaled and applied in a way that they're intended, but they also have to be grown wherever possible.

Prudence is another thing. For a long time, I thought prudence meant you had to sit inside your cardboard box in the basement and wait for the storm to pass. But prudence suggests to me right actions. It's one of the cardinal virtues. It means that you're taking deliberate careful action. It doesn't mean standing still. It doesn't mean hiding. It doesn't mean doing nothing, but it means that you are confidently, and with adequate information and with justification, moving towards the future that you imagined.

This also brings in the idea of creativity. We can't do business as usual. I used the cardboard box in the basement example. We need to get outside the box. We need to be thinking literally about what the future could be if we imagined it in a different way. We're going to be talking about some of those opportunities that we can have by structure, by finance, by mission, by workforce as we move through this program this afternoon.

What we'd like to do next is move into some of the substance of this afternoon's presentation. These are the kinds of planning concepts that we would address to our nonprofit tax-exempt clients. If you're going to think about this topic, about what are the kinds of things you need to study, these are some of the components: Your structure, mission, exemptions, funding, and your partners.

Partners maybe a different way, because some commentators will talk about constituents. Constituents would be those that care about the mission of the organization. They're not always your friends. They're your competitors. They're the state regulators. They're also your donors. They're also the public that reads about you in the newspaper. But here we're talking about partners in a particular way; those are the people that can help you get where you need to go.

A couple of words on structures, things that a nonprofit could do to think their way through this situation, one is to think about: If you're organized—no matter how you're organized I guess—set up subsidiaries that align income streams, operations, or risks. If you are providing childcare services in the city, for example, and you have an educational component, you maybe for a while have had either childcare facilities or even a charter school; different opportunities have been created to have charter schools as part of your service organization. All of those specific kinds of operations have very different income streams, but also if you're involved in child education or childcare, to pick these examples out of the many that we could talk about, they have rather unique risks. What we're talking about is using this as an opportunity instead of having everything amalgamated into one big entity and doing your structure by balance sheet, by having somebody through ledger entries or other things figure out where the money is coming from and where it's going. Use this as an opportunity to say, "Well now it's time for us to separately incorporate this daycare center or this daycare facility that's affiliated with our hospital or school. This operational issue that has always been nagging at our governance, well this is a time for us to separate it out, to give it a legal character of its own," and thereby, as I say, align income stream, operations and risks. This makes prudent risk management sense, but it also makes financial sense.

Another thing which can be done, which sometimes isn't done until charities and nonprofits get into duress, is create express trusts or trust accounts for restricted gifts. Again, sometimes they're simply marked as ledger entries and they're managed separately. I'm not suggesting that they're being mismanaged, but it's an opportunity, especially if you think that your nonprofit may be in trouble with a contractor or with other general creditors, it may owe money to different people, this is the time to make sure that the things that you're doing are properly restricted so that your restricted assets, through inadvertent or carelessness or just neglect, don't become executable at the behest of ordinary creditors, if your nonprofit or charity gets into trouble.

It may also be an opportunity, finally, to create that fundraising entity. A number of our clients have created public campaigns. They used to do this through a development office. Now, giving this a separate legal character to provide a direction and provide an opportunity, again, to educate your constituents, educate donors, members of the public regulators, and so on that you're still around, you're still doing good work, you need their help. We know it's tough for everybody and here's how we can work together to achieve the mission of this organization.

Finally, a thing, which again if you didn't want to create new structures, go back and make sure that everything is properly documented and then respect those restrictions. When everything's happening at the same time or in times when money is good and when operations seem rosy, we don't think about these things, but it's too late to think about them when the judgment creditors arrive. If you're in one of these modes where you're trying to figure out where you are and where you are going to go from here, this would be something specific that could be done.

Chris, you had some issues you wanted to raise here about the other issues that might be considered when you're thinking about these structures.

