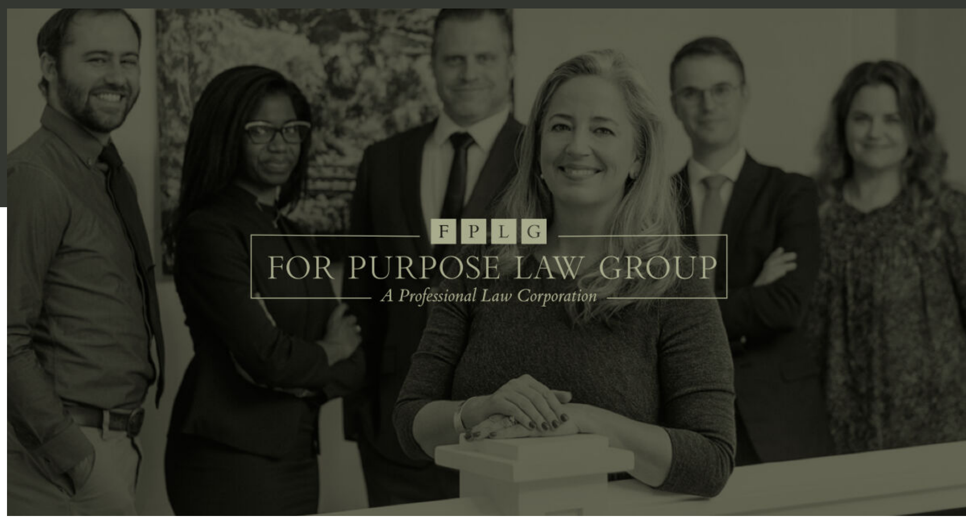
NONPROFITS: INTERNAL REVENUE SERVICE

When The Revenue Agent Comes Calling: Financial Oversight

09.21.16 | Linda J. Rosenthal, JD



For the past 15 years or so, government regulators have taken a keen interest in preventing – and a hard-line stance on exposing and penalizing – financial improprieties in the nonprofit sector.

Haven't the Internal Revenue Service and state charity officials always been concerned about accounting irregularities and diversion of assets? Yes, but after the huge corporate scandals – Enron and Worldcom – in the early 2000s, they sprang into action.

There were big changes in government oversight of charitable organizations including, for instance, the comprehensive overhaul of the IRS Form 990 in 2008.

States acted, too. The California Nonprofit Integrity Act and similar legislation in other jurisdictions focused on the accuracy and transparency of financial statements and other reporting by nonprofit organizations. Think tanks and leading agencies within the philanthropic community developed "best practices" standards for nonprofits.

Nonprofits adopted changes, especially in connection with the relationships with auditors. Many have adopted ethics guidelines for their financial officers along the lines of the federal Sarbanes-Oxley Act enacted in the aftermath of the major corporate financial scandals. Board audit committees are now more independent.

The Revenue Agent At Your Door

This is the fifth in our series highlighting how IRS Revenue Agents are directed to conduct examinations.

The 2008 changes in the Form 990 led to revisions in the procedures and instructions for the audits of 501(c)(3), tax-exempt, charitable organizations. Form 14114, Governance Check Sheet, was issued in 2009.

Agents now come knocking at your door armed with this short audit guide that is divided into 6 separate sections. We've already posted about the first four categories: (1) Governing Body and Management; (2) Compensation; (3) Organizational Control; and (4) Conflict of Interest.

Financial Oversight

The financial oversight questions come fifth on the Form 14114. There's no apparent reason why this section was not placed first; after all, the Internal Revenue Service's primary concern in connection with tax-exempt organizations relates to money and assets. Perhaps it just fit better in 5th place on the two-page document.

As with the previous sections, there are multi-part questions, including drop-down menus for the agent to record detailed answers.

The IRS wants to know:

- If you have systems or procedures in place intended to make sure assets are properly used, consistent with your organizational mission;
- How often your board members are provided with written reports of the organization's financial activities – notice that the question is not "if" but "how often";
- How often the board discuss/consider reports of the organization's financial activities – once again, "how often," not "if";
- If, prior to filing your Form 990, it was reviewed by the full board and/or a designated committee – interesting and unexplained reversion to "if"

Next up in this section are questions relevant to an independent accountant's report, if any:

- If, during the primary year under examination, an independent accountant's report was prepared;
    - (If yes), was the accountant's report discussed/considered by the full board and/or a designated committee;
    - Was a management letter prepared by the independent accountant?
    - (If yes), was the management letter reviewed by the full board and/or a designated committee?
    - (If yes), did the organization adopt any of the recommendations contained in the management letter?

Conclusion

Of course, since the audit concerns one or more Form 990s, there will be detailed scrutiny of the financial information included, above and beyond these few questions.