

**Tax Exempt Bonds Questionnaire Project:  
Final Report on Governmental and Charitable Financings**

*July 1, 2011*

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## **VI - Analysis and Conclusions**

The data derived from the questionnaires aided TEB in evaluating governmental bond issuers' and § 501(c)(3) organizations' knowledge of post-issuance compliance requirements applicable to their bond issues and their procedures for ensuring compliance. From this analysis, TEB was able to review the types of practices used by the respondents to support their responses stating that they maintained written procedures and record retention policies. TEB was also able to identify weaknesses in the questionnaire process and develop improved questions for future questionnaire projects.

### *Analysis of Charitable Financing Questionnaire*

Between 93% and 95% of the respondents reported that they had post-issuance written procedures or guidelines to ensure that their tax-exempt bonds remained in compliance with the federal tax requirements applicable to the proper and timely use of bond proceeds and bond-financed property (94.79%), arbitrage yield restriction and rebate (93.75%), and timely filing of returns and other general requirements (94.27%). However, our analysis indicated that only 15% had formal written procedures and 33% had ad hoc procedures or guidelines. A small percentage (5%) indicated that they had written procedures but did not provide a sufficient description for a conclusive determination. The remaining respondents either: (1) indicated that they relied on procedures contained in their bond documents (28%); (2) restated the question in their response (4%); (3) did not provide enough detail to determine what procedures, if any, they were following (6%); or (4) did not give a response (9%). The analysis indicates that 85% of the § 501(c)(3) organizations do not have written procedures, while a slight majority do not have any formal procedures.

The § 501(c)(3) organizations indicated that the primary person(s) responsible for monitoring post-issuance compliance are management officials (89%) and board members (3%). Few responded that no one was responsible. The responses indicate that the § 501(c)(3) organizations in the study are predominately delegating the responsibility for post-issuance compliance to a high-level person within the organization. Moreover, 89% of the § 501(c)(3) organizations indicated that they are providing training to the persons responsible for monitoring their post-issuance compliance.

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The responses indicate that there is a high level of awareness (approximately 87%) of the self-correction options under the Treasury Regulations and the voluntary correction programs under TEB VCAP.

The record retention responses of the § 501(c)(3) organizations indicated that nearly all of the organizations (97%) adequately maintained the necessary bond records to ensure post-issuance compliance. However, some of the organizations responded that they did not keep certain required tax-exempt records, such as their Form 1023. Failure to maintain these records may violate statutory requirements applicable to § 501(c)(3) organizations and could result in noncompliance with the requirements of § 145.

The responses to the questionnaire indicated that there is a high recognition of the importance of post-issuance compliance and recordkeeping, however, the overall effectiveness of the implementation of such programs is questionable.

*Analysis of Governmental Bond Financing Questionnaire*

Between 54% and 63% of the respondents reported that they had written procedures or guidelines to ensure that their tax-exempt bonds remained in compliance with the federal tax requirements applicable to the proper use of bond proceeds (58.86%), timely expenditure of bond proceeds (58.29%), proper use of bond-financed property (57.14%), arbitrage yield restriction and rebate (62.29%), timely filing of returns and other general requirements (60.57%), and documenting compliance with other general requirements (55.43%). However, our analysis indicated that only 20% actually had formal written procedures (8%) or ad hoc (12%) procedures or guidelines. A significant percentage (14%) indicated written procedures but did not provide a sufficient description for a conclusive determination. The remaining respondents either: (1) indicated that they relied on procedures contained in their bond documents (46%); (2) indicated that they hired third parties to ensure compliance (5%), (3) did not provide enough detail to determine what procedures, if any, they were following (4%); or (4) did not give a response (12%). The analysis indicates that 92% of the governmental organizations do not have formal written procedures, while a large majority does not have any formal procedures.

The governmental organizations indicated that the primary person(s) responsible for monitoring post-issuance compliance are elected or appointed officials (43%), non-elected or non-appointed officials (22%), and staff persons (38%). Few responded that no one was responsible (2.29%). The responses indicate that the governmental organizations in the study are predominately delegating the responsibility for post-issuance compliance to a high-level person within the organization. Eighteen percent of the respondents indicated that if more than one individual is responsible for maintaining the records related to bond financings, they have written procedures for assigning responsibilities that would ensure compliance. Moreover, 64% of the governmental organizations indicated that they are providing training or educational resources to the persons responsible for ensuring compliance with the post-issuance private use limitations for bond financed property.

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The responses indicate that there is a significant level of awareness (approximately 63%) of the self-correction options under the Treasury Regulations and the voluntary correction programs under TEB VCAP.

The record retention responses of the governmental bond issuers indicated that a high percentage of the issuers (94%) adequately maintained the necessary bond records to ensure post-issuance compliance. However, a small percentage reported they did not keep these records or did not answer the question. Further, for certain types of records, a large percentage of respondents indicated that the records were not applicable for their bond issues.

The responses to the questionnaire indicated that there is a good degree of recognition of the importance of post-issuance compliance and recordkeeping; however, it is unclear whether adequate resources are being applied to implement compliance programs.