CHRIS SCARPA: I did. Thank you very much, Mark. Mark spoke a bit about potentially looking at structures and forming different subsidiaries that might align income streams, operations, and risks and/or forming a fundraising entity to conduct a capital campaign as an example. Just a couple of cautions or things to think about in that regard is: Anytime a new entity is created, obviously one of the first questions that the exempt organization creating that entity might ask or might have to consider is obtaining a tax exemption for that new organization. So, that's one thing to keep in mind where you would have to go through that process again of obtaining a federal tax exemption for a new organization, of obtaining potentially any state and local tax exemptions that might be available for that organization as well.

The concept of creating corporate entities around fundraising or operations also presents organizations with the opportunity to use something called "supporting organizations for federal income tax purposes," where the charitable organization that's creating the subsidiary or affiliated entity can maintain control of the organization that's created and have the organization that gets created as a subsidiary or an affiliate obtain public charity status, 501(c)(3) Public Charity Status, on a derivatives basis based upon the activities of the parent organization. It's something to keep in mind; the use of supporting organizations might be appropriate in those circumstances and might be useful to avoid having to qualify as a public charity under some of the more mechanical tests for federal income tax purposes.

Mark also spoke about the use of trusts, whether they be express trusts or sort of ledger entries. It's important to properly document what those funds can be used for, whether the income only from those funds can be used or whether the principal can be invaded for certain purposes. So, all-important considerations as you think about structures in this environment or any environment. Mark, with that let me turn it back over to you.

MARK CHOPKO: Thanks very much.

MIKE ROYNAN: I guess Mark, I'm sorry to interrupt at the mic. I just wanted to say on some of these points that were raised by both Mark and Chris here, certainly we want to make sure that any organizations that have debt financing with any significant covenants in them to drag out their loan documentation and make sure that as they attempt to reorganize or put assets in protective trusts, that they've taken a look at whatever their restrictive covenants may be in their documents contemporaneously to make sure that they're not running afoul of whatever types of restrictions they may have in favor of their creditors.

MARK CHOPKO: Now that is actually an excellent point that we have had this situation I guess, Mike, in a couple of cases where entities have decided what they needed to do was [inaudible] their income streams or assets, but some of their financing documents required a clearance by some of their creditors. Is that right?

MIKE ROYNAN: Correct, so it's certainly something that you kind of want to have on your timeline to do contemporaneously.

MARK CHOPKO: But, again, sometimes the people who are doing this sort of structuring exercise are not the ones who have responsibility for these documents, so this is a good time to mention the additional caution of making sure that people are working together on this, that you have the right people around the table to make this work.

Mission and direction: some considerations. At a time of stress, you have to ask yourself: Can we do everything? We started out as a multifaceted organization, serving 17 different community-based needs. This may be the time to say—because at times maybe your management felt that they were overextended; they didn't really know how to pull back, it wasn't politic to pull back. You didn't want to suggest that the organization was in trouble, but this is the perfect opportunity given the economics. You have a ready reason to say, "We're studying mission direction and we're trying to ask: Can we do everything. Can we continue to do everything that we planned to do?"

Number three is sort of the flipside of that. Are you really doing what you do best? If you started out doing a particular brand of community service or health or education or promotion of the public welfare, whatever the mission of the organization was, have you lost that focus on what your roots are?

Or, and question two raises that, are you following the funding? For a number of years, I've watched several organizations follow the funding around. As their initial funding dried out, as some of the initial people who set up the organization passed the scene, as some of the initial enthusiasm for the organization started to fade, they started then to follow projects. It wasn't that they had deviated from their charitable missions such that they needed to re-file or go through some proceeding with the assets they had, but they ended up sort of following: What do some of the donors really want them to do or what do some of the government agencies really want them to do or what's the project du jour? That I always felt was a dangerous place for nonprofits and charities to be in because it means that other people are calling the tune. I think this is the time for nonprofits and charities to ask themselves the question: Are we doing what we set out to do? Are we on the right path and can we take care of the business that we planned to? With raising this consideration again come precautions. Isn't that right Chris?

CHRIS SCARPA: Thank you Mark. Mark always makes me be the person who puts a damper on the party here.

MARK CHOPKO: You'll get to throw me under the bus later if you want.

