

**REMARKS OF STEVEN T. MILLER
COMMISSIONER, TAX EXEMPT AND GOVERNMENT ENTITIES
INTERNAL REVENUE SERVICE
GEORGETOWN SEMINAR EXEMPT ORGANIZATIONS
PANEL ON NONPROFIT GOVERNANCE
APRIL 23, 2008**

It is always a pleasure to be here and it is really good to spend the day on governance. This panel is almost the perfect way to start. By including the Hill, the states and the IRS, you have before you three provocateurs in this area. There is a fourth conspirator – the sector itself. And we need to recognize the work of the Independent Sector and others for their leadership in this area.

Tomorrow, you will hear me talk about gaps in our ability to regulate, including the governance area. In governance there are no specific Internal Revenue Code requirements. The word “governance” does not appear in section 501. Nonetheless, we have been and will remain active in this area. We will continue to educate, engage, and, yes, even irritate, through various means I will discuss.

In my time this morning, I would like to answer four questions:

- First, why does governance matter to the IRS?
- Second, what has the IRS done in the past year to encourage good governance?
- Third, where will the IRS go from here?
- Finally, what can you do, going forward, to help your clients and organizations strengthen good governance?

Why governance matters to us

It is evident that we care about this area – we have been out front on it for some time and we agreed to co-sponsor today’s event because of our commitment.

I am not going to spend a lot of time going over this ground. Over the past year, we have said repeatedly that we care because a well-governed organization is more likely to be compliant, while poor governance can easily lead to trouble. Good governance also allows for self-identification and resolution of problems. Some disagree with us on this.

My view is clear. Despite the absence of explicit federal statutory provisions setting forth clear governance standards, what I am calling jurisdictional gaps, we are not interlopers trying to regulate an area that is beyond our sphere. Rather, the effects of good or bad nonprofit governance cut across virtually everything we see and do in our work. It impacts whether the organization is operated to further

exempt purposes and public, rather than private, interests. It dictates whether the organization's executives are compensated fairly or excessively. It influences whether the organization makes informed and fair decisions regarding its investments or its fundraising practices, or allows others to take unfair advantage.

The question is no longer whether the IRS has a role to play in this area, but rather, what that role will be.

What have we done in the area in the past year?

So not only do we care about governance, we have been quite active in the governance area over the past year. The crown jewel of this effort is the governance section of the revised Form 990, effective for 2008.

This section asks about the composition and independence of the governing body, about governance policies and procedures, and how and whether governance and financial information is made available to the public.

As many of you know, the 990 draft instructions we released just a few weeks ago include new definitions of many terms relevant to this area: *officer*, *director*, *key employee*, and *independent voting member*, to name a few.

In addition, in February, we released an educational piece on our Web site, which encourages leaders of nonprofits to consider key governance issues, and ties these issues into the governance section of Form 990. We want to notify organizations about the questions they will be asked each year from now on as they file their 990s. The purpose of that piece is to highlight governance matters that leaders of charities of all sizes and types should consider throughout the entire life cycle of their organizations, from cradle to grave.

Where do we go from here?

So what is in the works from the IRS for the future?

First, what will we focus on? To date we have concentrated on board composition. And this remains vital. While the diversity of the sector may mean that one size does not fit all, that does not mean that there are not some general principles to be considered when you set up and operate a tax exempt organization.

You cannot convince me that outside of very very small organizations and perhaps family foundations, the gold standard should not be to have an active, independent and engaged board of directors overseeing the organization. An exempt organization's board or governing body is accountable to the community it serves. In some cases this is the general public; in other cases it is the

organization's membership; but in all cases it is accountability to someone other than the officers and directors of the organization. And remember that the organization exists to serve and be accountable to a broader group.

Independent board members are important because they increase the likelihood that decisions will be made for the best interests of the organization and for the community it serves.

So composition of the board will remain a key focus of our efforts. We will also continue to press forward on procedures and controls that will safeguard assets. Key among these is the presence and operation of internal financial controls. Other procedures should exist that ensure that large scale decisions are reviewed so that the expenditure or activity is for appropriate purposes.

