

Risk Management ESSENTIALS

Tips, Knowledge and Tools
for Nonprofit Organizations

Herman Honored



Melanie L.
Herman,
executive director,
Nonprofit Risk
Management

Center was selected as one of The NPT 2007 Power & Influence Top 50 in *The NonProfit Times*, Aug. 1, 2007, and honored at a gala in Washington, DC, in September. "These executives were selected for the impact they have now and for the innovative plans they are putting in place to evolve the charitable sector,...(they are) high-level executives who can move a nation," reads the introduction. Acknowledging the honor of such recognition, NRMC board chairman Michael Downs remarked, "On behalf of the staff and board, I congratulate Melanie for this distinguished award that recognizes 11 years of exemplary service to the nearly 20,000 nonprofits we serve."

Good Governance Is Sound Risk Management

By Jennifer Chandler Hauge

Governance has been top-of-mind at the Nonprofit Risk Management Center of late. In Washington, DC, we've watched the governing board of "our nation's museum," the Smithsonian, re-organize its board, hold the CEO more accountable, and re-think the museum's business strategies. This instance is one in a long line of headline-grabbing missteps by nonprofit boards that have stirred Congress to action.

Recently, the IRS has proposed new questions for the revised IRS Form 990 that specifically focus on governance issues, such as size and independence of the board, whether the organization has adopted policies that comply with Sarbanes Oxley (www.soxlaw.com), and whether board members participate in review

of annual financial reports. Earlier this year, the IRS issued a discussion draft *Good Governance Practices for 501(c)(3) Organizations* (www.irs.gov/pub/irs-pdf/p4221.pdf).

Re-thinking how nonprofits govern themselves is not just a phenomenon in the nation's capitol. Across the country, state associations of nonprofits are encouraging their members to voluntarily adopt "best practice" principles. In many museums, community foundations, voluntary health organizations, land trusts and international humanitarian organizations best practice standards are being promoted, either through voluntary adoption, or formal accreditation procedures—complete with peer review and, in some cases,

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...find the answer here

Staff Directory

(All staff can be reached at 202.785.3891)

Jennifer Chandler Hauge, Esq. ■ *Senior Counselor and Director of Special Projects*
Jennifer@nonprofitrisk.org

Melanie L. Herman ■ *Executive Director*
Melanie@nonprofitrisk.org

Barbara B. Oliver ■ *Director of Communications*
Barbara@nonprofitrisk.org

John C. Patterson ■ *Senior Program Director*
John@nonprofitrisk.org

Special Advisor
George L. Head, Ph.D.
George@nonprofitrisk.org

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Election Year Risks

Avoid these Campaign Pitfalls

Most nonprofit managers are aware that a charity may not directly campaign for, or against, a candidate for public office. The penalty is severe—loss of tax-exempt status. However, there is often confusion about related activity, and whether it is improper—or permissible—under IRS regulations. For instance,

- If a candidate is opposing government funding for one of the nonprofit's most important programs, can the nonprofit speak up?
- Can a nonprofit's Web site include a link to a candidate's Web site?
- If the staff leader of a nonprofit is asked to speak at a campaign rally about an issue that the candidate feels strongly about, is that considered to be an *endorsement* or *support* for the candidate?
- If a nonprofit employee regularly writes a column in a local paper and includes criticisms of a candidate in her weekly column, will that be considered opposition to that candidate *by the nonprofit*?

The Rule

The answers to these questions are based on the IRS position that no nonprofit recognized as tax-exempt under 501(c)(3) of the Internal Revenue Code may intervene in elections of candidates for public office. [Although 501(c)(4) organizations are permitted to intervene in campaigns for political office as an incidental part of their overall activities, any amount spent on these activities is subject to an excise tax imposed by Internal Revenue Code Section 527.] The IRS will consider

all the "facts and circumstances" surrounding the conduct of the nonprofit to determine whether improper "intervention" has occurred.

When It's OK to Speak out as an Organization

Nonprofits are, however, permitted to voice opinions on issues and inform the public about the positions of candidates on policy questions as long as it is done in an impartial manner. Forums such as debates or panel discussions that are organized by nonprofits for the purpose of educating and informing voters are not improper intervention, as long as the information is presented in an unbiased, nonpartisan way that does not advance one candidate over another. A "candidate" is defined as anyone who is offering him- or herself or "is proposed by others" as a contestant for an elected public office, whether the office is of national, state or local scope. Therefore it could be someone running for national president or the local school board. "Intervention" is broadly defined also: the conduct is not confined to oral or written statements—but could be indirect intervention, such as creating a link from a nonprofit's Web site to a candidate's home page.