#### *Comparison of Questionnaires' Results*

As a general matter, there were fewer positive responses to questions in the governmental bond financing questionnaire. Approximately one-third fewer governmental bond issuers than charitable organization borrowers reported they had written procedures or guidelines to ensure compliance. One-half as many governmental bond issuers demonstrated conclusively that they had formal written procedures, one-third as many indicated they had ad hoc procedures, and almost twice as many (approximately 1.8 times) relied solely on the requirements stated in the tax certificates or other descriptive bond documents as their means to comply. Approximately 3 times as many charitable organization borrowers had procedures in place to coordinate post-issuance compliance when more than one person was responsible for compliance, compared to the governmental bond issuers.

Responses to the questions concerning rates of maintenance of records were generally comparable in the two questionnaire projects, although more than 3 times as many governmental bond issuers relied solely on paper records. For specific types of records relating to private activity compliance, there were fewer positive responses from the governmental bond issuers, but a high percentage of non-positive responses were indicated as "not applicable." This choice was not available on the charitable financing questionnaire, so a comparison between the two questionnaires of these responses is not possible.

#### *Lessons Learned and Responsive Actions*

Several of the questions in the charitable financing questionnaire did not include an opportunity for the respondent to answer "not applicable." We believe that the lack of this choice may have adversely affected the reliability of the responses to certain questions in the charitable financing questionnaire, and prevented us from reporting precise data in those instances. Additionally, the apparent divergence between the Yes and No responses to Question 1 in the charitable financing questionnaire and the accompanying narrative responses highlighted the value of supplemental or

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narrative responses with respect to key questions. To increase the reliability of the responses provided and in recognition of the value of supplemental and narrative responses, we included in the governmental bond questionnaire both “not applicable” choices to respond to certain questions and instructions to provide detailed descriptions of certain procedures (or copies of such procedures if written copies were available). This strengthened the reliability of the data collected as part of the governmental bond questionnaire.

Similarly, after reviewing responses to the charitable financing questionnaire, which did not require respondents to indicate the dates of implementation of various procedures referenced in the questionnaire, we recognized that identifying such dates would improve our ability to assess both historical compliance practices and, possibly, the effectiveness of the “soft contact” approach in encouraging respondents to adopt such procedures voluntarily.

The questionnaire recently sent to issuers of build America bonds includes “not applicable” response options, requires detailed descriptions of written procedures, and requests information regarding the dates the respondents adopted or last revised their policies or practices to determine how long such policies or practices were in place. Future questionnaires will likely also use these approaches. These enhancements to our soft contact approach should increase reliability, encourage voluntary compliance, and provide important information regarding post-issuance compliance procedures.

TEB also learned important lessons regarding the benefits of partnering with external stakeholders, including the ACT, NABL and others, in order to more effectively implement compliance initiatives and work to improve compliance.

### Conclusions

Our analysis of the data gathered from the questionnaires allowed us to draw certain conclusions concerning the level of post-issuance compliance relative to the implementation of formal written procedures or guidelines. This includes recordkeeping and retention policies as they apply to arbitrage yield restriction and rebate requirements, bond expenditures and asset management requirements, and private business use monitoring requirements. Overall, our analysis indicated a high level of awareness of compliance requirements in each of the aforementioned areas. However, there still appear to be significant misconceptions and inadequacies concerning the responsibilities of governmental issuers and conduit borrowers in post-issuance compliance.

#### Post-Issuance Compliance Gaps:

The data in the charitable financing questionnaire indicates approximately one-half of the respondents have either written or “ad hoc” procedures to ensure post-issuance compliance and record retention practices. However, the data also indicates a significant percentage lacks formal written procedures and safeguards. The data in the governmental bond questionnaire indicates approximately 20% of the respondents have either written or “ad hoc” procedures to ensure post-issuance

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compliance and record retention practices. As with the charitable financing questionnaire, the governmental bond questionnaire data also indicates a significant percentage lacks formal written procedures and safeguards. These conclusions are consistent with previous TEB examination experience, which has noted significant pockets of industry inattention to post-issuance compliance, particularly with respect to maintenance of records throughout the life of the bonds.

Recent ACT reports addressed post-issuance compliance procedure and record retention practice issues prior to commencement of these projects. Their analysis recognized that tax-exempt bonds are issued to finance projects with long useful lives, often with bond maturities of 30 years or more. In addition, subsequent refundings of bond issues necessitate the retention of the refunded bond issue's records for the life of the refunded and refunding bond issues, a span of potentially several decades. The reports also noted the significant record retention burdens resulting from a single bond issue financing multiple projects. The reports concluded that, without written procedures, record retention policies might be inadequate to promote post issuance compliance. Moreover, under § 6001 of the Code an issuer's failure to maintain required records may result in its inability to document compliance in an audit.

