Internal Revenue Service
Appeals Office
4330 Watt Ave. SA7890
Sacramento, CA 95821

Number: **201422033**
Release Date: 5/30/2014

Date: March 7, 2014

ORG
ADDRESS

Department of the Treasury

Taxpayer Identification Number:

Person to Contact:

Tax Period(s) Ended:

UIL: 9300.99-02

Certified Mail

Dear

This is a final adverse determination regarding your exempt status under section 501(c)(3) of the Internal Revenue Code (the "Code"). It is determined that you do not qualify as exempt from Federal income tax under section 501(c)(3) of the Code effective **January 1, 2005.**

Our adverse determination is based on the following reasons: You have not demonstrated that you are operated exclusively for exempt purposes within the meaning of Internal Revenue Code section 501(c)(3) and Treasury Regulations section 1.501(c)(3)-1(d). You did not engage primarily in activities that accomplish one or more of the exempt purposes specified in section 501(c)(3). You are operated for a substantial non-exempt purpose, which is not an exempt purpose. You are operated for the benefit of private rather than public interests and your activities resulted in substantial private benefit.

Contributions to your organization are not deductible under section 170 of the Code.

You are required to file Federal income tax returns on Forms 1120 for the tax periods stated in the heading of this letter and for all tax years thereafter. File your return with the appropriate Internal Revenue Service Center per the instructions of the return. For further instructions, forms, and information please visit www.irs.gov.

If you were a private foundation as of the effective date of revocation, you are considered to be taxable private foundation until you terminate your private foundation status under section 507 of the Code. In addition to your income tax return, you must also continue to file Form 990-PF by the 15th Day of the fifth month after the end of your annual accounting period.

Processing of income tax returns and assessments of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Code.

If you decide to contest this determination, you may file an action for declaratory judgment under the provisions of section 7428 of the Code in one of the following three venues: 1) United States Tax Court, 2) the United States Court of Federal Claims, or 3) the United States District Court for the District of Columbia. A petition or complaint in one of these three courts must be filed within 90 days from the date this determination letter was mailed to you. Please contact the clerk of the appropriate court for rules for filing petitions for declaratory judgment. To secure a petition form from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217. See also Publication 892.

You also have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States Court. The Taxpayer Advocate can however, see that a tax matters that may not have been resolved through normal channels get prompt and proper handling. If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this letter. You may call toll-free, 1-877-777-4778, for the Taxpayer Advocate or visit www.irs.gov/advocate for more information.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely Yours,

Acting Appeals Team Manager

Enclosure: Publication 892

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
TE/GE EO Examinations
TE/GE Division, EO Group
9350 Flair Dr. 2nd Floor, El Monte, CA 91731-2885

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: October 30, 2009

Form Number:
Tax Year Ended:
Taxpayer Identification Number:
Person to Contact:
Employee Identification Number:
Employee Telephone Number:
(Phone)
(Fax)

ORG
ADDRESS

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear

We have enclosed a copy of our report of examination explaining why we believe revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

If you accept our findings, please sign and return the enclosed Form 6018, Consent to Proposed Action - Section 7428. If you have already given us a signed Form 6018, you need not repeat this process. We will issue a final revocation letter.

If you do not agree with our proposed revocation, you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

An Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, The Examination Process, and Publication 892, Exempt Organizations Appeal Procedures for Unagreed Issues, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Sunita Lough
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination

In lieu of Letter 3618

LEGEND
ORG - Organization name XX - Date City = city State = state EIN = EIN website = website FUND-1 = 1st fundraiser BM-1 = 1st BM RA-1 through RA-4 = 1st through 4th RA President = president Vice President = vice president Secretary = secretary Treasurer = treasurer Treasurer-2 = 2nd Treasurer Co-1 through CO-26 = 1st through 26th COMPANIES

ISSUE

Whether ORG ("ORG") was operated exclusively for exempt purposes described within Internal Revenue Code ("Code") section 501(c)(3):

a. Whether ORG is engaged primarily in activities that accomplish an exempt purpose?

b. Whether more than an insubstantial part of ORG's activities is in furtherance of a non-exempt purpose?

c. Whether ORG was operated for the purpose of serving a private benefit rather than public interests?

FACTS

Determination Application:

ORG ("ORG"), Employer Identification Number EIN, was incorporated in the State of State on June 27, 20XX. The specific purpose of the corporation was to assist needy debtors in improving their finances through educating them as to better means of managing their money and seeking for them, if appropriate, an extension or other reorganization of their debts.

ORG filed Form 1023, *Application for Recognition of Exemption under Section 501(c)(3) of the Internal Revenue Code*, for the Service to make a determination as to whether ORG was exempt under Internal Revenue Code ("Code") section 501(c)(3) and a publicly supported organization described under Code section 509(a)(2) in November 20XX. The application was signed by President as President of ORG. ORG described its activities and operational information on page 2 of Form 1023 as follows:

> *"ORG ('ORG') was formed to help reduce the incidence of personal bankruptcy by (i) educating the public about personal money management skills and (ii) assisting needy, predominantly low-income individuals and families with their financial problems. ORG will initially address these problems in their ways (more fully described below): (a) providing information to the general public on sound money management; (b) counseling individuals and families who have serious financial difficulties; and (c) preparing budget plans for those needy individuals and families who can benefit from them.*
>
> *Until ORG develops a full clientele, ORG anticipates spending approximately 60% of its time, effort, and resources on public information. This percentage should diminish over the first year or so of operations until public information activities take up approximately 20% of ORG's time, effort, and resources. The corresponding percentage for counseling activities should increase from 35% up to 60%. The percentage for budget planning should increase from 5% to a maximum of 20%.*

In order to develop its clientele, ORG will place advertisements in the telephone yellow pages and in other local media. In addition, ORG will seek referrals from internet financial sites, including eventually one that it will develop for itself. ORG will also publicize its services through financial and budgeting workshops. These will be offered free of charge (donations solicited) to religious organizations, civic groups, labor unions, businesses, and educational organizations through a cover letter and a brochure. Attached hereto is a draft outline of the agenda and materials for one such workshop (on basic budgeting). Groups that agree to sponsor a workshop will be expected to publicize it to their members through fliers and other regular membership mailings. The groups targeted will be those with a membership consisting principally of lower to middle-income individuals and families.

(a) Public Information

ORG will prepare videos, pamphlets, and other educational materials on budgeting, buying practices, and the sound use of consumer credit. Attached are draft copies of educational material that ORG anticipates placing on a website to be established. ORG may also purchase money management videos from third parties and pay standard purchase or rental fees to the providers. These materials will be provided free of charge to religious organization, civic groups, labor unions, businesses, and educational organizations. ORG will also provide knowledgeable speakers for these same audiences.

(b) Counseling

For most clients, the first, and often the only, contact with ORG will consist of one or more counseling sessions in person or over the telephone. Individuals and families referred to ORG will receive personalized advice, from trained financial counselors, on budgeting and the appropriate use of consumer credit. They will also receive copies of the public information materials.

Referrals are likely to be made by clergy, employers, labor unions, finance companies, creditors, and interested individuals. Other referrals are expected to come from yellow page advertising and internet financial sites. All of the referrals are expected to be needy persons and families predominantly with low incomes.

(c) Budget Plan

As part of the counseling program, clients will receive information about the availability from ORG of budget plan services. If a client requests participation in the budget plan program, ORG will intercede with creditors to try to persuade them to accept partial periodic payments in satisfaction of the debt. Attached is a draft client agreement and intake information for use in association with ORG's budget plan services.

Any clients who participate in the budget plan program will make fixed monthly payments to ORG to retire their debts to the creditors. We expect that approximately half of the creditors will request a payment of 2% of the balance due each month. Other creditors may request as little as 1% or as much as 5% each month.

Client payments will not be kept in an escrow account. They will however be processed and forwarded to the appropriate creditor promptly. The period between receipt of funds from the client *and their disbursement to the creditors should not exceed three business days. Some creditors may request that their payment be sent to them by electronic funds transfer (RPS). ORG will be able to arrange such transfers through an unrelated financial services company that ORG has hired to administer its clients' budget plans.*

Each client will be requested, when it signs up for the budget plan service, to make a voluntary commitment to pay periodic fees to ORG to help defray the costs of the service. ORG will be suggesting a payment of $ per creditor per month, with a minimum suggested payment of $ and a maximum suggested payment of $ per client. It is anticipated that many clients will decline to pay the full suggested amounts. No client however will be refused service for a failure to pay the full suggested amounts.

ORG expects that, in many instances, creditors will agree to accept less than the face amount of the debt when they understand that ORG is working with the clients on payment arrangements. ORG will neither make loans to clients nor negotiate loans on their behalf.

ORG anticipates that 20% or less of the time of its professional counselors will be devoted to budget plan preparation.