When It's OK to Speak out as an Individual

The IRS regulations do not restrict leaders of nonprofit organizations in their own expression of free speech or personal political views—only the nonprofit itself is restricted. However, when representatives of the nonprofit voice their opinions about a candidate at an official function of the nonprofit, that statement is interpreted as an act of the

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How Lifestyle Figures in an Appropriate Mentor Match

By John C. Patterson

There is a fine line between gathering the necessary information for making the appropriate match and infringing on the privacy of all parties involved. Yet, the parents' right to set limits on who they feel is an acceptable match for their child requires information about the lifestyle of the mentor matched with their child. For example, smoking, drinking alcoholic beverages, sexual orientation and religion may all be factors in whether a particular mentor is acceptable match for a specific child. Thus, the screening process must ask about parental/child lifestyle concerns and the volunteer mentor's lifestyle.

The road to these answers is not always paved. Staff interviewers may encounter bumps, roadblocks and misdirection. Matching prospective mentors and children requires staff skill in obtaining sensitive information from each party that will be considered when forming a suitable pairing.

Address Blank Answers

Some applicants for mentor positions may find the information requested on the application form to be too personal and may resist answering questions related to their personal lifestyles. When this happens, the match-support professional should seek to obtain the desired information during the interview with the prospective mentor by acknowledging the sensitive nature of the information and explaining why the information is necessary and how the information will be used to make an appropriate match. If the applicant chooses not to provide the information, he or she should not be given a mentoring assignment.

Address Falsified Answers

As a rule, falsification of any information on the application for a volunteer or employee position should be grounds for terminating the organization's relationship with the applicant. When faced with falsified answers to lifestyle-related questions staff should follow this rule.

Provide Universal Precautions

Tell all mentors as part of their training that it is not appropriate for them to discuss the private aspects of their lives with the children they are mentoring. The Nonprofit Risk Management Center has learned over the years that a frequent precursor to child sexual abuse is engaging the child in discussions about the molester's (or the child's) sexual behavior. Often sharing intimate details of one's life can lead to confusion or to the appearance of impropriety; therefore, it is not acceptable mentor behavior.

Ascertain Parental Preference

Just as you may request information about the mentor's lifestyle on your application form for matching purposes, you may also ask parents to indicate their wishes on their child's application. Three choices that you may want to present are:

- I would accept a mentor for my child regardless of the mentor's lifestyle.
- I would accept a mentor for my child, but wish to be informed of the mentor's lifestyle, specifically ___ Sexual orientation; ___ Religion; ___ Smoking; ___ Drinking.
- I would not accept a mentor for my child if the mentor were ___ homosexual; _____ (specify a religion); ___ a smoker; or, ___ a drinker of alcoholic beverages.

Balancing the parents' wishes, the child's safety and the applicant's privacy is a tricky proposition, but one that a mentoring organization needs to set down as policy and procedure. ■

Customizing Your Organization's Mentor Screening Process

Checklist

- Your nonprofit uses written descriptions for each position.
- Your nonprofit uses application forms for employees and volunteers.
- Your nonprofit conducts interviews with applicants.
- Your nonprofit checks applicants' references.
- Your nonprofit conducts record checks determined by risks inherent in the position description.
- Your nonprofit uses other screening techniques dependent on the risks inherent in the position requirements.

Source: Adapted from *Staff Screening Tool Kit*, 3rd edition, Chapter 9, "Using the Tools to Customize Your Search," <http://nonprofitrisk.org/store/staff-screening.shtml>.

“...at the Nonprofit Risk Management Center, the focus this year is on helping nonprofits define good governance and identify best practices that are sound risk management strategies for their organizations.”

Good Governance continued from page 1

sanctions for failure to demonstrate compliance with the standards.

The majority of nonprofits do not participate in formal accreditation programs or in voluntary self-regulation standards, leaving the definition of good governance to the determination of individual boards of directors. Boards generally want to do the right thing, but there is a growing concern that nonprofit boards are not engaged enough, and may not have the tools they need to implement the good governance practices that should guide their organizations.