CHRIS SCARPA: Absolutely. A few things to keep in mind as you're looking at mission and direction and thinking about whether you've engaged in any types of activities that might be deviating from the core mission in a significant way, such that it might require notification to the Attorney General, which fits in an oversight capacity in many states over charitable organizations, whether they're formed as trusts or nonprofit corporations. It might not be the case that there's anything necessarily wrong with the deviation, but it might require Attorney General approval in order to conduct that new activity as compared to the historical activities. That same question of deviation of charitable assets comes up when nonprofits undergo any types of fundamental changes such as mergers, dissolutions, divisions or different transactions like that, so it's something to keep in mind.

Also, we have the concept of IRS review with respect to mission and direction, and it's important to keep in mind that if you're undertaking some new charitable activity, that you're required to inform the IRS of the change or the new activity that wasn't necessarily the basis upon which the IRS granted exemption in the first instance. If it's very different from the basis upon which the IRS granted exemption initially, it might be a case where you have to go back to the IRS to reconfirm the tax exemption or it might be a good idea to do that. That will also provide donors with certainty on a going forward basis regarding the tax exemption of the organization.

Also, when you talk about deviating from mission of an organization, it brings up concerns potentially about unrelated business income. It's not necessarily a bad thing to generate unrelated business income, because it is an additional source of revenue for the organization and the organization is likely putting those earnings back into the charitable mission, but questions that it raises is whether the activity can be conducted in some different way, so at least there might be some argument to say that it should not be taxed as unrelated business income for federal or state tax purposes.

Or if it is in fact unrelated business income subject to tax, the organization will want to make sure that the unrelated business income is limited perhaps to 15% or 20% of the gross revenue of the organization because if it's not, it potentially can call into question whether the organization continues to operation primarily in furtherance of its mission. If the unrelated business income becomes more than 15% or 20% of gross revenue, there are planning opportunities where the organization can continue to conduct the activity but would want to do that perhaps through a taxable subsidiary organization as opposed to directly at the exempt organization level itself. Could you go to the next slide for me?

Also, as we're talking about mission and direction, some of the other things that come to mind here are organizations maximizing the available exemptions that might be available to them. Mike had spoken earlier about public finance type transactions where a tax-exempt organization might be financing a significant capital project, building a new building, something along those lines, and the question that comes up or comes to mind is whether the organization is ensuring that its contractors are taking advantage of all available sales tax exemptions that might be available to the organization to potentially drive the costs down. That's something that you'd have to look at on a state-by-state basis in terms of what's available. Also, for any new organizations that get created as you're considering structure, it's important to consider how the

organization might qualify for a sales tax exemption or if it's holding real estate, real estate tax exemptions as well and the value of those exemptions to the organization.

Also, we thought that it would be important to talk about unemployment compensation and to mention to you the distinction between contributory and reimbursable employers where in a contributory basis, the tax rate is based on experience, but on a reimbursable basis it's a claims made type of situation. Many, if not all, states require the exempt organization to make an election to be treated as a reimbursable employer. Electing reimbursable status I suppose is similar to making a decision to discontinue carrying some type of insurance, and if no occurrence results, the cost of the premium is saved, so it's something that you would consider if it's not already in place.

Mark, if you could go to the next slide please.

MARK CHOPKO: OK, I was just prompted to do that. There we go. Is that it? Yes.

MIKE ROYNAN: Yes, thank you very much. I appreciate it. Again, we had spoken earlier of aligning activities and risks and potentially forming new corporate entities. Again, just to mention that issue of qualification for tax exemption, both at the federal and state level. It's important to keep that in mind that you would have to go through that process all over again. Not necessarily too difficult of a process, but nevertheless something that has to be considered and accomplished in putting any new structures in place.

Also, we thought it would be important to mention the concept of good governance and best practices which has been a focus of the IRS, both in various informal statements that it has made and it also appears in the newer revised Form 990 that's currently in effect. It also becomes an important consideration for donors as various organizations are competing for funds. What we see [is] donors are looking very hard at the organizations that they're contributing to and making sure that appropriate safeguards are in place.

