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**Washington, DC 20548**

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July 7, 2006

The Honorable Jim Ramstad  
Chairman  
Subcommittee on Oversight  
Committee on Ways and Means  
House of Representatives

Subject: CFC Charities: Responses to Posthearing Questions

Dear Mr. Chairman:

This letter responds to your request for additional information related to the subcommittee's May 25, 2006 hearing on whether charities participating in the Combined Federal Campaign (CFC) are meeting their employment tax responsibilities. Enclosed are our responses to the supplemental questions you submitted. Our responses are based on work performed during our audit, communication with the Internal Revenue Service, our views of generally accepted accounting principles and generally accepted auditing standards, and on professional judgment.

If you have any further questions or would like to discuss these responses, I can be reached at (202) 512-7455 or [Kutzg@gao.gov](mailto:Kutzg@gao.gov).

Sincerely yours,

Gregory D. Kutz  
Managing Director  
Forensic Audits and Special Investigations

Enclosure—1

**Enclosure I**

**Responses to Supplemental Questions for the Record**  
**Submitted by**  
**Representative Jim Ramstad**  
**Subcommittee on Oversight**  
**Hearing on**  
***Charities and Employment Taxes: Are Charities in the***  
***Combined Federal Campaign Meeting their***  
***Employment Tax Responsibilities?***  
**May 25, 2006**

1. **It is my understanding that you came across a number of CFC charities about which the IRS has no current information, and which they classify as being in “unable to locate” status. Is that correct? How many of these did you find participating in the CFC?**

**Answer:**

We referred Combined Federal Campaign (CFC) charities with questionable exempt status to the Internal Revenue Service (IRS) for further review. Based on preliminary research, the IRS classified as “unable to locate” more than 40 organizations that participated in the 2005 CFC. The IRS also classified more than 80 other organizations as “terminated or merged” that participated in the 2005 campaign. According to the IRS, this status indicates the IRS either revoked the 501(c) (3) status or received notification that the charity had merged with another charity. In addition, the IRS identified about 70 organizations from the 2005 CFC whose employer identification numbers (EIN) matched an EIN of a taxable organization with the same or similar name. Therefore, about 200 organizations of the 22,000 charities that participated in the 2005 CFC have questionable tax exempt status and may not be legitimate charities under 501(c)(3).

**2. OPM emphasizes that it requires financial audits of an organization for admission into the CFC. Yet there were more than 1,280 charities with tax debt. Wouldn't an independent audit detect any tax debt when reviewing an organization's finances? Can you explain if GAO discovered this during its examination of CFC charities?**

**Answer:**

A charity's outstanding tax debt may or may not be disclosed in a charity's financial statements prepared in conformity with Generally Accepted Accounting Principles (GAAP), depending on the specific facts and circumstances. Several factors affect (1) management's decisions about whether to separately disclose liabilities for taxes, and (2) the ability of a financial audit to detect a situation where the financial statements did not conform with GAAP. For example, management may decide to not separately report the liability in the financial statements or specifically disclose it in the related footnotes if the amount is not material to the financial statements taken as a whole. In addition, if charity management assesses the probability of payment to be remote,<sup>1</sup> an amount would not be recorded or disclosed under GAAP.

Generally accepted auditing standards require an auditor to plan and perform an audit to obtain reasonable, but not absolute, assurance about whether the financial statements are free of misstatements, including any material misstatement of tax debt. However, it is possible that an audit would not in all cases detect improper recording or disclosure of tax debt, particularly if the amounts involved are immaterial to the financial statements or the risk of material misstatement is very low.

As part of our audit and investigative procedures, we requested from CFC copies of the charities' independently audited financial statements. We found that 4 of the 13

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<sup>1</sup>For example, the entity may consider the likelihood of payment remote because management disagrees with the amount of a tax assessment or there may be disputed penalties and interest charges. GAAP defines remote as a slight chance of a future event or events occurring.

charities we investigated with significant tax debt had financial statements that separately reported outstanding tax debt either in the body or the footnotes to the financial statements.<sup>2</sup> For the remaining 9 charities, we are unaware of the reasons why the tax debt was not disclosed.

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<sup>2</sup>We investigated 15 charities and requested from CFC copies of audited financial statements included with each of the charity's application packages. As of the end of our fieldwork we received audited financial statements for 13 of the 15 charities we investigated.

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