



Corporate Responsibility and Tax-Exempt Organizations

By Bruce R. Hopkins

It is not surprising that concepts emanating from the rapidly rising body of law encompassed by the words *corporate responsibility*, presently applicable only with respect to publicly traded corporations, are seeping into the law of tax-exempt organizations.

What is surprising is the speed with which the exempt organizations component of the Internal Revenue Service is embracing these concepts.

The Sarbanes-Oxley Act was signed into law on July 30, 2002. On Sept. 4, 2002, the IRS announced that it is considering grafting some corporate responsibility concepts onto Form 990 (*Ann. 2002-87*). That, in government circles, is swift movement indeed.

Resources Lacking

This is particularly shrewd behavior on the part of the IRS. The agency is woefully understaffed and poorly financed, and thus lacks the resources to adequately audit exempt organizations and meaningfully review their annual information returns.

It desperately needs a means to bring into compliance those who are causing nonprofit organizations to act in, shall we say, errant fashion. The corporate responsibility devices are perfect for this end and, as coincidence would have it, have arrived just in time — for the IRS.

It also is not surprising that, from the government's standpoint, the corporate responsibility movement is initially manifesting itself in connection with Form 990. The IRS knows that all too many of these returns are inaccurate — often inadvertently but sometimes deliberately.

How can corporate responsibility devices help? One technique would be to have the CEO of a tax-exempt organization personally certify the accuracy of Form 990.

Another would be subjecting these returns to review by an audit committee. (These approaches likely would require legislation, particularly if penalties are imposed.)

Conflict of Interest Policies

The IRS, in recent years, has been trying to shame exempt organizations (outside the health field) into adopting a conflict-of-interest policy. The corporate responsibility movement may hasten that process.

Now, in addition, the IRS may be able to at least force disclosure as to whether such a policy has been developed. There may be a similar approach with respect to a code of ethics for senior executives.

There is much more to tap into. If there is a need for an accounting restatement by a tax-exempt organization resulting from misconduct, should bonuses and the like recently paid to executive personnel have to be reimbursed? Should there be a rule requiring real-time disclosures by exempt organizations? How about a prohibition on loans to directors and officers?

There is still more. Should a tax-exempt organization strive to retain the services of an accounting firm that is registered with the Public Company and Accounting Oversight Board? Should an exempt organization follow the rules regarding audit partner rotation? Should an exempt organization separate audit and nonaudit service providers?

Disclosures Favored

Some of this goes far beyond what the IRS is considering. The agency definitely likes the ideas of conflict-of-interest policies and independent audit committees. More disclosures are favored, particularly involving founders, trustees, directors, officers, and key employees.

Indeed, the IRS is pursuing other changes that would "increase public confidence in the integrity of exempt organization disclosures."

The IRS, on this occasion, produced one of the most remarkable of the agency's recent pronouncements: "It may be argued that there are similarities between the need for veracity in the public information used by shareholders in making investment decisions and the need for veracity in the public information used by contributors and others in making decisions regarding exempt organizations."

There is, of course, one problem with all of this: facing the burdens and perhaps penalties of corporate responsibility, nonprofit organizations may find it increasingly difficult to find competent individuals to serve as officers and directors.

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