The best practices that the IRS talks about are things like having a clearly articulated mission statement, having a code of ethics and a whistleblower policy in place, ensuring that the board of the organization is fulfilling its duty of care and acting in the charity's best interest, that the board is fully informed about the charity's financial status, ensuring that there's transparency, that the Form 990 and any annual reports are available freely to the public. Also, the organizations have fundraising policies in place, so that there are policies to ensure that fundraising solicitations meet federal and state law requirements and that solicitation materials are accurate and truthful and that funds are being used for any restricted purposes. Also, in the case of organizations that have substantial assets or revenue, it's important to make sure that the organization is obtaining financial audits. Perhaps that might be required by state law for states that have charitable solicitation laws, depending upon the revenue or the assets of the organization.

Finally, there's a focus on compensation practices and ensuring that the executive staff of the organization is receiving no more than reasonable compensation for services rendered. There's the focus on 501(c)(3) Public Charities following the Intermediate Sanctions Rules and having

disinterested members who are a committee of the board approve compensation arrangements in advance based on comparability data to ensure that the organization is not being taken advantage of.

MARK CHOPKO: These are the kinds of things that an organization would be required to do anyway, at least in certain regimes, right? Also, doesn't it make sense that if there are certain kind of organizational inertia, that this might be a perfect opportunity if the entity is under duress to say, "Well, let's give some attention to these, not just because the IRS mentions them, but because they're the right things to do."

MIKE ROYNAN: Exactly, they're the right things to do. I think we're in an environment, and even before the economic crisis had hit, we were in an environment where donors were increasingly expecting organizations to do these things and have these policies and procedures in place. Also, from the IRS's perspective, the IRS has admitted that although they're out in the forefront with good governance practices, they've admitted that they don't have the authority necessarily to regulate in that area, but they have reminded exempt organizations that they have the authority to audit, and in their view, an organization that is well governed is one that is fulfilling its mission and making sure that donor funds are being spent in an appropriate fashion.

On the other hand, they feel as if organizations that aren't following these good governance practices and procedures, these best practices, are perhaps organizations that aren't fulfilling their mission and there might be other problems with the organization that the IRS might be interested in.

CHRIS SCARPA: The bad news is this is not the right time—it's never the right time for the IRS to come knocking—but during a recession if you're already feeling down, this is like kicking him now when he's down.

To look at the next slide, you're not suggesting that donors go through this sort of beauty contest to distinguish possible recipients, but certainly a charity would have an edge on other charities if it can publicly say, "We're doing all these things," right?

MIKE ROYNAN: That's exactly right. It would be an ability to if not distinguish, a charity to distinguish itself perhaps from another charity or in other circumstances, at least not to look any different from the other organizations that are doing it and competing for the same dollars.

MARK CHOPKO: Did you want to go back to finish something on the IRS or do you want to move forward on funds?

MIKE ROYNAN: No, I think that we could move forward on funds.

MARK CHOPKO: Okay, there's obviously no stimulus in the works. It's interesting; a year ago there was some discussion about whether the nonprofit sector deserved its own economic stimulus. As far as I can tell, no one has ever returned to that discussion in any responsible way, but there are other things that nonprofits and charities are doing to try to figure out how to generate new income. This is an opportunity for them to do so. Chris and Mike, I'll turn it back over to you.

CHRIS SCARPA: Thank you Mark. One of the things in thinking about this presentation and conversation we wanted to raise with the concept of targeted tax credits or other incentives that are out there for, not necessarily for exempt organizations, but which all of us have seen exempt organizations be involved in these types of transactions.

For example, one thing that comes to mind is new markets tax credits. New markets tax credits were put into the Internal Revenue Code a number of years ago and the idea was to help impoverished low-income communities to stimulate economic activity in low-income communities. So, for example, both Mike and I have worked on transactions where an exempt organization was either directly involved as a recipient of new market tax credits from the U.S. Treasury Department, which it then deployed in these low-income communities by making loans to businesses in those low-income communities or the exempt organization itself was located in the low income community and was the recipient of a loan with a better interest rate than it would have otherwise obtained through commercial financing, whether it be taxable or tax-exempt financings. It's something to keep in mind and certainly something to look out for in case you're located in a low-income community, considering doing something in a low-income community, and have the types of projects that might qualify for the financing.