As for the individuals who will conduct the activities, President will serve as ORG's executive director and principal manager of day to day activities. President is also a director and the President of ORG. President's hiring and salary were approved by the remaining three unsalaried, independent directors. ORG's bylaws provide, in Article 3, Section 6 and 7, that a majority of the members of the Board of Directors will be unsalaried, that no director will participate in any decision respecting his or her own employment, and that a majority of the disinterested and unsalaried directors must approve such employment.

The counseling and budget plan development work will ... a year, be done by six full-time budget counselors. Clerical work, including some of the budget plan implementation work, will, within a year, be done by two full-time administrative aides. The salary expenses for President appear in Part IV a, Line 17. The expenses for the remaining personnel appear in Part IV A, Line 18. Other office expenses appear on the succeeding lines."

The officers listed on page 3 of Form 1023 were President as president, Vice President as vice-president, Treasurer as treasurer, and Secretary as secretary.

ORG adopted its bylaws on June 27, 20XX. The Service recognized ORG as exempt from tax under Code section 501(c)(3) and a publicly supported organization under Code section 509(a)(2) on January 3, 20XX.

<u>Officers and Directors of ORG:</u>

ORG's officers and directors are as follows:

President - President
Vice President- Vice-President
Treasurer-2 - Treasurer
Secretary - Secretary
BM-1 - Director of Counseling Services from years 20XX – 20XX

Director of Operations - currently

Minutes:

During the years under examination, ORG conducted several board meetings. None of the minutes were signed by any of ORG's officers, or any other individual.

In the minutes dated February 2, 20XX, attended by Vice President, Secretary, and President, one of the discussions was about replacing the treasurer, Treasurer, with Treasurer-2. Another discussion was on the backend processing. The discussion is hereby quoted,

> *"-President reports that the transition from CO-1 doing the backend processing and customer service to ORG will be completed on 2/28/20XX. We will use the software program developed by CO-2...*
>
> - *Board Development Committee Report:*
>
> *-The CO-3 20XX Fall Conference was very informative. Representatives from the IRS encouraged companies to do their own processing, which solidified our decision to depart from CO-1. The IRS also explained that education and counseling should be the first priority and the debt management plans are second..."*

In the minutes dated May 13, 20XX, attended by Vice President, Secretary, President and Treasurer-2, one of the discussions was on the Customer Service Department. It was now in-house and fully operational. This allows ORG to service its clients from start to finish, provide better service, and save a substantial amount of money. Another discussion was on the education and counseling. The minutes stated as hereby quoted,

> *"The CO-3 20XX Spring Conference was very informative. The IRS once again explained that education and counseling should be the first priority and the debt management plans are second. This is evidence we need to expand our education department. The Bankruptcy Reform Law was probably the most important issue of the conference. Once there are more details made available about the role of credit counseling agencies, we will decide whether or not to get involved with potential bankruptcy candidates."*

In the minutes dated August 17, 20XX, attended by Vice President, Secretary, President and Treasurer-2, one of the discussions was on purchasing new clients. The discussion is hereby quoted,

> *"With the recent audits of nearly half of our industry, the IRS is revoking a number of 501(c)(3) licenses. As a result, we have been approached by two different companies about purchasing clients. The fact that we still hold our license and do our own backend processing makes our company an attractive option to companies that want to sell clients. After a brief discussion, it is decided that President will compile some addition information about the acquisition of new clients from an existing company.*
>
> *-In an effort to provide as many services and options to our clients, we are establishing partnerships with other companies in the financial industry. These partnerships will include mortgage companies, debt negotiation or settlement companies, bankruptcy attorneys, estate planners and*

financial planners. This will allow us to provide education and alternative options to clients that wouldn't benefit from a debt management plan.

-It has been suggested by President that the company have local legal representation. All members of the Board are asked to consider any qualified attorneys and nominate them at the next meeting.

- *Financial Committee Report:*

-In an effort to satisfy IRS requirements and generate additional income, we are considering hiring a grant writer. After a brief discussion, it is decided that Secretary will contact a grant writer that was referred by CO-3. He will present his finding at the next meeting..."

In the minutes dated November 18, 20XX, attended by Vice President, Secretary, President, and Treasurer-2, the discussions were as follows,

"-As discussed in the previous meeting, ORG has the opportunity to acquire a portfolio of about 3,000 clients from CO-4 CO-4 is looking to get a lump sum payment for the portfolio. It is decided by the Board that ORG will provide two offers to CO-4. The first will be a deal in which they are paid over a six-month period at a rate of up to $ per client. This will allow ORG complete the deal without having to take out a note or involve a third party. The other offer will be a lump sum payment at $ per client.

-With all the changes in the industry and the IRS revoking a number of 501(c)3 licenses, many agencies are considering becoming a non tax-exempt non-profit. It is decided by the Board that ORG will continue to conduct business as a 501(c)3 and reconsider the direction of continuing under this exemption at a later date.

-It was under consideration to seek local legal representation during the previous meeting. After careful consideration, the Board has decided that our current legal team is sufficient despite being located in another state.

- *Finance Committee Report:*

-At the suggestion of the Board, ORG has researched and hired CO-5 to provide grant writing services. This will satisfy IRS requirements of seeking alternative sources of income."

In an telephonic minutes dated December 2, 20XX, attended by Vice President, Secretary, President, and Treasurer-2, the agenda of the meeting was on the purchase of clients. The discussion is hereby quoted,

"The agenda for the meeting was to vote on the purchase of the CO-4 portfolio. Earlier that day CO-4 had accepted the offer to sell their portfolio of approximately 2,800 clients at $ per client with payment being spread out over a six (6) month period. Member Treasurer-2 and President reviewed the portfolio, terms and projected revenue from the portfolio which meets ORG's objective. Member President moved to approve the purchase. Member Treasurer-2 seconded the motion which passed by roll call vote 4-0."

In an minutes dated February 15, 20XX, attended by Vice President, Secretary, President, and Treasurer-2, the discussions were as follows,

"-The purchase of the CO-4 portfolio was completed on December 14, 20XX with the actual conversion taking place on January 14, 20XX. We were not able to purchase CO-4's State clients at this time.

- *Finance Committee Report:*

-ORG strives to serve the financial needs of individuals through education, counseling, and Debt Management Plans. At this point, when a client finishes the DMP we have limited resources and partners that will meet the continuing financial needs of the clients. In response to this, the Director of Education (Secretary) in currently seeking a Certified Financial Planner designation. Upon completion Secretary will be able to offer his services as a CFP for clients that finish their DMP. This will allow ORG *to guide clients from debt elimination to wealth building..."*

In an minutes dated August 16, 20XX, attended by Vice President, Secretary, President, and Treasurer-2, the discussions were hereby quoted,

"-ORG will be cutting its counseling staff to two people. This will allow us to retrain the staff and restructure their compensation to follow the guidelines provided by the IRS in its Core Analysis Tool. These changes should also increase the fair share that we receive from the larger creditors...

The FUND-1 golf tournament was a success this year, raising nearly $ for the scholarship fund."

In an minutes dated November 15, 20XX, attended by Vice President, Secretary, President and Treasurer-2, the discussions were as follows,

"• Chief Executive's Report:

-It is the ongoing goal of this organization to fully comply with the requirements necessary to retain the 501(c)3 status. This will also provide ORG with a better opportunity to receive fair share from creditors..."

In an minutes dated February 13, 20XX, attended by Vice President, Secretary, President and Treasurer-2, the discussions were hereby quoted,

"• Chief Executive's Report:

-President suggests that the Board review the details of a proposed deal between ORG and CO-6. If accepted, ORG would process credit counseling deals for the law group. According to BM-1, ORG could add 4,000 new clients under current structure (No new staff). This deal could generate 300-1000 clients per month. Board concluded, upon legal review, that this would be a good value-added opportunity for ORG and the customer...

-On a follow-up basis, Treasurer-2's model predicted the purchase cost of the CO-4 portfolio at $ /file for 2,988 files, total cost $K. At $ per file, purchase price was $0K. It probably ended up somewhere in between. Projected revenue over the life of the files was $K, profit $K..."

In an minutes dated May 15, 20XX, attended by Vice President, Secretary, President, and Treasurer-2, the discussions were as follows,

"• *Chief Executive's Report:*
-Update on the deal with CO-6. We have agreed to start processing their deals. Projections are 200 clients per month. We will create an action plan to execute the portfolio...

• *Finance Committee Report:*
-The industry seems to be switching from fairshare to grants. Because of that, we need to take steps to maximize our eligibility for those funds.

-CO-7 is a creditor that still uses fairshare. They would increase our fairshare from 3% to 8% if we were part of .. The downside is the compliance is more demanding than ISO. The upside is that CO-7 could add $k per month to their current contribution...

• *Board Development Committee Report:*
-The tone from the CO-3 conference is that 501(c)3 Credit Counseling Agencies could be a thing of the past. There could be a shift to taxable non-profits. ORG should continue to follow the IRS Core Analysis Tool as closely as possible, but have a plan B incase we don't pass the audit..."

