

**O'CONNOR  
DAVIES**

## **Best Practices for Good Controls and IRS Examination Trends and Initiatives**

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# Tone at the Top

- Board policies
- Senior management
- Written policies – enforced – for all
- Everyone must buy into the importance of this

# What Policies are Needed?

- Conflict of Interest Policy
- Whistleblower Policy
- Comprehensive accounting policies and procedures

# Conflict of Interest Policy

- Adopt a clear written policy
- Stress its importance – not just to fight fraud but to protect the reputation of the organization
- Applies to many people throughout the organization
- Require annual signed off statements disclosing conflicts or potential conflicts

# Conflict of Interest Policy *(continued)*

- Who Should Submit Annual Statements?
  - Board of directors or trustees
  - Senior management
  - All employees involved in purchase of goods and services
  - All employees
  - Vendors

# Conflict of Interest Policy *(continued)*

- What is an appropriate review process?
  - Initial review performed by senior management
  - Results screened by Board Committee (Audit Committee)
  - Results presented to Board and included in Board minutes

# Whistleblower Policy

- Adopt a clear written policy
- Employees need a way to contact a board member – may not be comfortable going to management
- Best to provide a means of anonymous communication - 800 number or website
- Board members must take this seriously, protect the reporting employee, contact legal counsel if necessary

# Accounting Policies and Procedures

- Is your policies and procedures manual up to date?
- Is it available to a wide variety of users?
  - Accounting and finance
  - Development
  - Top management
  - All those involved in incurring costs and initiating disbursements by the organization



# Cash Disbursements

- Do checks and wires over a certain amount require more than one signature or approval?
- What about wire transfers?
  - We have seen where the controls over wires disbursements are not at the same level of approval as check disbursements
- Does the organization have an effective system implemented to verify that services performed or goods purchased are complete and acceptable before issuing the disbursement for the service or good?

# Cash Disbursements

- Are the proper controls in place for credit card payments such as sufficient supporting documentation, proper level of approval and acceptable business purpose?
- Who reviews the expense reports of the top officials? Is there a clear policy regarding supporting documentation? Does a board member review the expense report of the executive director? Is there sufficient control?

# Property and Equipment

- When was the last time you had a physical inventory of movable assets?
- Does the organization have a formal procedure to ensure that disposals of fixed assets are reported to accounting and finance and are then removed from the accounting records?

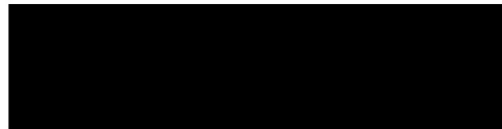
# Information Technology

- Does the organization require that network or other passwords be changed on a periodic basis?
- Is a formal process in place to authorize user account creation, modification and termination?
- Are files backed up frequently? Is there a disaster recovery plan? Is it tested?

# Journal Entries

- Fraud is not just loss or misuse of assets. Fraud is also deliberate misstatement of financial results.
- Do journal entries have an evidentiary mark that a supervisory review or authorization has taken place?

**Internal Revenue Service**  
Tax Exempt and Government Entities Division  
Exempt Organizations: Examinations  
625 Fulton Street  
Brooklyn, NY 11201



Department of Treasury

Date: March 20, 2012

Taxpayer Identification Number:  
[REDACTED]

Form:  
990

Tax Year(s) Ended:  
June 30, 2010

Date and Time of Appointment:  
April 11, 2012

Place of Appointment:  
To Be Determined

Person to Contact/ID Number:  
[REDACTED]

Contact Numbers:  
[REDACTED]

Manager's Name/ID Number:  
[REDACTED]

Manager's Contact Number:  
[REDACTED]

Dear Sir or Madam:

We plan to conduct an examination for the above periods on the date, time, and location indicated above. We would appreciate your calling our office as soon as possible to confirm this appointment.

We realize some organizations may be concerned about an examination of their returns. We hope we can relieve any concerns you may have by briefly explaining why we examine exempt organization returns and what your appeal rights are if you do not agree with the results.

## I. IRS Examinations

Most common client question asked upon receipt of examination notice from the IRS:

“Why was my organization selected for examination?”

## I. IRS Examinations

Many times it is easily determined and in fact could have been predicted and sometimes prevented just by focusing on exempt sector information, results of industry specific focus areas and examinations conducted by the IRS and state regulatory agencies.



# I. IRS Examinations

## Federal Form 990

- “Magnifying Glass of The IRS and Other Regulatory Agencies”
- Provides comprehensive information about the organization
  - Enhances transparency of governance (or lack thereof)
  - Compliance with tax rules and regulations
  - Starting point for examinations, questionnaires, check-sheets and priority guidance

## I. IRS Examinations

- IRS Exempt Organizations 2012 Annual report and 2013 Workplan

*“Since the redesigned Form 990 was introduced, the IRS examinations unit has used the form’s expanded data to better identify patterns of noncompliance, understand the causes and target potential offenders.”*

*“The effectiveness of this process relies, however, on accurate reporting by Form 990 filers.”*

## I. IRS Examinations

### IRS Examinations

- In 2012 the IRS conducted 14,000 examinations
- The examinations were a direct result of:
  - Expanded information disclosed on the form 990
  - Federal – State Coordination
    - 104 cases recommended to the IRS
    - Over 27,000 cases recommended by the IRS
  - Public allegations of potential law violations

## I. IRS Examinations

Creation of questionnaires and check-sheets since the re-designed form was placed in service:

- Governance checksheet
- College and University questionnaire
- Community Foundation questionnaire
- Self-Declared Exempt Organization questionnaire
- 512(b)(13) checksheet

## II. Focusing on Examination and Investigation Issues

- **Current areas of Exempt Organization non-compliance**

The following issues were identified based on the results of examinations and other investigations and apply to **ALL** organizations in the exempt sector:

- Lack of governance policies or enforcement leads to poor tax compliance
- Under reporting of unrelated business taxable income
- Failure to properly establish and substantiate executive compensation
- Employment reclassifications
- Failure to report foreign bank accounts, disclose foreign investments and safeguard foreign assets

## II. Examination and Investigation Issues (cont'd)

- **Lack of governance policies or enforcement**

**Issue:** Non-implementation of IRS preferred policies and failure to monitor and enforce such policies results in tax non-compliance

**Problems:**

1. Organizations not adopting IRS preferred policies normally have tax compliance issues upon examination
2. Inaccurate reporting on Form 990
3. Inconsistent monitoring of organizational adopted policies
4. Improper documentation of enforcing organizational policies

**Best Practice: Consider the needs of your organization, identify areas of governance non-compliance and adopt, enforce and properly document and report compliance with such policies on Form 990.**

## II. Examination and Investigation Issues (cont'd)

- **Under reporting unrelated business taxable income**

**Issue:** The unrelated business taxable income rules are complex and arise from direct or indirect trade or business or debt financing activities of the organization. IRS examination and investigations reveal non-compliance in the exempt sector.

**Problems:**

1. Failure to report UBTI
2. Incorrect application of the UB TI rules
3. Improper allocation of UBTI expenses
4. Filing of tax Form 990-T / Estimated tax payment to IRS

**Best Practice: Review all current and new sources of revenue to identify transactions that are conducted outside your organization's exempt purpose. Create policies and procedures to track expenses incurred to generate UBTI. Review all investments and establish checklist. Capture losses by filing 990-T.**

## II. Examination and Investigation Issues (cont'd)

- **Executive Compensation**

**Issue:** Executive compensation cannot exceed the FMV of services rendered. Through its examinations and investigations the IRS has found that many organizations are beginning to establish safe-harbor procedures but documentation sometimes is not present to support reasonable compensation determination and the process is sometimes incomplete. State regulatory agencies looking at this information.

**Problems:**

1. Insufficient and incorrect disclosure on form 990
2. Policies and procedures do not include all elements of the IRS safe harbor for establishing reasonable compensation
3. Comparable data includes for-profit comparison data
4. Inadequate documentation of compensation committee deliberations

**Best Practice: Adopt policy and procedures for the board or compensation committee to follow that ensure approval of executives compensation is performed by independent persons, uses the compensation data from comparable organizations and that the deliberations of the approving individuals are adequately documented. Properly describe such process on Form 990.**



## II. Examination and Investigation Issues (cont'd)

- **Employment and other tax compliance issues**

**Issue:** The Form 990 is not only used by the IRS to measure an exempt organizations compliance with its exempt status, UBI and executive compensation it is also used to determine its overall tax and regulatory compliance. Examinations of exempt organizations have shown non-compliance with employment taxes, foreign investing and international activities.

**Problems:**

1. Incorrect employee classification
2. Exempt organizations not filing FBARS to report foreign bank accounts
3. Exempt organizations not complying with foreign investment disclosure
4. Foreign grant and operational activity does not include necessary oversight and expenditure responsibility

**Best Practice:** In light of recently passed legislation, exempt organizations should review their independent contractors to ensure compliance with the employment tax laws. Compliance officers should develop policies and procedures over international investing and foreign activity to make sure the correct forms are being filed and adequate procedures are in place to ensure exempt assets are being used in furtherance of the organization's mission.

### III. Self Audit and Correction

#### Steps to take to identify areas of non-compliance and protect against an IRS audit

- Step 1:** Stay current with all relevant IRS priority guidance and focus areas
- Step 2 :** Adopt, update, monitor and enforce corporate governance policies and procedures
- Step 3:** Review your organization's governing documents and compare them periodically to your operations
- Step 4 :** Examine your organization's website and activities
- Step 5 :** Review your documentation and records to substantiate tax positions taken
- Step 6:** Review employment contracts / agreements and approval process. Stay current with employment and benefit plan tax filings
- Step 7:** Review all foreign investments and international activities on an annual basis
- Step 8:** Create review process to ensure your Form 990 is prepared completely and accurately

**Internal Revenue Service**

**Department of the Treasury**

Internal Revenue Service  
TE/GE: EO Examinations  
1100 Commerce Street MC: 4900 DAL  
Dallas, TX 75242

Date: OCT 17 2012

[REDACTED]  
[REDACTED]  
[REDACTED]

**Taxpayer Identification Number:**

[REDACTED]

**Form:**

990

**Tax Year(s) Ended:**

June 30, 2010

**Person to Contact/ID Number:**

[REDACTED]

**Contact Numbers:**

[REDACTED]  
[REDACTED]

Dear Sir or Madam:

We are pleased to inform you that our examination for the above period(s) disclosed that your organization continues to qualify for exemption from Federal income tax. Accordingly, we have accepted your return(s) as

# Questions and Answers

# Checklists, Questionnaires and Articles

Available at Web Addresses:

IRS Materials  
O'Connor Davies Information

[www.irs.gov/eo](http://www.irs.gov/eo)  
[www.odpkf.com](http://www.odpkf.com)