The other thing that we've come across are exempt organizations that have a focus on social services and they've been involved in low-income housing tax credit transactions, where they're actually going out and developing low income housing for the elderly or some other population. And exempt organizations are big players in that market as well.

Finally, I thought that I'd mention there's been a lot of news press about energy incentives, energy tax credits that are available, and ways that that can reduce energy costs for either taxable organizations or for individuals. We're actually seeing transactions where exempt organizations with a big need, let's say a school with a big need for power, are the beneficiaries of a cheaper cost for electricity as a result of, let's say, a solar panel development where they purchase power pursuant to something called a Power Purchase Agreement from a third party that actually builds a solar panel development to supply power to the school itself. There's a whole bunch of tax wrinkles involved with that including ensuring that that Power Purchase Agreement is respected as a service contract for federal income tax purposes, but at the end of the day, the bottom line is that the exempt organization that is the beneficiary of that Power Purchase Agreement ends up with a lower cost for their electrical utility service as compared to what they would get in the market perhaps. So, also something to look out for and perhaps consider for organizations that have substantial needs.

Mike, I think that you wanted to talk about business plans?

MIKE ROYNAN: Sure, it's certainly something that we're seeing that has become more and more important for nonprofit organizations, both with respect to their relationships with their bankers and their donors. I think, Chris, you touched upon earlier that donors are becoming much more discriminating in who they give their money to. They're interested in not only enhanced internal controls, but they also want to know that the organizations they're supporting do have strong viable business plans for the future. They certainly don't want to see their donations go into organizations which may not be there three or four years down the road because they didn't

have a good roadmap on how to succeed. We think that it's very important for the nonprofits as they're trying to seek new sources of funding to go ahead and find ways to put together a presentation in a package, which demonstrates how they're going to carry out the implementation of their programs when those funds are received in the most viable of methods. The more an organization can have, on paper, which demonstrates that they've thought the relevant issues through, the better success they're likely to have in raising those funds, whether it be from a donor or in the form of a loan from a bank.

MARK CHOPKO: So we're not arguing for people to print money, but to look for ways in which they can re-imagine the kinds of money and finances and so on that might be available to those who are willing to put in a little more effort, be a little more creative.

MIKE ROYNAN: Right.

MARK CHOPKO: One of the last areas that we would focus on in this sort of exercise is to think about partnerships, partnerships that would trim waste and duplication. I have had several recent experiences with organizations, charitable organizations, that have related, but not identical missions. In some instances, they even occupy offices on different floors in the same office building. They all think that at the end of the day, at the end of the recession, that they will be the one to emerge from this and that somehow that they will then attract all of the energy that would otherwise have been devoted to these other charitable organizations. They all think that they can do it on their own. They all think that they can make it on their own and that their product is better than everybody else's. That may be true, but there are things that they can do to help themselves through this time of need without sacrificing this sort of hubris, the idea that we'll all make it.

One way that assures that they all come through this is to think about ways in which they can eliminate the things that they do in common. Housekeeping and overhead collaboration is one. Does everybody need an HR director? Does everybody need a separate accounting office? Maybe accounting services can be contracted out and several organizations can share it. Maybe it's general services, building maintenance, that sort of thing, especially if these nonprofits are in adjacent areas. They don't even have to be related with similar, but not identical, missions. Just the idea that nonprofits sharing a common physical space might be able to, through some creativity, figure out ways that they can help each other. Maybe one organization says, "Well, look, we'll keep the HR function and you can use our HR function." They decide somebody else will have accounting and somebody else will have the general services contract. Instead of doing this five or six or seven times, you do it one time.

Another way that this might be done is the idea of a lead agency, where you can have a group of organizations—a consortium—that decides, "You really are the best at outreach to senior citizens. Why don't you do that? We think we do better with college age populations. Why don't we do that?" There may be ways that they could stop tripping over each other in devoting so much time, attention, energy, and resources to competing for the same dollars in the same community in the same way that through a little imagination, they might actually be able to work together. Whether that ends up as a formal merger or whether that eventually results in the formation of one agency by defaults is something that can be discussed in the future. For now,

what you're trying to figure out are ways that you can stop hurting the other people who are trying to work to improve the lot of people in the same area of public welfare, education, or health care community services or whatever it is.

