

## IRS Audit Checklist for Exempt Organization Governance

Over the past decade or so the IRS has become increasingly interested in monitoring the governance practices of tax-exempt organizations, and particularly those of public and religious charities. This interest has been shown through public statements of IRS officials, the development of training materials for IRS personnel on the subject, explanations to the general public and the charitable community of why the IRS considers governance important, and addition of questions about board makeup and policies to the exemption application form (e.g. Form 1023) and the annual information return many charities are required to file (e.g. Form 990).

Not all members of the exempt organizations community agree that the IRS should focus on governance. However, the IRS rationale is that a well-governed organization is a tax-compliant organization. Consequently, the IRS has developed and released a governance issues checklist to be completed by IRS personnel whenever they engage in an audit of an exempt organization. The checklist clearly shows the interest areas and concerns of the agency and provides a very specific road map for exempt organizations to compare their practices and policies with what the IRS wants to see. As such, it can be an effective tool for organizations to use to help ensure compliance where it may be necessary. Let's take a look at the form.

The **Governance Check-sheet** is a two page document (IRS Form 14114), which is to be used by IRS exempt organization revenue agents in their examination of public and religious charities. The check-sheet lists questions in six (6) specific areas that are to be considered by the agent. There are questions concerning; (a) governing body and governance topics; (b) compensation; (c) organizational control; (d) conflict of interest; (e) financial oversight; and (f) document retention. The check-sheet is designed to be completed by the agent online, with drop-down menus of possible responses and very little opportunity for narrative or description.

In addition to the governance questions included in the revised Form 990, the Check-sheet addresses the following points;

- certain organizational document issues (e.g. whether they include an articulation of a charitable purpose, and information about the composition, duties, qualifications and voting rights of board members),
- whether board members have received copies of the organization's articles of incorporation and current bylaws,
- whether the organization's articles and bylaws are available to the public, and if so, whether they are generally available or only on request,
- the frequency of board meetings as compared to bylaw requirements,
- whether there is a single individual or small group of individuals to whom the board typically defers,
- frequency with which the conflicts of interest policy is actually adhered to (e.g., how often have conflicted members actually recused themselves from the corresponding decision making process?),

- the extent to which board members are provided with information concerning the organization's financial condition and discusses those reports and related financial activities, and
- whether the revenue agent's examination was hindered by a lack of necessary documentation.

Ultimately, the data collected will likely be included in a long-term study the IRS is undertaking to gain a greater understanding of the connection between charities' tax compliance and corporate governance practices. The IRS is not expected to make poor governance practices, by themselves, a reason for not granting or revoking an exemption, but it is conceivable that evidence of problematic governance may contribute to the consideration of penalties where evidence of severe organizational abuse exists.

## **Recommendation**

Any time the IRS develops an interest in a particular activity area of charitable organizations, it is reason enough to sit up and take notice. While the IRS can be slow in picking up on areas of potential concern, or even enforcing current regulations consistently (i.e. political activity), when they do decide to get involved it is because they believe there is something substantial going on. So it might be a good idea to take a few minutes sometime soon to read over the attached check-sheet and evaluate your organization against the issues and concerns reflected in the document. At minimum you will learn something about how your organization is structured and operates. You may even find areas where you need to shore up internal practices to keep your ministry "squeaky clean" and in full compliance.

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