That is why at the Nonprofit Risk Management Center, the focus this year is on helping nonprofits define good governance and identify best practices that are sound risk management strategies for their organizations.

Governance Assessment

So what does the Nonprofit Risk Management Center look for when we conduct an assessment of an organization's governance practices? Here is an outline.

How much information flows to the board?

Too much? Not enough? An informed board is an engaged board, and an engaged board is more likely to support the organization financially and share its expertise with the organization.

An informed board is better armed to ask questions that can protect an organization from being derailed. Too often boards are left in the dark when an organization is faltering financially, which is exactly when the board needs to kick into high gear.

Some of the most notorious criticism of nonprofits' conduct recently has arisen from the exposure of financial deals that enriched either a board member or a staff member, generally without the knowledge or consent of the majority of the

Urban Institute Study Reveals Good Governance Not So Good

Results from a new national study on nonprofit governance provide a wake-up call. They reveal that significant numbers of nonprofit boards are simply not demonstrating good governance practices. The study of over 5,000 nonprofits tells us that:

- Only 52 percent reported that their boards were “very actively engaged” in setting organizational policy or financial oversight;
- Only slightly more, 54 percent, reported that their boards were actively engaged in reviewing the CEO/executive director's performance;
- Only 50 percent of the respondents reported having a written conflict of interest policy—the figure drops to 30 percent for organizations with less than \$100,000 in annual revenues.
- A large 75 percent do not require board members to disclose their own financial interests in entities doing business with the nonprofit, which could mean that those organizations are unaware of existing conflicts of interest.
- Only 50 percent of the responding organizations reported having a written policy to protect whistleblowers.

Source: The Urban Institute, *Nonprofit Governance in the United States: Findings on Performance and Accountability from the First National Representative Study* (Ostrower, 2007)

Conflicts of Interest and Related-Party Transactions

Sample Policy

The potential for a conflict of interest arises in situations in which a person is responsible for promoting one interest at the same time he or she is involved in a competing interest, whether financial or otherwise. If this person exercises the competing interest over the fiduciary interest, he or she has engaged in a conflict of interest transaction. Conflicts of interest should always be avoided, but if they exist, they should be disclosed to the board of directors as follows:

I. Conflicts of Interest

- (1) All trustees, officers, agents, and employees of this organization shall disclose all real or apparent conflict of interest that they discover or that have been brought to their attention in connection with this organization's activities. "Disclosure" means disclosing at a board meeting or in writing to the Chair of the Board or President the facts composing the real or apparent conflict of interest.
- (2) An annual disclosure statement shall be circulated to trustees, officers, and certain employees and outside vendors to assist them in identifying and disclosing conflicts of interest, but if a conflict develops, it should be disclosed at that time.
- (3) The written disclosure statements will be filed with the Chief Executive Officer or such other person designated by the Chief Executive Officer to receive such notifications.
- (4) As needed, disclosures of real or apparent conflicts of interest shall be identified for the board at a board meeting and noted in the minutes.

An individual trustee, officer, agent, or employee who believes that he or she or an immediate member of his or her immediate family might have a real or apparent conflict of interest, in addition to filing a notice of disclosure, must abstain from:

- (1) participating in discussions or deliberations with respect to the subject of the conflict (other than to present factual information or to answer questions),
- (2) using his or her personal influence to affect deliberations,
- (3) making motions,
- (4) voting,
- (5) executing agreements, or
- (6) taking similar actions on behalf of the organizations where the conflict of interest might pertain by law, agreement, or otherwise.

At the discretion of the board or a committee thereof, a person with a real or apparent conflict of interest may be excused from all or any portion of discussion or deliberations with respect to the subject of the conflict.

A member of the board or a committee thereof, who, having disclosed a conflict of interest, nevertheless shall be counted in determining the existence of a quorum at any meeting in which the subject of the conflict is discussed. The minutes of the meeting shall reflect the individual's disclosure, the vote thereon, and the individual's abstention from participation and voting.

The Chief Executive Officer shall ensure that all trustees, officers, agents, employees, and independent contractors of the organization are made aware of the organization's policy with respect to conflicts of interest.

II. Related Party Transactions

Related-party transactions occur between two or more parties with interlinking relationships. As with conflicts of interest, these transactions should be disclosed to the governing board and evaluated to ensure the transaction is based on a sound economic basis that is in the best interest

of the organization. The organization should pursue any related-party transactions that are clearly advantageous to the organization, but should avoid those that present conflicts of interest.