In an minutes dated November 14, 20XX, attended by Vice President, Secretary, President, and Treasurer-2, the discussions were hereby quoted,

"• *Chief Executive's Report:*
-To date we have processed over 600 CO-6 clients. The goal is to process 1,000 new clients per month by Quarter 1 20XX. As a result, we are hiring more Client Service reps to handle to workload..."

In an minutes dated February 18, 20XX, attended by Vice President, Secretary, President, Treasurer-2, and BM-1, the discussions were as follows,

"-There is interest with 5 other companies to have ORG process their deals.
-Currently CO-8 is sending 15-20 deals per day.
-ORG is actively searching for a new law firm to work with. The reason for the change is to find a firm that is more efficient and provides better customer service to our clients...

-There will be more of efforts to diversify our educational programs offered. The emphasis is to reaching out to various community groups and employers and offer financial literacy workshops, among other services..."

Upon reviewing the above minutes from 20XX through 20XX, there were no detailed discussions as to how ORG would educate its clients.

<u>Associated business entities:</u>

In April 20XX, ORG entered into an agreement called "Back-office Outsourcing Agreement" with CO-6 ("CO-6"), a law firm which provides bankruptcy (chapter 7 and 13,) debt settlement, and lawsuit defense services. Under the requirements of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ., individuals seeking to file bankruptcy are required to obtain a certificate of credit counseling and repayment plan within 180 days of filing for bankruptcy. For these types of clients, CO-6 forwarded them to

ORG for budget analysis and back-office processing services. The marketing agents for CO-6 are CO-9, CO-10, and CO-11. CO-6 was referred to ORG through these marketing agents.

ORG's president, President, has ownership interests with the for-profit entities CO-8 and . As quoted above from the minutes dated February 18, 20XX, CO-8 had sent 15 to 20 deals per day to ORG. Three of ORG's officers were reported to the Internal Revenue Service as receiving compensation from CO-8 in both 20XX and 20XX, while six of ORG's nonofficer employees received wages from CO-8 in 20XX, and three of ORG's nonofficer employees received wages from CO-8 in 20XX. In October 20XX, ORG and . entered into an agreement to have . provide software design and development, technical consulting services and maintenance, and custom hardware configuration. President is the president and CEO of this entity. ORG paid $ per hour for services performed by this entity. No documentation has been provided to establish that the contract was entered into at arms length.

Number of clients:

For the years under examination, ORG's number of existing clients, new clients, and drop-out clients are as follows:

Category	20XX	20XX	20XX
New debt management plan clients			
Existing clients beginning of year			
Existing clients end of year			
Drop outs			
Clients finished debt management plans			

Purchased DMP clients from another entity:

On January 14, 20XX, ORG and CO-4 ("CO-4") entered into an agreement for ORG to purchase around 2,820 DMP clients for a total purchase price of $. ORG did not clarify whether the above existing DMP clients for the 20XX year already included the 2,820 DMP clients from CO-4.

Transferred DMP clients to another entity:

On May 1, 20XX, ORG entered into an Account Assignment Agreement (Agreement) with CO-12 to transfer ORG's State Clients (STATE). CO-12 is a non-profit corporation in State. The contract specified that CO-12 assumed all obligations of ORG of the variuos client agreements between ORG and the State Clients and served these clients. CO-12 would collect all fees from these accounts from now on. ORG has not clarified whether these clients are those identified in the minutes dated February 15, 20XX. ORG also did not clarify whether the number of existing DMP clients in 20XX already excluded the transferred individuals.

30 Sample Client Files:

During the course of examination, 30 client notes were requested as a sample for review. From these notes, ORG 's employees indicated "Education Call" made to these clients. The files contained no detailed descriptions as to what consisted an education call. For example, an entry was made on Client Number client notes on June 13, 20XX, as "Education Calls lm regarding updates to program." On this date, there was no detail entry explaining what was being discussed about these updates.

Form 886-A (Rev. January 1994)	EXPLANATIONS OF ITEMS	Schedule number or exhibit
Name of taxpayer ORG	Tax Identification Number EIN	Year/Period ended 12/31/20XX thru 12/31/20XX

Recording calls:

ORG provided nine recording calls for the Agent to listen. However, the Agent was only able to listen eight of them. The remaining one's recorded volume was low and was unable to hear the entire session. The clients from the majority of these sample calls were interested in lower interest rate and one consolidated payments. Some of them were not behind on their bills. From these calls, ORG's counselors presented the seven options to the clients without going into detail discussions as to how the clients got into the financial situations they were in. From these calls, the counselors did not address the clients' budget and finances, there was no discussion on the clients' employment, education, buying habits, significant expenditures, and past or anticipated changes in their earnings, assets, expenses and liabilities, including the reason or cause for those changes. The counselors emphasized the benefits of DMP because of lower interest rate and paying off the debts faster by asking the clients to fill out creditor worksheet so the counselors can show them the different payment and how the clients could save money. In some of these calls, ORG's counselors even mentioned there was an affiliated debt settlement company that ORG worked with which the clients could keep the information in mind if they decided to choose the debt settlement option later on.

Services performed by outside entity:

During the initial office visit at ORG's site, ORG provided a Termination of Fulfillment Agreement dated February 24, 20XX, between CO-1 Inc. and ORG. Per the agreement, CO-1 Inc. entered into a Fulfillment Agreement with ORG on January 20XX to have CO-1 Inc. perform certain fulfillment, back-office, and customer relations services for ORG's budget plan clients. CO-1 Inc. could charge ORG $ per active ORG budget plan client and a one-time fee of $ per new budget plan client. As of February 24, 20XX, ORG and CO-1 Inc. entered into an agreement to terminate these services.

DMP set up fees:

For and , ORG's set up fee is $ and for each creditor, the service fee is $ with a maximum of $. For State, ORG's set up fee is $0 and 8% of monthly payments with a maximum of $. For State, the set up fee is $ and for each creditor, the service fee is $ with a maximum of $. These amounts and fees were stated during the initial interview. No further information has been provided with respect to the remainder of the United States.

Lead Providers:

ORG purchased leads for its DMP client's information from various companies such as CO-13 (Internet advertising), CO-14, CO-15, CO-16, CO-17, CO-18, CO-19, CO-20, CO-21, CO-22, CO-23, and CO-24

During the initial audit interview with President and BM-1, both indicated ORG uses the Leads 360 software system where leads are input from ORG's own website and from other lead purchases. The system also has an online chat feature similar to America Online's ("AOL") Instant Messager. ORG's other software system is CO-2. The system contains both client information and creditor information. Based upon information entered, the system automatically calculates the payments and lowers interest rate as applicable, per the information stored in its creditor information databases.

The software is also integrated with a third party electronic signature software called , that has an E-Signature screen where the clients can e-sign the application. For ORG's clients, the screen is in blue color. For clients from CO-6, the screen is in red color. The software system also features a screentab where conversations with clients are recorded in the "Action Description Section".

For the years under examination, ORG incurred the following amounts on lead purchases:

Year	12/31/20XX	12/31/20XX	12/31/20XX
Amount			

In 20XX, ORG had signed an agreement with CO-6 to provide back-office processing to its clients. ORG had reduced its purchases on leads.

Contract with CO-6:

On April 4, 20XX, ORG entered into an agreement with CO-6 ("CO-6") to provide financial literacy education, debt management planning and back-office processing services on an outsourced basis for CO-6's clients ("Client(s)"). Section 3 of the agreement called for ORG's obligations to CO-6 ("Law Firm"). The following had been quoted from that section:

> *"3. Obligations of ORG*
> *3.1 ORG shall provide financial literacy education, debt management planning and back-office processing services for Clients. ORG's obligations shall consist substantially of the following: (i) preparing a proposal to creditors reflecting the budget plan approved by Client; (ii) communicating the proposal to the creditors; (iii) ascertaining from creditors whether changes in the proposal are necessary or appropriate; (iv) communicating the creditors' suggested changes to the proposal to the Law Firm so that the Law Firm can educate and counsel Client regarding the suggested changes; (v) obtaining Client's approval to any changes to the budget plan negotiated with creditors; (vi) receiving, depositing, and disbursing Client budget plan payments and refunds; (vii) responding promptly to Client inquiries regarding disbursements and balances; (viii) receiving claims from Clients for refunds, promptly communicating those claims to Law Firm, and disbursing any refunds approved by Law Firm; (ix) responding promptly to Client, creditor, and Law Firm inquiries about budget plan payments; (x) maintaining a current information database, accessible by Law Firm, respecting budget plan payments; (xi) providing Law Firm with a ORG employee to act as an Law Firm liaison respecting all matters under this Agreement; (xii) providing separate creditor and Client telephone and facsimile access numbers; (xiii) generating all client and creditor letters and other communications necessary or appropriate for the implementation of Client budget plans; (xiv) enabling Client inquiries through a unique web based link to ORG; (xv) providing Law Firm with a web module to enable Clients to have real time access to their payment and disbursement records and to permit the update of their personal information; (xvi) soliciting support payments from creditors; (xvii) mailing Clients quarterly a summary of their current payment and disbursement records; and (xviii) providing ongoing financial literacy education…"*

Section 4 of the agreement defines the compensation for ORG. Section 4.1 of the agreement states,

> *"4.1 As full compensation for the services to be performed by ORG hereunder, Law Firm shall pay ORG a fee equal to $ per Client per month, commencing in the first month of the DMP. ORG shall be authorized to debit such fees from the attorney escrow account."*

The above agreement does not have a section to explain in detail what financial literacy education consists of or the method of delivery.