A third area is fundraising. Professional fundraising is expensive, as we know, but maybe there's a way that those expenses can be shared among agencies. Everybody doesn't have to do everything. This is related to the idea of more formal joint ventures, group purchasing. I helped a group of religious nonprofits that were related because they had the same denominational name in their caption, but otherwise they didn't do the same thing; they weren't even all in the same state, but they figured out that even though historically they didn't really work well together, by leveraging their size, they were able to do better in purchasing commodities; office supplies, computers, things like that. They've also expanded that into insurance; designating lead agencies, and helping each other get under various policies. These are the sorts of creative things that some nonprofits are doing to try to improve their financial situation, but then they're better set for they coming recovering.

In the summary slide—I am conscious of the fact that we are running out of time here—these are the sorts of issues that we've raised today. This is not every issue that can be raised, clearly. In summary, what we were talking about, we're helping our clients, helping nonprofits and charities secure their income streams, isolate their risks, and protect their assets. We think that the nonprofits that do that will have a better chance of emerging more strongly and vigorously from the current situation.

Improving in having an engaged and committed workforce, we didn't really talk about labor and employment issues. We didn't talk about the impacts of downsizing and so on except that that's an impact. It results in higher insurance claims and that the workforce is under a stress, but frankly a workforce that sees that their organization, their employer, that something they care about is trying to improve its position in society, trying to improve its financial bottom line, trying to improve its operations will have a better more committed workforce than one that does not, that seems to be foundering.

Part of this is also keeping a laser focus on core mission. Why did we go into this business? Why are we doing this work? What are the sorts of things that we can do better than other people? Those organizations, I think, will do better in the long run.

Finally, those qualities of leadership, stewardship, taking care of business, prudence, not being afraid, but moving confidently, creativity, doing things that are a little bit outside the box, and to that we'd add the word patience. Things will take time, but our commitment, like yours, is to make sure that we all come through this together more strongly and better able to serve our communities.

I think with this, we will close the formal presentation part of this. Leslie, I will turn it back to you. You wanted to give a second verification code and then we wanted to see about questions and comments.

[The CLE code and instructions provided here were for use only by attendees of the live web cast.]

This will start our Q&A session right now. I'd like to remind all of our attendees you can ask a question at any time by typing it into the questions box on your control panel. Those questions will then be forwarded over to the speakers. With that, I'd like to turn it over to Jim.

JIM WOEHLKE: Thank you very much, Roberto. One that popped in was this: As I heard your presentation early on in the hour, it appears as though financial stresses could lead to governance breakdowns. Would you mind elaborating further on this?

MARK CHOPKO: Well, I'll start. I'd like my partners to join in. One of the things that happens in financial stress is you just starting cutting corners and people start looking the other way. As I said, you may be tempted to borrow from other operational accounts to keep things going. If you start the culture that you can look the other way on some of these transactions and let's not tell the board about that, maybe the board's not all that curious, before you know it you have an organization that's in trouble, because what you've done is you've moved from an organizational culture of fostering excellence and adherence rigidly to good, sound business ethics to one that's now said it's OK to cut corners and it's OK not to tell the board about it.

You may also then say, "Why do we need these people on the board that ask all these hard questions about why we're not doing so well? Maybe what we need is a more sycophantic"—if that's a word; you can look it up—"sycophantic board. We'd rather not have all these hard questions asked." Pretty soon, those people are in trouble, not with just the board feeling cut out, but board people tend to be people who care about the organization; oftentimes, they are also significant donors. That's sort of a bad reaction among real and potential donors that's very hard to overcome. Mike and Chris, do have comments on this?