The organization shall undertake transactions with related parties only in the following situations:

- (1) The audited financial statements of the organization fully disclose material related-party transactions.
- (2) Related parties are excluded from the discussion and approval of related-party transactions.
- (3) There are competitive bids or comparable valuations.
- (4) The organization's board approves the transaction as one that is in the best interest of the organization.

Example 1: An organization purchases insurance coverage through a firm owned by a board member. This would constitute a conflict of interest unless the cost of the insurance is disclosed, the purchase is subject to proper approvals, the price is below the competition's, and the purchase is in the best interests of the organization. The board member in question should not be present at the meeting when the decision is made. If the purchase passes these tests, it does not constitute a conflict of interest but qualifies as a related-party transaction.

Example 2: The CEO and several employees are members of the board. When the resolution on salary and fringe-benefit adjustments comes to the board, should those affected by the resolution discuss and vote on the matter? No. The CEO and employees not only should avoid discussing and voting on such matters, they also should absent themselves from the meeting to avoid even the appearance of a conflict of interest.

“Good governance includes not only having a policy to address conflicts, but also defining the types of conflicts that board members are expected to disclose.”



Good Governance *continued from page 4*

board. Keeping the board informed of financial transactions with insiders is a basic risk management step that can protect an organization time and again.

Is the board governing itself effectively?

Size can impact an organization's effectiveness. When a board is too large, decision making is unwieldy so there is a tendency for decision making to be delegated to a smaller group, which often disenfranchises the other board members. When a board is too small, the board may not bring enough resources of time, talent and treasure to the organization.

Similarly there may be too many committees for effective governance. Board committees may be duplicating staff's work—or—staff may be doing all the work and board committees not used effectively.

Board meetings may be too long or held at inconvenient times, resulting in low attendance at board meetings.

The organization may be facing a void in future board leadership with no focus on succession planning or attracting new board members.

Are appropriate financial controls in place?

Some of the biggest exposures in the nonprofit sector arise from a fraud that is practiced over a number of years by a trusted

employee. Boards ask, “What went wrong? Were we asleep at the wheel?”

More often than not fraud results from a board's trusting, but not insisting on, procedural checks and balances being in place. Nevertheless, good governance is more than protecting an organization's assets by patrolling for fraud. Investment policies, spending policies, policies requiring the documentation of transactions with related parties, and a disciplined budget review process are all important financial management practices that are reviewed during an audit of governance practices.

Board oversight of financial management policies is essential to discharging the board's legal duty of care. A board that pays little attention to the financial health of the nonprofit (or places all of its trust in the finance committee or the CFO) cannot fulfill its fiduciary duty.

Is the organization vulnerable to employment practices claims?

Hiring and evaluating the performance of the chief staff leader of the organization is one of the most critical governance obligations of the board. In turn, the CEO/executive director has the responsibility of managing the paid and volunteer staff members that are the engine of the nonprofit.

In a governance review, the personnel practices are examined to identify whether the organization is consistently practicing what its policies preach and whether or not the board is following

NEW!

Financial Risk Management: A Guide for Nonprofit Organizations

This brand-new book explores the topic of financial risk management in the nonprofit world. Subjects covered in this practical, how-to guide include financial accountability, fraud prevention and board-staff communication on financial management issues. Learn how to identify, measure and minimize risk to financial assets, while maximizing accountability to stakeholders, fiscal integrity and mission-fulfillment. Buyers of the book receive a companion online course at no additional cost. Published autumn 2007 — 104 pages. The cost is only \$25 for a single copy. Quantity discounts are available.

procedures that provide for effective communication and evaluation of the CEO/executive director.

Since serious IRS penalties can result from excessive or undocumented compensation to certain insiders, we review procedures for approving compensation and benefits for staff, and approving contracts for independent contractors and vendors.

Are board and staff sensitive to conflicts of interest?

Conflicts can be avoided most easily when the organization has a stated conflict of interest policy and annually canvasses the members of the board of directors and key administrative personnel to document potential conflicts. Awareness of the policy, of the obligation to disclose a conflict, and of the procedures that should be followed to manage each conflict are all critical risk management steps.