The IRS believes that it is important for § 501(c)(3) and governmental organizations to have clearly defined procedures and to implement and review those procedures over time to insure the current person(s) responsible for post -issuance compliance will be able to fulfill their duties. The appropriate procedures may vary substantially depending on the complexities of the bond issue, the project or projects financed, and the type and size of the issuer or conduit borrower. Assigning responsibility for post-issuance compliance is critical. Sufficient records should be maintained to allow newly installed officials or new personnel to successfully continue compliance monitoring. Monitoring of post-issuance compliance and recordkeeping should be integrated with existing accounting systems. Formal record retention policies for tax-exempt bond records can provide a strong foundation for ensuring continuity in maintaining effective post-issuance compliance practices.

Industry Recognition of Importance of Post-Issuance Compliance:

Subsequent to the issuance of the questionnaires, TEB has observed that industry stakeholder associations are actively discussing the importance of post-issuance compliance procedures and record retention programs, as well as the identification of best practices. In some instances, these associations have collaborated in working on best practices guidance. An example of this is the NABL and GFOA collaborative effort to develop a post-issuance compliance checklist for use by issuers and conduit borrowers. The IRS applauds these and similar efforts.

Recognition of the importance of ongoing compliance review is also found in the 2008 ACT Report and the recent 2010 Report of ACT (the "2010 ACT Report").<sup>1</sup> In

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<sup>1</sup> IRS Publication 4344 (Rev. 6-2010), *Advisory Committee on Tax Exempt and Government Entities Report of Recommendations*, dated June 9, 2009. See section entitled "Tax Exempt

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proposing additional streamlined voluntary closing agreement procedures, the 2010 ACT Report recommended that the Service articulate the most important factors in determining the extent of additional payment amounts in streamlined situations. In making that recommendation, the 2010 ACT Report stated that such factors should include “(1) whether the issuer acted in good faith by taking steps to implement a post-compliance procedure for all or a significant portion of its outstanding bonds; and (2) the timeliness of making a voluntary closing agreement submission after discovering the possible violation.”

TEB has received comments from many different stakeholders in response to Notice 2006-63, a formal request for comments on record retention guidance and limitation programs. The 2009 ACT Report proposed that a Revenue Procedure be published to address record retention and that it contain safe harbors permitting summarization of records and destruction of the original records if the issuer or conduit borrower can demonstrate appropriate post-issuance compliance monitoring. These comments have been extremely informative, particularly with respect to the practical difficulties of the retention of certain types of tax-exempt bond records required to substantiate post-issuance compliance. TEB supports this proposal and is working to devise a procedure issuers might use to address their record retention requirements. TEB anticipates continued joint efforts in the future to address these burdens.

#### Industry Feedback on Soft-Contact Approach to Compliance:

While an active examination program is fundamental to ensuring compliance, TEB has recognized the industry’s very positive response to alternative soft-contact compliance approaches. Specifically, comments have suggested that information gathering projects, such as these compliance questionnaires, should be an integral component to the IRS’s tax-exempt bond compliance program.

Comments from the industry indicate a high level of interest in receiving feedback from the results of the questionnaires. Certain stakeholder associations have also shown a willingness to make suggestions directed toward improving future questionnaires. Similarly, the § 501(c)(3) industry, as a whole, was very proactive in submitting comments on the recently released Form 990 and corresponding Schedule K, *Supplemental Information on Tax Exempt Bonds*. TEB will continue to encourage the tax-exempt bond community to provide input that assists TEB in developing mechanisms that effectively collect data for compliance purposes.

#### Future Post-Issuance Compliance Check Questionnaires:

In continuing efforts to obtain relevant post-issuance compliance data, TEB may issue future questionnaires targeting post-issuance compliance and record retention practices of issuers of other types of bonds. For example, TEB has issued a similar questionnaire to certain issuers of build America bonds in fiscal year 2010. Because issuers of build America bonds and other direct pay tax credit bonds must certify

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Bonds: Improvements to the Voluntary Closing Agreement Program for Tax-Exempt, Tax Credit and Direct Pay Bonds.”

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each interest payment date, when they submit a request for payment of the refundable credit, that their bonds are in post-issuance compliance at that time, the questionnaires are designed to promote policies that will assist issuers in making such ongoing certifications. Data gathered from these questionnaires will measure the effectiveness of issuers of build America bonds relative to their post-issuance procedures and record retention polices, among other matters.

TEB also issued a similar questionnaire to certain governmental issuers and exempt organization beneficiaries of tax-exempt advance refunding bonds in fiscal year 2011. In future fiscal years, TEB expects to initiate additional soft contact with issuers or beneficiaries of other types of bonds through similar questionnaires. An additional benefit of issuing a questionnaire is increased awareness by all segments of the tax-exempt, tax credit and direct pay tax credit bond community of the importance of post-issuance compliance and record retention policies and procedures.

TEB's ultimate goal is to promote post-issuance compliance while continuing to work with the industry to reduce the taxpayer burden relative to record retention and other tax-exempt bond requirements. TEB will work to strengthen its outreach efforts in this area, and will continue to collaborate with Chief Counsel and Treasury on record retention guidance.