

IRS Official Unveils Best Practices For Exempt Groups, Gives Program Update

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An Internal Revenue Service official Feb. 2 outlined the agency's "Good Governance Practices for 501(c)(3) Organizations," telling a gathering of exempt organization attorneys and accountants that the guidelines can help tax-exempt health care organizations and other charitable entities maintain regulatory compliance and public support.

IRS lacks the authority to impose governance standards for exempt organization boards, IRS's Marvin R. Friedlander said. However, he told the gathering that the nine guideline recommendations are designed to help ensure that directors of exempt organizations "understand their roles and responsibilities and actively promote good governance practices." Friedlander is the chief of the Exempt Organizations Technical Branch, Office of Rulings and Agreements, at IRS in Washington.

Despite the limits on IRS's formal powers, Friedlander said, the service would use its oversight authority and regular reviews of exempt organizations and their filings by the Tax Exempt/Government Entity Review of Operations Unit, to assess whether the governance measures were being adopted on a voluntary basis. "In the end, an organization's good governance practices should keep regulators happy and help tell a good story to the public," he added.

Congress, in adopting the Pension Protection Act, left exempt organization governance to self regulation, despite the well-documented cases where problems resulted from leaders being given unfettered decisionmaking authority with little public exposure, he said. As with many aspects of tax law compliance, the methods any one organization adopts will depend on the size of the organization and its board, he added.

The guidelines range from recommending that an organization have a mission statement and code of ethics, to calling for better accounting, independent audits, improved compensation practices, and greater transparency to the public.

Friedlander made the remarks at the Joint Annual Meeting of the Gulf Coast, Great Lakes and Mid-Atlantic Areas TE/GE Council, held in the Washington offices of Sidley & Austin. The group is described by IRS as "an organized public forum for the IRS and representatives who deal with employee plans, exempt organizations, tax-exempt bonds, and federal, state, local and Indian tribal governments," and has the objective of allowing the agency "to receive regular input on administrative policy and programs affecting these customer groups."

Friedlander Urges Commitment to Openness

In introducing the guidelines, Friedlander stressed that exempt organization board members must be informed, active, and committed to openness and that they should not tolerate secrecy or neglect that can lead to the waste of charitable assets.

As important as it is that board members be passionate about their organization's programs, he said, it is equally important that they have expertise in critical areas such as accounting, finance, compensation, and ethics.

With regard to the proper size for a board, an issue that gained significant attention in the context of congressional oversight efforts, Friedlander said IRS has adopted the "Goldilocks approach: Not to big, not too small."

Too few board members may indicate the absence of an appropriate mix of the public or community, while too large a board may lead to excessive delegation of authority to an executive committee and loss of transparency within the board, he said

Specific Recommendations

The guidelines specifically recommend:

- adoption of an organization mission statement, to "explain and popularize" the charity's purpose and guide its work and leadership;
- use of a code of ethics and a whistleblower policy for the organization, adopted and evaluated regularly;
- calling for board members to exercise due diligence with respect to ensuring they have sufficient information to fulfill their duty of care and act in the charity's best interests;
- requiring board members to fulfill their duty of loyalty to the organization, through adoption of conflict of interest policies and other measures, such as requiring signed statements under such a policy, that are clear and enforceable;
- mandating transparency in all activities by ensuring full and accurate information is available to the board members, regulators, and ultimately, the public;
- truthful, accurate and candid fundraising activities and methods;
- enhanced financial auditing protocols, including use of audit committees, additional internal reporting, and independent and, in some cases, rotating auditors to ensure the board can properly steward the organization's assets;

- controls on compensation decisions, using the rebuttable presumption method in Section 4958, both on payments to board members, if appropriate at all, and to corporate officers and staff; and,
- document retention policies, designed to ensure the organization can produce information needed to satisfy regulators and the public, whether in electronic, paper, or other medium.

In response to a question about whether it was appropriate to require new auditing of organizations on a regular cycle, Friedlander said the comments were useful and that the recommendations are still being assessed. He said they should be finalized by the end of 2007, and be posted as part of an online "cyber assistant" program to aid exempt organization compliance efforts.