ORG's Management Review Reports:

During the course of the examination, ORG also provided its management review reports for June 28, 20XX, December 22, 20XX, March 15, 20XX, and September 8, 20XX. The following portions are excerpted from the Quality Objectives sections of the reports. In the report dated December 22, 20XX, the report called for having 4,000 total recurring clients at the end of the year, and maintaining a retention rate above 62% in 20XX. In the report dated March 15, 20XX, the report called for having 7,000 recurring clients at the end of the year, and increasing the conversion rate to 8%. In the report dated September 8, 20XX, the report also called for having 7,000 recurring clients at the end of the year, increasing the conversion rate to 8%, and having the average number of clients enrolled in debt management plans ("DMP") per counselor at 15 or greater. These reports did not discuss in any detail CCCI's education department or how ORG's credit counselors would educate the DMP clients.

ORG's number of employees:

For the years under examination, ORG's number of employees underwent a reduction from 38 employees to 23 employees. Two of these employees were Counselors. The remaining employees were Customer Service Representatives, Customer Service Supervisors, Administrators, Creditor Relations Representatives, the Director of Operations, and the Director of Educational Services. At the time of the initial audit visitation at ORG's office in May 20XX, the total number of employee had been reduced to 20.

ORG's employee qualifications:

ORG provided three positions for its employee qualifications. The information is hereby quoted:

"Entry level positions for Counselors, Administrators, and Customer Service Representatives:

- *6 months experience at a position similar to position available.*
- *High School Diploma*
- *Bilinguals in Spanish and English (occasionally)*

Supervisor positions for Systems Administrators and Customer Service Supervisors:

- *2 years experience at a position similar to position available.*
- *High School Diploma*
- *Bilingual in Spanish and English (occasionally)*

Key Employee positions for Directors and Managers:

- *3 years experience at a position similar to position available*
- *2 years experience in Finance industry*
- *High School Diploma"*

When asked for the advertisements that ORG used for hiring different job positions, ORG provided two advertisements, one for Credit Counseling Customer Service Representative and the other for Administrative Assistant.

The advertisement for Credit Counseling Customer Service Representative is as follows:

"Customer Service Representatives needed for rapidly growing Credit Counseling Company!!! We're looking to hire 2 representatives ASAP. Candidates must possess the following skills:

* *Strong Communication Skills*
* *Good Work Ethic*
* *Positive Attitude*
* *Enjoys helping people*

Daily duties are communicating with clients on debt management program and with their credit card companies. Heavy Inbound & Outbound calls. Fun work environment! Come join our team and help thousands of our clients become debt free!

$-$ per hour (based on experience). Full time only. 7am-4pm or 8am-5pm. Medical, Dental, 401K benefits. Paid Training.

Please email resume. Visit website for more information about our company."

The advertisement for Administrative Assistant is as follows:

"Administrative Assistant needed for rapidly growing Credit Counseling Company!!! Candidates must possess the following skills:

* *Strong Communication skills*
* *Good Work Ethic*
* *Positive Attitude*
* *Enjoys helping people*
* *Must have basic computer knowledge (Microsoft Office)*

Daily duties are data entry, filing and supporting Customer Service staff.

$ per hour. Full time only. 8am-5pm. Medical, Dental, 401K benefits. Paid Training.

Please email resume. Visit website for more information about our company."

ORG did not provide an advertisement for the counselor job position.

<u>Bonuses and incentives:</u>

For the years under examination, ORG paid bonuses, incentives, and commissions to its employees. The following table lists a breakdown of amounts for each category from the general ledgers for the three years:

	20XX	20XX	20XX
Bonus			
Bonus/Incentive			
Commission			
Wages-sales			
Total			

When asked how the bonuses and incentives were determined, ORG responded by stating,

> *"Bonus and Incentives were determined using the following criteria:*
>
> *For employees other than management we graded employees 0 – 10, with 10 being the highest on four (4) areas. i) Productivity ii) Punctuality/Dependability iii) Work Ethic iv) Attitude.*
>
> *For management the Board used CO-3's Credit Counseling Industry Compensation Study as a guide."*

When asked for the amounts of bonuses and incentives that ORG's officers received for 20XX and 20XX, ORG provided the following amounts:

	20XX	20XX
RA-1		
RA-2		
BM-1		
Secretary		

Based on the sample employee evaluations that were received during the initial office visit, ORG did not rate the employees with the aforementioned grade system for 20XX and 20XX. The grade system was started in 20XX. From the data presented in the general ledgers, ORG had used other incentive system(s) to pay bonuses, commissions, and incentives to its employees. ORG has to date not provided documentation of the methodology behind the determination of the bonuses and incentives paid to the employees for the three years.

<u>ORG's training materials:</u>

ORG provided the PowerPoint handout that it uses to train its employees. ORG stated the benefits of its credit counseling/Debt Management Program are:

"1. *Lower Interest Rates!!!*
2. *Possible Lower Monthly Payment*
3. *One Convenient Payment*
4. *Debt Free in 3-5 years*
5. *Eliminate Late and Overlimit Fees (if behind)*
6. *Stop Harassing Phone Calls (if behind)*
7. *Re-age accounts (if behind)"*

In order to be in the DMP, the client needs to make the following qualifications:

"1. $,000 total debt
2. Unsecured debt- No collateral
3. Payments with creditors are current to 3 (up to 6) months behind (Not charged off)
4. High Average Interest Rates (12% or higher)
5. Monthly Income Source (Employed)"

For Ideal Client, the following are the criteria:

"1. $,000 total debt
2. Credit Card debt
3. Payments with creditors are current to one month behind
4. High Average Interest Rates (20% or higher)
5. Monthly Income Source (Employed)"

In this PowerPoint, Debt Settlement and Negotiation Benefits are also mentioned. ORG pointed out six benefit areas to its employees and they are:

"1. Lower Monthly Payment (typically lower than credit counseling)
2. Only pay about 40-50% of total debt owed
3. Debt Free in typically 1-3 years
4. Resolve Financial situation without filing bankruptcy
5. One Convenient Payment
6. Stop Harassing phone calls"

The ideal client for Debt Settlement/Negotiation would be:

"1. $0,000 total debt
2. Unsecured Debt- No collateral
3. Client is 3 months or more behind with payments
4. Can't afford payment on own
5. Can't afford Credit Counseling payment
6. Client is not concerned with Credit Rating"

In the PowerPoint handout, seven options that clients can consider paying off their debts are also mentioned. The seven options are as follows:

"1. Continue to Pay On Own
2. Refinance Home/Use Equity to pay off
3. Credit Counseling/Debt Management Program
4. Debt Settlement
5. File Bankruptcy
6. Get an Unsecured Personal Loan
7. Sell Assets"

ORG's other employee training manual is called "   ". Page 3 of this training manual provides scripts for outgoing calls made by the credit counselors. The manual provides scripts for the counselors to follow from the initial call to the final call made to individuals. One script for final calls deals with individuals who submitted the application online a while ago and the counselor makes one last call to the individuals regarding their applications. This page of the training manual is called “Leaving Message for Client”. The first three calls provide statements as follows:

> *“Hello,….I am calling regarding your online inquiry for assistance with bills…..”*

For the Fourth Call, the script is as follows:

> *“Hello,….; this is a final message for ____. You had contacted us regarding one of our debt management programs, and I have left you several messages. Unfortunately, if I do not receive a call back, I am instructed to withdraw your application. I look forward to helping you, but I need you to return my call……..”*

Page 4 of the training manual provides the “Initial Client Contact” instruction. In the beginning of the conversation, the counselor would ask the individual about his/her financial situation and the reason for applying with ORG. After the counselor gets a sense of the individual's situation, the counselor would ask how soon would the individual look to change his/her current situation. The counselor would then proceed by giving the seven options from which the individual would choose. After that, the counselor would mention about giving the individual a free financial analysis. After the financial analysis, the counselor would then be directed to state the following:

> *“Great. I have submitted your information to our credit department and should have the analysis complete in about 5 minutes. So while the credit department is working on your file, let me tell about our Debt Management Program that we offer at ORG.* ***GO TO DMP Presentation.***
>
> *IF NO:*
> *When do you think you would be able to get your statements? (Offer to email Creditor Worksheet to client if client wants to fill out their own time, otherwise set up time and date to call them back.) In the meantime, let me explain how our Debt Management Program works.* ***GO TO DMP Presentation.***
>
> ***(If client request for you to mail the form)*** *No! the form is in our computer system and I can't mail it. I have to email them to you. If you don't have email, what I can do is call you back tomorrow when you have your statements and we can do the evaluation over the phone. Does that sound good to you?”*

Page 5 of the training manual provides the seven options of handling one's debt. The options are:

1. Continue to handle the debt on your own
2. Debt management plan/credit counseling
3. Bankruptcy
4. Debt Settlement/Negotiation
5. Home refinance/Home equity loan
6. Personal loan/Signature loan/Balance transfer
7. Selling some of your assets such as stocks, car, home, etc.