While most policies focus on conflicts of interest in financial terms, any duality of interest, whether arising from a personal or professional relationship, including board members

who serve on the boards of other nonprofits, can jeopardize a nonprofit's position among stakeholders.

Many board members are not aware of conflicting transactions with related parties because they are not disclosed or reported to the IRS, as required. Good governance includes not only having a policy to address conflicts, but also defining the types of conflicts that board members are expected to disclose.

Is the mission being fulfilled?

Board oversight is key to mission fulfillment. Board review can be invaluable to the staff—helping them view things in a new light and take a different perspective on key indicators and environmental shifts that will impact the organization and its programs for years. Board oversight can only be effective if all the organization's systems are running smoothly and strong governance practices are in place.

Policies that protect your organization

One of the most important governance policies, arguably THE most important, is a conflict of interest

policy. Conflicts of interest and related-party transactions are similar; however, there are distinctions that need to be recognized. The sample policy (page 5) defines conflict of interest broadly and also defines and requires the disclosure, documentation and reporting of related party transactions.

Where to Go From Here?

Effective governance requires accountability built on written policies, established procedures, education and adherence. Organization culture, history, size, resources and the personalities of the people around the board table all come into play in determining the *ideal* ingredients for effective governance.

The Nonprofit Risk Management Center advises each nonprofit to start somewhere and do what it can, when it can, but keep on keeping on. Divide and conquer. Take baby steps. Delegate. But bite off no more than what you can swallow. No matter which approach works for your board, start where the need is greatest to establish, shore up or polish your nonprofit board's good governance. And call on us. We can be of assistance. ■

Election Year Risks continued from page 2

nonprofit. The key is for the nonprofit to remain nonpartisan at all times. For example, preparation and distribution of voter education materials, such as descriptions of various candidates' positions on policy issues that impact a nonprofit's activities or mission, is permitted (because it falls under the definition of "voter education") as long as it is conducted in a nonpartisan manner e.g., *all* candidates' positions are covered. Any bias reflected in the materials would be an indication of improper intervention under the IRS "facts and circumstances" test. Official publications of a nonprofit must remain nonpartisan.

Put Your Knowledge to the Test

Test how much you and your staff know about the IRS rules that prohibit charities from supporting or opposing a candidate by answering the following questions.

1. During a board meeting a board member jokingly makes comments about a particular candidate and passes out homemade bumper stickers that contain campaign slogans. Will the board member's conduct be imputed to the nonprofit? *Yes or No?*

If the board member clearly encouraged his colleagues to vote for a particular candidate, this would constitute improper political campaign intervention, since the

comments were made at an official meeting of the nonprofit.

2. During a heated local election, someone suggests that inviting a local candidate to the nonprofit's annual meeting is sure to increase attendance. *Good idea? Bad idea?*

This is a fine idea—as long as *all the other candidates are also invited*. If candidates ask to speak, the message needs to be controlled so that their speeches are about the nonprofit and its issues, not campaign rhetoric. It is hard to control what politicians say on the campaign trail, so many organizations shy away from permitting candidates

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Have You Renewed Your Nonprofit's Corporate Status?

Most states require nonprofit corporations to file an annual report with the state in order to maintain the nonprofit corporation's good standing in that state. If you fail to submit the annual report, the state is unlikely to remind you. Instead, you may discover down the road that unbeknownst to you, the corporation's good standing was revoked, resulting in penalties — and funders or other partners who won't do business with you until the nonprofit corporation is back in good standing.

In 2008, the same sort of renewal will be required by the IRS for small tax-exempt organizations. Until now, small public charities with gross annual receipts of less than \$25,000 did not have an annual filing requirement with the IRS. But last year the Pension Protection Act of 2006 changed all that. In an attempt to keep track of the growing number of start-up and small charitable organizations, the U.S. Congress directed the IRS to develop a procedure to gather annual information from charities recognized as tax-exempt that previously were too small to file an IRS Form 990, or 990 EZ. The Pension Protection Act also includes a penalty provision for those small organizations that fail to file for three consecutive years: **loss of tax-exempt status**.