CHRIS SCARPA: I think about that question and I go to the area of restricted funds. I see the temptation perhaps that there's a fund that's been set aside to provide scholarships let's say, but there's another pressing need of the organization somewhere else. Either, as Mark had mentioned, it's not presented to the board or the board is somehow complacent in the activity and the organization uses those funds for that other purpose without very good authority or ability to do so. I think that that's one example of potential governance breakdown in these difficult or challenging economic times. Certainly it's something that could have both bad consequences or the organization itself in terms of negative publicity, which it doesn't need, in an atmosphere where funds are more difficult to come by and also for the directors themselves that are actually involved in that activity where you could have state Attorney Generals bringing surcharge actions against the individuals involved in recovering those funds. It's not a nice situation at all.

JIM WOEHLKE: Here's a second one that popped in. I think this ought to be directed to Chris and Mike from the looks of it. You seem to be calling for a burst of creative energy on programming to improve revenue. Can you give us some additional ideas you've seen pop up?

MIKE ROYNAN: I guess the creative ideas in terms of diversifying the offerings of the organization, is that the intent of the question?

JIM WOEHLKE: Well it looks as though it could be added. It appeared to be wide open to what sort of cutting edge things you have noticed on the horizon.

CHRIS SCARPA: One organization that Mike and I both work with actually has come up with something that I personally consider to be very creative. It has some issues associated with it, but they've actually gone out and they have obtained a line of credit from a bank at a very favorable interest rate. They're very savvy investors, even in this environment. They've gone out to donors who are interested in funding this organization and they've said to the donors, "We'd like you to enter into this enforceable pledge and based on that pledge, we'll go out and we'll draw down money on this line of credit which we'll employ in our charitable activities and we wouldn't draw down this money but for our reliance on your pledge." They then go out and take down this money under the line of credit. The documents with the donor require the donor to pay the pledge over some specified period of time and also require the donor to fund the organization's interest expense on the line of credit. So, I thought that that was a pretty creative way to generate dollars to employ in this organization's mission and also to involve donors as well, who perhaps at this point in time might not be in the best position to fund a commitment to the organization, but over the long term have very good prospects in terms of funding that commitment.

JIM WOEHLKE: We started a little late, so we'll take one more question that I see came in. The question is: I agree with the idea of resource sharing, especially for small organizations, but my observation has been that some organizations are just as competitive as IBM or Microsoft, which is why they resist. What are your thoughts on that?

MARK CHOPKO: That's exactly right. I think that if you represent one or more of these organizations, you may have an opportunity as counselor—and I distinguish the counselor as somebody giving them sound and prudent advice from the attorneys than somebody telling them what the law is—to talk turkey with them and say, "Stop drinking the Kool-Aid. It's really time maybe to think about ways in which you can work together."

Maybe the way to phrase it is to say, "We want you to be here; we want us all to be here. Our goal is to help you get there." The question is exactly right; some of these organizations that share a common mission, a common goal, a common legal objective, I have seen this so many times here in Washington D.C. where you've got 17 organizations all committed to the same thing. How many organizations, grassroots and otherwise, not just the big boys, but the grassroots people are on health care reform on one side of the issue. They're all competing for the same dollars and they're looking for this little niche. When you scratch, you may even find some of them badmouthing their collaborators because "give your money to us, not to them." But at some point, if people are not willing to join together around a common mission, I'm just simply suggesting that it may be possible for them, because I've made this suggestion that organizations can work together by sharing some of their overhead expenses. That should result over the long run in more money being available to be spent on mission.

JIM WOEHLEKE: Thank Mark, Mike, and Chris. I think that you've painted a portrait for us of what the picture is for nonprofits in this environment and I think you've also shown us some important approaches to make that portrait be a little sunnier than it otherwise could have been.

That concludes our webcast today. I want to be sure and thank the panelists for their time and the firm, as well, for this excellent presentation. I also want to thank Stradley Ronon for sponsoring the webcast.

Once again, let me remind the audience that the webcast will be available on the SmartPros website. It will be archived there for about a year. I also want to thank the audience for attending the webcast. Remember, if you have any questions related to the topic today, you can send an e-mail to Mark at mchopko@stradley.com. Please don't forget to complete the survey. It is a requirement depending on the state you are planning to apply for your CLE in. Thank you for joining us today and you may now log off.