Page 8 of the training manual provides the DMP Presentation script, hereby quoted, *"With our Debt Management Program, we're able to do is to consolidate all of your UNSECURED BILLS into one simple payment. So that once a month you would only have to make one payment to our company and we would disburse individual payments to each of your creditors on your behalf. As you pay your bills through our company, we are able to gain certain benefits from your creditors to help save money.*

The most important thing the creditors will do for you on this program is reduce the interest rates they are charging you which will allow much more of your money to go to the balances.

Also, sometimes we're able to lower the amount of money you are spending monthly. It's all what the creditors are willing to do. And lastly, we will be able to simplify your bill paying process so you will only have one monthly payment. ***How nice will it be to have only one payment? Any questions, before I continue?***

*****IF BEHIND**:*** *Another important benefit for you is to bring your accounts back to a current status so you don't have to make up the back payments or late fees. Most of the creditors we work with will do this for you.* ***Do you agree that this is important? (Pause) Are you getting Harassing calls?*** *If yes, most of the time we can get those calls stopped. We also provide a number for you to give to your creditors to have them call us.* ***How great will that be for you to get those alls stopped or sent to us?***

What you need to do on your end is simply make that one payment each month on time to our company. This will allow us to maintain your accounts properly, and the end result is we will have you out of debt much faster on our program than the direction you are going. That's what we do.

Does that make sense on how the program works?
What we're doing for you is putting you into a position where we can get you out of debt as quickly and safely as possible.
Now based on what I mentioned about our program, which of these benefits do you feel are most important to you?

IF YOU ALREADY HAVE CREDITOR INFORMATION/STATEMENTS: Go to PRESENTING THE BEST OPTIONS:.."

Page 9 of the training manual provides the presentation of the best options. It states,

"<u>Presenting the Best Options</u>

Once you have analyzed all of the data, give the client at least 2 possible solutions including the pros & cons of each.

From all of the information that you've given me, it looks like you have __ options. Turn to the appropriate page on read the pros and cons of each. If applicable continue on to the Pitching the DMP.

<u>Pitching the DMP</u>

Go over the appropriate benefits of the program for this client!

(Read one of the following, A to D)

O.K. I just got the results back from the credit department. .....You have an average of interest rate of ___%. That means that you are paying $___in finance charges per year. (Show alarming examples of creditors with high payoff periods. Have them take out a calculator – Show them what their monthly finance charge is, amount going to balance, and how long it will take them to get out of debt.)

Do you see why we need to make an immediate change to your situation?

Now let me go over with you what we can do for you on our Debt Management Program...

A. *When client's PAYMENT GOES DOWN A LOT:*
Okay, what we were able to do is get your monthly payment down (a lot) from what you were paying, and it's going to take less time to get it paid off because of the reduced interest! (If they ask "what reduced interest", give an example or two, then GO TO FINAL INSTRUCTIONS)

B. *When client is more than 2 months BEHIND, they are most concerned with getting calls from the creditors:*
Okay, the great thing about working with us is that you're not going to have to worry about making back payments or late fees with most of these creditors. And the creditors that are calling you, once we get you in our system, simply tell them you've hired us as your debt management company and refer them to us and we'll handle them for you. (GO TO FINAL INSTRUCTIONS)

C. *When client's INTEREST RATES ARE REDUCED, or their payment hasn't been lowered enough to use letter A.(Above):*
Okay, what we are able to do is to get your interest rates down a lot from what they were charging you. This will allow your balance to come down much faster, and you'll see that right on the statements you get in the mail from the creditors. A couple of examples being (creditor) will go down to as low as (percentage) and (creditor) will go down to as low as (percentage) (GO TO FINAL INSTRUCTIONS)

Do you see the great savings in interest? *..."*

ORG also provided a CD, which had a training schedule for September and October 20XX. The September training had only one day and the October training's duration was three weeks. The training outline for the September schedule mentions in one section why ORG hired the individual and what was ORG's expectation of them. One area of expectation was that the new hire employees must have at least 100 phone calls and have 2.5 hours of calls each day. The training outline mentions why ORG was in business and one of the four reasons was to make money.

Another area from the training outline mentions the opportunities within ORG. Some of the opportunities within ORG would be to do processing for other companies, possible debt settlement, credit repair, buying out other debt management companies where the sky is the limit. Another area mentions what ORG does and how it helps the clients. ORG helps to get clients out of debt in 3-5 years vs. 20-25 years, reduce their credit card interest rates, lower their payments, stop and/or waive over-limit and late fees, stop harassing phone calls and so forth.

For the October Training Schedule, the second week of the training consists of having the new counselors sign up ten DMP appointments. The third week of the training involves closing the deals and going through paperwork.

From the training manuals and training schedules, ORG does not mention its education service nor does it instruct its counselors about how its education service works, where the clients can get its educational materials, seminars, and/or other information. These training materials also do not contain any sections on instructing the counselors on how to conduct follow up contacts to its clients for the purposes of educating them so that they will not encounter the same difficulties in the future. From ORG's Frequently Asked Questions in the training manuals, ORG does not shut down its client's entire line of credit, thus the client still has access to credit.

<u>ORG's Employee Evaluations and Training:</u>

ORG was requested to provide a sample of twelve employee files to review. Five of the twelve employees were former employees. From their personnel files, four former employees had only training records and no annual evaluations. One former employee had a 20XX review. ORG evaluated him on four areas: Sales, Punctuality/Dependability, Work Ethic, and Attitude. This employee was rated under the Sales Category as the second most sales in the office and was appraised by his supervisor as Excellent Salesman.

Another two employees of the twelve sampled are counselors. These employees were rewarded with commissions when they reached the sales average goal. ORG used a "Review" sheet for the employees that focused on four areas: Sales, Punctuality/Dependability, Work Ethic, and Attitude. For 20XX, ORG used the same review report format but revised the title for the Sales Area to "Client Services/Production". Under this Category, the employee was being reviewed as to how he/she handles clients' calls. In the 20XX review, the individual employee was being evaluated as to the number of calls he/she handled per month.

For 20XX, ORG's review report continued to focus on the four areas for the counselors: Productivity, Punctuality/Dependability, Work Ethic, and Attitude. In 20XX, the employee was being rated with a score. Under Productivity, the employee was rated with Strengths and Weaknesses for the number of clients enrolled into the DMP program. As an example, one employee was rated for as weak in a category when she did not meet the goal of signing up 20 clients per month. Her supervisor evaluated her in her annual review as follows:

> "(*Name intentionally omitted*) has fallen shy of our goal (20 deals per month) for 20XX. Her average from 9/XX through the end of 8/XX was 15.8 deals per month. She needs to work on learning new (and old) processes quicker. (*Name intentionally omitted*) frequently asks the same questions over and over. QA Scores for 20XX are below the target 90% - currently at 85% for the year."

The same individual was rated under the Productivity Section for her strengths. Her evaluation stated:

> "Strengths: (*name intentionally omitted*) always seems to be motivated to enroll clients onto onto our program regardless if we are doing a contest or not. She average 3 deals more per month than (*name intentionally omitted*). (*Name intentionally omitted*) does a great job encouraging clients to get signed up for APS. Her QA scores continue to improve – 93% for 3rd Quarter 20XX."

Of the remaining five employees from the twelve sampled, one was in Client Services and was rated by using the four criteria but was not rated based on the number of calls she received to see whether she met ORG's goal of how many calls per month. The other four employees were new employees at the time the initial visit was conducted at the office of ORG; their evaluations were not due at that time.

From the sampled employee personnel files, ORG provided annual training for its employees on ORG's Quality Objectives. No detailed documentation was in the files concerning the quality objectives that were used to train the employees. No detailed documentation was contained in the files showing how the counselors were trained in handling different financial difficulties of the clients. Per the evaluations, the counselors were not being evaluated based on how thoroughly and effectively they developed and presented options to match the particular circumstances of each client.

<u>ORG's Education:</u>

For the years under examination, ORG's current director of Education Department, Secretary, conducted educational presentations via the phone, as a guest speaker to various high schools within the City area. The presentations were not a part of the school curriculum. Secretary is certified with NACCC. He also received 2-day training from HUD for the housing counseling.

At the time of the interview with Secretary, he had also finished half of the training from CO-25 for pre-purchase housing counseling and for 1st Time Homebuyer training. Secretary also designed ORG's educational newsletters. In 20XX, Secretary was invited to be a guest speaker (via phone) for approximately 35 high school economics classes at various high schools in City area communities. In 20XX, Secretary was invited to be a guest speaker (via phone) for approximately 55 various high school economics classes in City area communities.