In late August, the IRS issued the following notice about the new annual electronic filing requirement for small charities starting in 2008:

Don't Throw Away Your Tax-Exempt Status

Beginning in 2008, small tax-exempt organizations will have a new filing requirement. It's short, easy and electronic; it's the new **e-Postcard**. If you are a tax-exempt organization that normally has annual gross receipts of \$25,000 or less and does not have to file Form 990 or 990-EZ, you *must* file the e-Postcard. The e-Postcard is due by the 15th day of the fifth month after the close of your tax year. Therefore, if your organization operates on a calendar year [January 1–December 31], the e-Postcard is due by May 15 of the following year.

When Is the e-Postcard Due?

If your fiscal year ends on December 31, 2007, the first annual electronic notice will be due May 15, 2008. If your organization's current tax period started in June or July 2007, the first annual electronic notice will be due in the fall of 2008.

What Information Will the e-Postcard Include?

The notice will require you to provide the following information:

1. The organization's legal name (and any other names the organization uses) its mailing address, Web site address (if applicable) and employer identification number (EIN);
2. Name and address of a principal officer of the organization, and verification of the organization's annual tax period (fiscal year);
3. Verification that the organization's annual gross

receipts are still normally \$25,000 or less, or

4. verification that the organization has terminated (is no longer in business).

What Happens if We Neglect to File?

If an organization fails to file for three consecutive years, the IRS will revoke the organization's tax-exempt status. The only way to reinstate the status will be to re-apply for tax-exemption, which will require paying the IRS tax-exempt application fee again.

More Information

Go to www.irs.gov/pub/irs-tege/cp299.pdf to read the full details of the letter the IRS issued recently that describes the new e-filing requirement.

And here's another risk management tip. The IRS has an e-mail newsletter, just for exempt organizations. Subscribing is good risk management! To subscribe, go to www.irs.gov/eo and click on EO Newsletter. ■

NEW! Second Edition! *Coverage, Claims and Consequences: An Insurance Handbook for Nonprofits*

This updated version of the Center's best-selling guide on insurance is available as a hardcopy book and as an interactive PDF containing hyperlinks to additional resources. Buyers of the book receive the online version at no additional cost. Published autumn 2007 — 220 pages. The cost is only \$30 for a single copy. Quantity discounts are available.

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2007

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5

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9 of 12

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3

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#10 of 12

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5

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* EDT (Eastern daylight time); EST (Eastern standard time); www.time.gov

Election Year Risks

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to make speeches unless they are in a controlled forum in which all candidates have equal voice. Note: No campaign fundraising should ever occur at an official nonprofit function.

3. A local politician offers to pull the winning raffle ticket at your next fundraiser. *Good idea? Bad idea?*

Since the politician is already in office, the person is not necessarily a "candidate" unless the person has publicly announced she or he is running for re-election. To play it safe, the nonprofit should consider how it can remain nonpartisan under the circumstances—such as inviting competing politicians to play a role at the fundraiser as well.

4. Your nonprofit leader is well known in the community. She attends a political event for Candidate X and stands up in front of the microphone and tells the audience that she personally believes that Candidate X should be re-elected. Has she jeopardized the nonprofit? *Yes or No?*

No. The charity leader is an established personality in the community. Her remarks were not made at an official nonprofit function and she did not state that her remarks were made in her role as nonprofit leader. Additionally, she used no assets of the nonprofit to make her remarks.

More Guidance

The IRS recently issued a helpful revenue ruling containing scenarios that describe what is permissible and what is impermissible. IRS Rev. Ruling 2207-41 can be found at <http://www.irs.gov/pub/irs-drop/rr-07-41.pdf>. ■

RISK MANAGEMENT MARKETPLACE

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Before investing or sending money, you should carefully consider the investment objectives, risks, charges and expenses (a contract fee, Separate Account expenses, and Underlying Funds expenses.) This and other information is contained in the contract prospectus and Underlying Fund prospectuses, which can be obtained online at mutualofamerica.com, from your local representative or by calling our toll-free number, 1-800-468-3785. Please read the prospectuses carefully before investing.

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*You can choose to place all or a portion of your IRA and contributions in the Interest Accumulation Account, which credits interest at a rate that we declare from time to time. This interest rate may increase or decrease at our discretion. The **minimum guaranteed** interest rate that is credited to your account is set by the laws of each state using a formula or amount adopted by the state for this purpose. All states do not use the same method, so the **minimum guaranteed** interest rates are not uniform and may be different from one state to another. We currently set 3.00% as the **minimum guaranteed** effective annual yield for 2007, which is higher than or equal to the minimum guaranteed interest rate required by any state.

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