

When the Revenue Agent Comes Calling

03.15.16 | Linda J. Rosenthal, JD



Back in the early 2000's, business scandals including Enron and Worldcom rocked the corporate world. Although that wrongdoing involved huge for-profit companies, it caught the attention of charity regulators at all levels of government.

We wrote in *Written Governance Policies: Which Ones Should Nonprofits Have?* (July 30, 2015) that the Internal Revenue Service as well as the California Attorney General (and equivalent officials around the nation) have, in the post-Enron years, taken a special interest in how 501(c)(3) organizations, and public charities in particular, govern themselves.

In the case of the federal tax agency, it's a bit of a departure from the laws relating to eligibility for tax exemption, its usual jurisdiction and focus. Nevertheless, the IRS "believes that a well-governed charity is more likely to obey the tax laws, safeguard charitable assets, and serve charitable interests than one with poor or lax governance.... [W]hile the tax law generally does not mandate particular management structures, operational policies, or administrative practices, it is important that each charity be thoughtful . . . [about] governance practices...."

There is substantial evidence of this interest by the IRS, including public statements of IRS officials, explanations in policy documents, and changes to the Form 990, adding questions about board composition and policies.

The federal tax agency "encourages a charity's board of directors to adopt" specific written policies on matters including executive compensation, fundraising, and investments. "These are not requirements," though – the IRS adds helpfully. They're not mandatory." Think of them as . . . suggestions; kind advice that a nonprofit can't exactly refuse.

And just to make sure charities are paying attention, the agents on a field audit are asking some pointed questions.

Audit Governance Check Sheet

In late 2009, the IRS issued [Form 14114](#), Governance Check Sheet, which is used by IRS field audit staff during audits of public charities. Many – though not all – of the questions on this two-page form are also on the Form 990. It is a “[very specific roadmap](#) for exempt organizations to compare their practices and policies with what the IRS wants to see and to make adjustments where necessary.”

The questions on the agent’s check sheet are arranged in six separate areas of corporate governance:

Governing Body and Management

Compensation

Organizational Control

Conflict of Interest

Financial Oversight

Document Retention

As an illustration of the comprehensive nature of this inquiry, the Governing Body and Management section asks six questions, each with multiple parts. There is a drop-down menu for the agent to write down the audited organization’s highly specific responses, including:

- Whether there is a written mission statement that is current;
- If the bylaws set forth information for the members of the governing body and the organization’s officers as to: compensation, duties, qualifications, and voting rights;
- If copies of the most recent versions of the articles and bylaws have been given to: all board members, only voting board members, general public (by request), general public (online), or not provided;
- How many board members during the primary year under examination had voting rights;
- How often a quorum of voting board members met during that primary year;
- How often the full board met during that primary year; and
- Whether the numbers of meetings referred to, above, met or exceeded the meeting requirements set forth in the organization’s bylaws

-

Conclusion

There has been disagreement among expert advisers to the IRS about this focus on governance issues; not all members of the exempt organizations community agree that the IRS should focus on governance. However, it’s likely that the agency’s interest in this topic will continue – or escalate.

In any event, state attorneys general – who *have* specific jurisdiction and authority over governance issues – are stepping up focus and enforcement on these same matters

— Linda J. Rosenthal, Esq., FPLG Information & Research Director