In general, RA-3 and RA-4, the credit counselors, were able to provide general answers for financial questions from clients, from individuals who were not in the DMP program, and from states to which ORG did not provide services. When clients had more complicated questions, they would be referred to Secretary.

Sometimes RA-3 and RA-4 would ask Secretary for his second opinion on their clients' financial matters. The counselors would keep brief notes from their conversations and gave them to Secretary. Some of these forms indicated the counselors suggested debt settlement as the only option to the callers. Secretary kept the counselors' phone consultations starting September 14, 20XX. These calls normally lasted around 20 minutes. During the initial office visit, Secretary provided the consultations form for 20XX and 20XX.

Secretary normally also gets calls from DMP clients on questions regarding their credit reports. He assisted them in the dispute process, on their credit report evaluations, and advised them on plans to improve their credit. He also conducted a few exit calls by advising the existing clients for the extra money they now has to start up a saving/emergency fund, so they could achieve short term and/or long term goals.

During the initial visit, Secretary provided a list of individual names with whom he spoke. For 20XX, the reports were divided into specific areas such as Bankruptcy Education Sessions 20XX, Debt Settlement Education Sessions 20XX, Charge-Off Education Sessions 20XX, Refinance Education Sessions 20XX, Credit Report Education Sessions 20XX, Student Loans Education Sessions 20XX, Budgeting Education Sessions 20XX, and Debt Pay-off Strategies Education Sessions 20XX.

ORG did not have these reports for 20XX. From the reports, the status of the majority of the individuals with whom Secretary spoke with was classified "Dead", "Return Lead", "Recycled", and so forth. When asked for the explanations of these statuses, ORG indicated the status meant,

> *"DEAD: A status code for a consumer who previously expressed interest in any of our service and is no longer unreachable via phone/email OR has notified us that they do not need our services.*
>
> *RETURN LEAD: A status code for a consumer who does not reside in a State we conduct business in OR does not fit the criteria of the services we offer.*
>
> *RECYCLED: A status code for a consumer who has a lukewarm interest in our services and did not have the time to go through an entire budget analysis and needs to be followed up at a future date…"*

The reports provided by Secretary did not explain in detail as to how Secretary educated these individuals who were not in the DMP program.

In early 20XX, ORG started a program named "FUND-1" to educate young adults on financial literacy. The goal was to educate young people and encourage them to become financially responsible adults. This program was opened to the community, to which they could invite Secretary to speak for the high school students on financial education.

This program also featured an essay-writing contest for high school seniors who planned to attend college or other type of continuing education. This program was offered to high schools free of charge. ORG also awarded ten $00 scholarships in the 20XX-20XX school years for young adults attending any of sixteen local high schools and colleges.

In 20XX and 20XX, ORG conducted golf tournament for fundraising for the FUND-1 scholarship program and revenue raised from the golf tournament was less than $ per year.

<u>Financial Data:</u>

ORG's Profit and Loss Statement for these three years were as follows:

<u>Revenue</u>	<u>20XX</u>	<u>20XX</u>	<u>20XX</u>
Fair Share contributions			
Service Fee Income			
Waves of the Future revenue			
Interest Income			
Total Revenue			
<u>Expenses</u>			
Compensation			
Marketing			
Rent			

Education
Other Expenses
Total Expenses

The total net income or net loss for the three years is as follows:

Category	20XX	20XX	20XX
Total Revenue			
Total Expense			
Net Loss/or Net Inc.			

ORG's Balance Sheet for these three years consisted of the following:

Category	20XX	20XX	20XX
Cash			
Client Trust Funds			
Receivables			
Officer Loan Receivable			
Fixed Assets			
Deposits			
Employee Advances			
Total Assets			
Accounts Payable			
Accrued Expenses			
Client creditor payables			
Long Term Liabilities			
Total Liabilities			

For the years under examination, ORG had the following accounts:

Name	Account #	Type	Year closed
CO-26		Operating Account	
CO-1 (Creditor 1)		Checking Account	20XX
CO-1 (Creditor 2)		Checking Account	20XX
CO-1 (Operating Acct)		Operating Account	20XX
Signature		Operating Account	
Signature		Creditor 1	
Signature		Creditor 2	
CO-26		FUND-1	

Loans between ORG and officer:

From ORG's inception, President had lent money to ORG to start up its operation. In 20XX, ORG's general ledgers designated two accounts, one called "Temporary Promissory Note" and the other called "20XX Promissory Note" to record transactions of money flowing in and out of ORG's operating account between President and ORG. Per ORG's response to a question about the accrued interest, as of the beginning of 20XX, the accrued interest for the 20XX promissory note was overstated by $. For 20XX and 20XX, no explanation or supporting documentation has been provided to date for the entries made during these two years. The entries that were recorded for the reported liabilities between ORG and President in the general ledger have not been verified for accuracy.

LAW

Section 501(a) of the Internal Revenue Code provides that an organization described in section 501(c)(3) is exempt from income tax. Section 501(c)(3) of the Code exempts from federal income tax corporations organized and operated exclusively for charitable, educational, and other purposes, provided that no part of the net earnings inure to the benefit of any private shareholder or individual. The term charitable includes relief of the poor and distressed. Section 1.501(c)(3)-1(d)(2), Income Tax Regulations.

The term educational includes (a) instruction or training of the individual for the purpose of improving or developing his capabilities and (b) instruction of the public on subjects useful to the individual and beneficial to the community-Treas. Reg. § 1.501(c)(3)-1(d)(3). In other words, the two components of education are public education and individual training.

Section 1.501(c)(3)-1(a)(1) of the regulations provides that, in order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

In Better Business Bureau of Washington, D.C. v. U.S., 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, would destroy the exemption regardless of the number or importance of truly exempt purposes. The Court found that the trade association had an "underlying commercial motive" that distinguished its educational program from that carried out by a university.

In American Institute for Economic Research v. United States, 302 F. 2d 934 (Ct. Cl. 1962), the Court considered the status of an organization that provided analyses of securities and industries and of the economic climate in general. The organization sold subscriptions to various periodicals and services providing advice for purchases of individual securities. Although the court noted that education is a broad concept, and assumed for the sake of argument that the organization had an educational purpose, it held that the organization had a significant non-exempt commercial purpose that was not incidental to the educational purpose and was not entitled to be regarded as exempt.

An organization must establish that it serves a public rather than a private interest and "that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests", Income Tax Reg. § 1.501(c)(3)-1(d)(1)(ii).Prohibited private interests include those of unrelated third parties as well as insiders, Christian Stewardship Assistance, Inc. v. Commissioner, 70 T.C. 1037 (1978); American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989). Private benefits include an "advantage; profit; fruit; privilege; gain; [or] interest." Retired Teachers Legal Fund v. Commissioner, 78 T.C. 280, 286 (1982).

An organization formed to educate people in Hawaii in the theory and practice of "est" was determined by the Tax Court to a part of a "franchise system which is operated for private benefit," and, therefore, should not be recognized as exempt under section 501(c)(3) of the Code, est of Hawaii v. Commissioner, 71 T.C. 1067, 1080 (1979). A for-profit entity owned the license to the "est" body of knowledge, publications, and methods. Although the organization was not formally controlled by the same individuals who controlled the for-profit entity, it exerted considerable control over the applicant's activities by setting pricing, the number and frequency of different kinds of seminars and training, and providing the trainers and management personnel who are responsible to it. The court stated that the fact that the organization's rights were dependent upon its tax-exempt status showed the likelihood that the for-profit entities were trading on that status. The question for the court was not whether the payments made to the for-profit were excessive, but whether the for-profit entity benefited substantially from the operation of the organization. The court determined that there was a substantial private benefit because the organization "was simply the instrument to subsidize the for-profit corporations and not vice versa and had no life independent of those corporations."

The Service has issued two rulings holding credit counseling organizations to be tax exempt. Rev. Rul. 65-299, 1965-2 C.B. 165, granted exemption to a 501(c)(4) organization whose purpose was to assist families and individuals with financial problems and to help reduce the incidence of personal bankruptcy. Its primary activity appears to have been meeting with people in financial difficulties to "analyze the specific problems involved and counsel on the payment of their debts." The organization also advised applicants on proration and payment of debts, negotiated with creditors and set up debt repayment plans. It did not restrict its services to the needy. It made no charge for the counseling services, indicating they were separate from the debt repayment arrangements. It made "a nominal charge" for monthly prorating services to cover postage and supplies. For financial support, it relied upon voluntary contributions from local businesses, lending agencies, and labor unions.

Rev. Rul. 69-441, 1969-2 C.B. 115, granted 501(c)(3) status to an organization with two functions: it educated the public on personal money management, using films, speakers, and publications, and provided individual counseling to "low-income individuals and families." As part of its counseling, it established budget plans, i.e., debt management plans, for some of its clients. The debt management services were provided without charge. The organization was supported by contributions primarily from creditors. By virtue of aiding low income people, without charge, as well as providing education to the public, the organization qualified for section 501(c)(3) status.