Now will board composition, internal controls and the like guarantee no lapses or losses? Of course not. But even if they fail to prevent problems, such measures make it more likely that these problems will be uncovered, addressed, and resolved before we get there. And doesn't everyone win if and when that happens?

This means that board composition and internal controls and governance structure will remain a large part of our focus going forward. But what actions will we be taking to sharpen this focus? First and foremost we need to continue to educate through Bobby Zarin's excellent education and outreach programs.

Second, we need to more formally and consistently educate during the determination letter process. In the determination process we will be implementing what we lovingly refer to as the cyber assistant. This will allow folks to use a software system to fill out the Form 1023 application. Cyber will provide help along the way including some educational material on governance so that those who are setting up organizations have the help they need to do it right.

So we will continue to educate widely and to communicate about governance during the determination process. As I have discussed, we will also continue to press for transparency in reporting as part of our Form 990 work.

That leaves the examination process. Let's talk about the enforcement side of the Service. We have been saying that good governance is related to tax compliance. Some say prove it. We will be working on that. It seems like a logical inference but some want definitive proof of its correctness. One suggestion is that our agents at the end of examinations should ask themselves a set of questions. Did we uncover a problem that was the result of a governance weakness? Or would the problem we found have been discovered and corrected without us if appropriate governance had been in place? Are there actions the organization can take going forward that will help compliance?

Some of these questions are being asked informally already. For example, we should be asking about some governance and financial practices at the start of an examination as we determine what issues we will look at and the depth of our inquiry.

But it seems to us that some sort of new post-exam checklist might also be useful to get a better feel for the impact of governance. I expect after some period to publicly report out what we find. We are not there yet but this would appear to be the next natural extension of our work in the governance area. Other projects based on our analysis of the new 990 are also likely.

Now as the Service and others drive self-identification and correction of problems shouldn't the Service have a more robust voluntary compliance program? The answer is of course we should, and we need to work on that. We will have one out shortly for non-filing and that is a start, but I would look for more broadly based programs into the future.

Last question – What can you do?

All of us that are a part of the exempt sector share the same goal – helping to assure that the broad sector and individual organizations themselves operate for the benefit of society.

Last year I concluded my remarks at this seminar by doing what I like to do: ask a few questions. Specifically, I asked who should lead the sector on the nonprofit governance issue. That question remains relevant today.

The sector has been busy with this topic since we met last year. The Urban Institute, BoardSource, and today Georgetown Law Center, are all examples of organizations that have convened forums on the topic of nonprofit governance. I know there are many others who have done the same.

Later today you will hear from Diana Aviv on one of the most important developments in the past year, the release in October 2007 of "Principles for Good Governance and Ethical Practice: A Guide for Charities and Foundations," by the Panel on the Nonprofit Sector. I urge you to review that document, listen closely this afternoon, and ultimately work to adopt governance practices consistent with what I view as exceptional principles. And the sector's work must continue.

More immediate to the practitioners in this room is that you will play a critical role in helping organizations that file a Form 990 prepare for filing the 2008 form. You can help them consider how they want to answer many of the new questions on the form, including the governance questions, so that they are not scrambling after the end of the 2008 tax year and wishing they had only adopted a conflict of

interest policy, or established a compensation committee. This is work you can be doing now.

But what can you do beyond this? I think the next step is for you to help assure that these organizations go beyond the mere establishment of policies and procedures and committees. We know that paper policies and procedures do not mean that they are being used. You can help organizations implement and follow their procedures so that meaningful self regulation in fact occurs. That is where you come in.

Conclusion

Let me wind up. I suspect some will continue to say that the IRS is inserting itself into something best left to others, or that it lacks authority here. But we have satisfied ourselves that we have jurisdiction to play a role in this area, and that it is proper and important for us to do so.

I believe that poor governance leads to wasted assets, inefficient use of assets, and loss of public trust in the sector. For us to ignore these realities would be shirking our responsibility, our obligation, to assure that assets are used for exempt purposes, and that the billions of dollars of federal tax subsidies Congress has authorized are well spent.

You can argue the states can do this work. You can argue the sector can do this work. Both can and should help, but at the end of the day, the Service has a robust role to play as well.

Once again, thank you for the opportunity to be with you this morning. I will be happy to take your questions.