In the case of Consumer Credit Counseling Service of Alabama, Inc. v. U.S., 44 A.F.T.R.2d 78-5052 (D.D.C. 1978), the District Court for the District of Columbia held that a credit counseling organization qualified as charitable and educational under section 501(c)(3). It fulfilled charitable purposes by educating the public on subjects useful to the individual and beneficial to the community. Income Tax Reg. § 1.501(c)(3)-1(d)(3)(i)(b). For this, it charged no fee. The court found that the counseling programs were also educational and charitable; the debt management and creditor intercession activities were "an integral part" of the agencies' counseling function and thus were charitable and educational. Even if this were not the case, the court viewed the debt management and creditor intercession activities as incidental to the agencies' principal functions, as only approximately 12 percent of the counselors' time was applied to debt management programs and the charge for the service was "nominal." The court also considered the facts that the agency was publicly supported and that it had a board dominated by members of the general public as factors indicating a charitable operation. See also, Credit Counseling Centers of Oklahoma, Inc. v. United States, 79-2 U.S.T.C. 9468 (D.D.C. 1979), in which the facts and legal analysis were virtually identical to those in Consumer Credit Counseling Centers of Alabama, Inc. v. United States, discussed immediately above.

The organizations included in the above decision waived the monthly fees when the payments would work a financial hardship. The professional counselors employed by the organizations spent about 88 percent of their time in activities such as information dissemination and counseling assistance rather than those connected with the debt management programs. The primary sources of revenue for these organizations were provided by government and private foundation grants, contributions, and assistance from labor agencies and United Way.

Outside the context of credit counseling, individual counseling has in a number of instances, been held to be a tax-exempt charitable activity. Rev. Rul. 78-99, 1978-1 C.B. 152 (free individual and group counseling of widows); Rev. Rul. 76-205, 1976-1 C.B. 154 (free counseling and English instruction for immigrants); Rev. Rul. 73-569, 1973-2 C.B. 179 (free counseling to pregnant women); Rev. Rul. 70-590, 1970-2 C.B. 116 (clinic to help users of mind-altering drugs); Rev. Rul. 70-640, 1970-2 C.B. 117 (free marriage counseling); Rev. Rul. 68-71, 1968-1 C.B.249 (career planning education through free vocational counseling and publications sold at a nominal charge). Overwhelmingly, the counseling activities described in these rulings were provided free, and the organizations were supported by contributions from the public.

Internal Revenue Code section 501(c)(3) specifies that an exempt organization described therein is one in which "no part of the net of earnings inures to the benefit of any private shareholder or individual." The words "private shareholder or individual" in section 501 to refer to persons having a personal and private interest in the activities of the organization, Income Tax Reg. Section 1.501(a)-1(c). The inurement prohibition provision "is designed to prevent the siphoning of charitable receipts to insiders of the charity..." United Cancer Council v. Commissioner, 165 F.3d 1173 (7th Cir. 1999). Reasonable compensation does not constitute inurement, Birmingham Business College v. Commissioner, 276 F.2d 476, 480 (5th Cir. 1960).

Internal Revenue Code section 4942(j)(3) defines the term "operating foundation" as any organization

(A) which makes qualifying distributions (within the meaning of paragraph (1) or (2) of subsection (g) directly for the active conduct of the activities constituting the purpose or function for which it is organized and operated equal to substantially all of the lesser of (i) its adjusted net income (as defined in subsection (f)), or (ii) its minimum investment return; and

(B) (i) substantially more than half of the assets of which are devoted directly to such activities or to functionally related businesses (as defined in paragraph (4)), or to both, or are stock of a corporation which is controlled by the foundation and substantially all of the assets of which are so devoted,

(ii) which normally makes qualifying distributions (within the meaning of paragraph (1) or (2) of subsection (g)) directly for the active conduct of the activities constituting the purpose or function for which it is organized and operated in an amount not less than two-thirds of its minimum investment return (as defined in subsection (e)) or,

(iii) substantially all of the support (other than gross investment income as defined in section 509(e)) of which is normally received from the general public and from 5 or more exempt organizations which are not described in section 4946(a)(1)(H) with respect to each other or the recipient foundation; not more than 25 percent of the support (other than gross investment income) of which is normally received from any one such exempt organization; and not more than half of the support of which is normally received from gross investment income.

Notwithstanding the provisions of subparagraph (A), if the qualifying distributions (within the meaning of paragraph (1) or (2) of subsection (g)) of an organization for the taxable year exceed the minimum investment return for the taxable year, clause (ii) of subparagraph (A) shall not apply unless substantially all of such qualifying distributions are made directly for the active conduct of the activities constituting the purpose or function for which it is organized and operated.

Internal Revenue Code section 4942(g)(1) defines "Qualifying distributions" as,

(A) any amount (including that portion of reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in section 170(c)(2)(B), other than any contribution to (i) an organization controlled (directly or indirectly) by the foundation or one or more disqualified persons (as defined in section 4946) with respect to the foundation, except as provided in paragraph (3), or (ii) a private foundation which is not an operating foundation (as defined in subsection (j)(3)), except as provided in paragraph (3), or

(B) any amount paid to acquire an asset used (or held for use) directly in carrying out one or more purposes described in section 170(c)(2)(B).

TAXPAYER'S POSITION

ORG did not respond to the preliminary finding sent by the Service on September 25, 20XX.

GOVERNMENT'S POSITION

The Service contends that ORG has a more than insubstantial nonexempt purpose. ORG operates its DMP service as its primary activity. Therefore, its exemption status should be revoked.

Organizational facts:

In order for an organization to meet the requirements for exemption under Code section 501(c)(3), an organization has to meet both the organizational test and the operational test of Treasury Regulation 1.501(c)(3)-1 by operating exclusively for charitable, educational, and other purposes. ORG's application for recognition of exemption under Code section 501(c)(3) specifically stated that it would devote 60% of its time and effort into counseling activities. Per the application, ORG would advertise its services via yellow pages and other local media. ORG would receive referrals from clergy, employers, labor unions, and interested individuals. ORG also anticipated that 20% of its time and effort would go into budget planning. ORG met the organizational test for educational purpose based on the documentation originally provided. However, for the years under examination, ORG's main activity was to conduct DMP. DMP activity is not an exempt function activity. Therefore, ORG fails to be exempted under IRC 501(c)(3).

Board

For the years under examination, ORG does not have a community based board. The majority of the board of directors is comprised of individuals who are the founder and employees of ORG. The board does not have any individuals who are from a recognized community segment such as religious groups, civic groups, labor unions, or educational institutions.

Minutes

The main concern outlined in the minutes provided by ORG was to increase DMP clients. One method was to purchase existing DMP clients from other Code section 501(c)(3) organizations whose federal tax exempt status had been revoked. The board also discussed how to increase the number of DMP clients served through referrals from for-profit entities, such as CO-6 and CO-8. The latter was founded by President, ORG's President.

Financial

The revenue from the three years involved a total amount of $. ORG received almost all of its revenue from fair share from creditors and client service fees. ORG did not receive any private or governmental grants. ORG had predominantly relied on creditors' fair share and clients' fees for its operation. The golf tournament income was immaterial in comparison to the primary sources of income. In the minutes dated November 18, 20XX, the board mentioned it had researched and hired CO-5 to provide grant-writing services just to satisfy IRS requirements of seeking alternative sources of income. There were no subsequent follow up actions taken by the board on pursuing grants. ORG has also failed to demonstrate that it has extensively pursued public funding in supporting its activities.

For these three years, ORG also purchased leads to generate DMP clients. ORG paid a total of $ to lead providers and listed these expenses as marketing expenses on its Forms 990. In 20XX, ORG had completely relied on purchasing leads from various marketing companies to obtain all of its clients. In 20XX, ORG purchased DMP clients from CO-4 In 20XX, ORG entered into an agreement with CO-6 to provide backend office processing services for CO-6's existing clients who were enrolled into the DMP program. From the 20XX minutes, ORG even received deals from CO-8 (owned by ORG's President.) ORG has failed to demonstrate that its clients were referred from employers, union leaders, clergymen, community organizations, or creditors.

For these three years, ORG spent from $ to $ on educational expenses while its revenue was derived from $ to $. ORG spent an insignificant amount of money toward its educational activity.

DMP

In all of the minutes, the board primarily concentrated on the issue of getting more DMP clients, whether by acquiring clients from revoked Code section 501(c)(3) organizations, from for profit entities, or by increased advertising. The board focused on increasing personnel to handle the workload caused by adding more DMP clients. For example, the acquisition of existing DMP clients from CO-4 was mentioned four times from the minutes dated November 20XX, through the minutes dated February 13, 20XX. However, there were no discussions of how ORG would provide educational counseling to this group of DMP clients.

In 20XX, ORG had a deal with CO-6 to process credit counseling deals for the law group. ORG added around 4,000 clients under this deal and generated around 300 to 1,000 clients per month. In 20XX, the board discussed receiving 15 to 20 deals per day from CO-8. Some of ORG's employees also performed services for CO-8, as reported to the IRS. The extent to which the private interests of its founder's related for-profit entity were served by ORG was more than incidental, and was in fact substantial.

The discussion on education was only mentioned in the minutes dated February 2, 20XX, and May 13, 20XX, which stated that the IRS had explained that education and counseling should be the first priority and DMP should be secondary. Because of the concerns, ORG's board had decided to look into expanding its education department. In the February 18, 20XX, minutes it mentioned about diversification of ORG's educational programs. However, there was no detailed discussion as to what actions ORG planned to take to expand this department.

From the agreement ORG has with CO-6, ORG's function is to provide back-office processing services for CO-6's clients. Even though the agreement mentioned that ORG would provide financial literacy education, there was no section in the agreement, which defined the method(s) that ORG would use to deliver the financial literacy education.

From the minutes provided, ORG is and was focused on acquiring more DMP clients either through purchasing existing clients from other organizations, getting referrals from the law firm, or from the related (via the founder) for-profit entity. From ORG's Management Review Reports provided for 20XX and 20XX, under the Quality Objectives, ORG's management evaluated its DMP operation in areas such as the percentage of retention rate, the conversion rate, and the average number of clients enrolled per counselor. ORG has steered itself away from its original intention of providing education.

As previously mentioned ORG also purchased leads with the intention of increasing enrollment in its DMP program. ORG has failed to provide data showing whether the individuals who ORG contacted were referred from clergy, employers, labor unions, finance companies, creditors, and interested individuals.

ORG's DMP program is substantial as compared to its overall activity. Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations specified that in order to be exempt as an organization in Section 501(c)(3) of the Code, an organization has to be organized and operated exclusively for charitable, educational, and other specified purposes. The DMP program itself it not an exempt activity. ORG's DMP program was the principal activity of ORG for these years. As stated in Better Business Bureau v US, 326 U.S. 279 (1945), the existence of a substantial nonexempt purpose, regardless of the number or importance of exempt purposes, will cause failure of the operational test. Furthermore, ORG served the private interests of CO-8 by receiving clients from it and performing services for this entity.

Thirty client notes were sampled during the initial visit at ORG's office. From the clients' notes, there were no discussions made by the counselors on areas regarding the clients' employment, education, buying habits, spending patterns, or changes in the clients' earnings and expenses. There were no written recommendations from the counselors regarding various options presented by the counselors to the clients addressing their debt problems. Furthermore, there was no documentation showing any discussion on advantages and disadvantages of various options or any recommendations regarding the best option that was suitable to the client's particular situation, other than DMP. ORG has failed to demonstrate how its counselors provide educational advice to its DMP clients.

From the eight recording calls, ORG's counselors emphasized the benefits of DMP because of lower interest rate and paying off the debts faster by asking the clients to fill out creditor worksheet so the counselors can show them the different payment and how the clients could save money. ORG's counselors presented the seven options to the clients without going into detail discussions to find out how the clients got into the financial situations they were in. From these calls, the counselors did not address the clients' budget and finances, there was no discussion on the clients' employment, education, buying habits, significant expenditures, and past or anticipated changes in their earnings, assets, expenses and liabilities, including the reason or cause for those changes. All the calls lasted around fifteen to twenty minutes. In some of the calls, ORG mentioned to the callers that ORG also worked with an affiliated debt settlement company so the callers could keep in mind if they decided to choose debt settlement option later on. ORG has failed to provide educational counseling sessions to the callers since the counselors placed so much emphasis on how much money the callers could save by having lower interest rate and shorter term payments.

From the different job position descriptions for counselors, administrators, and customer service representatives, and its advertisements for the various job positions, the requirements were minimalistic. None of the positions required any specialized education or skill sets. For example, entry-level counselors, administrators, and customer service representatives had the same employee qualification requirement: six months experience at a position similar to the available position, a high school diploma, and being bilingual. For the years under examination, ORG only had two counselors out of the total 23 employees. Majority of the employees was Customer Service Representative, Customer Service Supervisors, Administrators, and Creditor Relations Representatives.

There was no specific advanced educational or skill set requirement for the counselors who are supposed to educate the potential DMP clients to avoid the same pitfalls in the future. When asked for the advertisements for various job positions, ORG only provided the advertisements for Customer Service Representative and Administrative Assistant; there was none for counselors.

From the twelve employees personnel files that were requested for sample review, ORG evaluated its employees based on number of calls he/or she made and how many DMP deals he/or she could generate from these calls. The counselors were being rated based on the goal of closing a certain number of deals per month. In the files, the employees were documented as to whether they met the Quality Objectives, but no documentation was provided as to what these objectives were.

ORG also provided bonuses, incentive, commissions, and sales for these three years. ORG stated that the bonuses and incentives were determined based on productivity, punctuality/dependability, work ethic, and attitude. However, this grading system was not used until the 20XX year. ORG did not provide the criteria or the bonuses that were determined in the earlier years. The counselors were not evaluated based on how thoroughly and effectively they develop and presented debt resolution options to match the particular circumstances of each client.

During the course of the examination, ORG provided a CD with the training schedule for the new hires in 20XX. The training schedule required the new employees to have at least 100 phone calls each day. The training outline also mentioned that ORG was in business to make money. The new hires are not being trained to have counseling skills to help potential clients. They are trained to handle large volumes of short calls and sign individuals into its DMP program.

From ORG's PowerPoint handout for new employee training, the emphasis in client communications is about the benefits of enrollment in debt management plans. From another employee training manual called " ", during the potential client's wait for the financial analysis come back from ORG's credit department, the counselor is directed to pitch the DMP to the potential client at this time and stress the benefits of ORG's DMP program as stated in the PowerPoint handout. manual also directs the counselor as to what to say in specific situations, all involving debt management plans.

ORG does not have any training manuals to train the counselors how to review the potential client's budget and discuss with clients on topics such as employment, education, buying habits, major expenditures, any significant past or anticipated changes in their earnings, assets, expenses and liabilities, or the causes for these changes.

ORG's Perfect Credit Counselor manual contains seven standard options that the counselors would mention to the potential clients to handle his/or her debts. However, after the counselor gathered enough information from the potential clients to prepare the budget analysis, the counselor was instructed to go to the DMP Presentation. The emphasis in the manual was DMP oriented. There was nothing in the manual to instruct the counselors in how to educate the potential clients to avoid falling into the same pitfalls in the future.

Outreach education

For the years under examination, even though ORG provided financial literacy within the community by having Secretary as a guest speaker to various high schools, and having Secretary design ORG's educational newsletters, the educational aspect of ORG constitutes an insubstantial portion of ORG's overall operation.

From the phone consultation form records from 20XX and 20XX and the assistance that Secretary provided for the counselors, there was no detail in these records showing whether the counselors asked for detailed information from the potential clients or clients about the type, amount, or sources of all significant items of income, assets, liabilities, or expenses. There was no detailed record from these forms showing how the counselors might interview these individuals about their budget and finances, discuss topics including their employment, education, buying habits, significant expenditures or any significant past or anticipated changes in their earnings, assets, expenses and liabilities or reasons for these changes.

Some of these forms indicated the counselors recommend debt settlement but no explanation was given as to why debt settlement was the best option for the callers. Since most of these calls lasted around 20 minutes, the duration of these calls could not possibly allow the counselors to gather enough information to provide a full scope counseling session.

From the reports provided by Secretary for 20XX, that he spoke with the individuals in areas such as bankruptcy education, debt settlement education, charge-off education, refinance education, credit report education, student loans education, budgeting education, and debt pay-off strategies education, ORG did not provide any detailed information showing what was being discussed in these calls or what kind of information Secretary provided to them. Due to lack of documentation, ORG fails to demonstrate how it provided counseling to these individuals.

CONCLUSION

In summary, ORG was not operated exclusively for exempt purposes within the meaning of Code section 501(c)(3). ORG failed the operational test by engaging primarily in activities that served no exempt purpose. Operation of a debt-management plan program is not in itself an exempt activity. Such activity, if insubstantial, and conducted in conjunction with a full course of budget planning, financial analysis, counseling, by an organization whose board was dominated by members of the general public, and publicly supported through grants and actual donations, would traditionally be considered incidental by the courts. In contrast, the majority of time, staffing, and resources were devoted to the DMP activity.

ORG additionally provided more than incidental private benefit to a for-profit entity owned by its president, thus creating inurement to President. CO-8 referred clients to ORG, and had ORG's employees perform services for this entity. Accordingly, it is determined that ORG is not an organization described in section 501(c)(3), and is not exempt from income tax under section 501, effective January 1, 20XX. Please see a separate Revenue Agent Report regarding the conversion of the Form 990 filing to Form 1120 filing.