

**Internal Revenue Service**

**Department of the Treasury**

**Taxpayer Identification Number:**

**Date:** FEB 02 2012

**Person to Contact:**

**Number:** 201614040

**Release Date:** 4/1/2016

**Tax Period(s) Ended:**  
June 30, :

**UIL:** 0501 .00-00

**Certified Mail**

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

The revocation of your exempt status was made for the following reason(s):

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. 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](http://www.irs.gov).

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](http://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,

Kafen A. Skinder  
Appeals Team Manager

Enclosure: Publication 892

cc:

**Internal Revenue Service**

**Department of the Treasury**  
Attn:

Date:

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

**Certified Mail - Return Receipt Requested**

Dear Mr. :

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, take no further action. 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. We will also notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code.

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,

Director, EO Examinations

Enclosures:  
Publication 892  
Publication 3498  
Report of Examination

Form 886-A	EXPLANATION OF ITEMS	Schedule or Exhibit No.
Name of Taxpayer XXXXX		Year Ended XXXXX

[Note: In accordance with 26 C.F.R. § 301.6110-3(b), substitutions have been made in this document with respect to certain information deleted pursuant to I.R.C. § 6110(c).]

## FACTS:

### (A) Background – Incorporation of XXX & Founder, XXXXX – Exempt Status

XXXXX (XXX), formerly known as XXXXX (XXXX) was incorporated on XXXXX. We will use XXX normally to refer to the TP, unless based on the circumstances using XXXX is more appropriate. Regardless of the term, XXXX and XXX both refer to the taxpayer under audit. XXXX filed Form 1023, Application for Recognition of Exemption, in late XXXX and received their final determination letter on XXXXX. XXXX was originally organized to render financial planning service(s) to the public. During the application process, they changed their purposes to meet Section 501(c)(3) requirements. Their current purposes are generic exempt purposes within the meaning of § 501(c)(3), providing little information to explain their specific purposes.

Its first Board of Directors consisted of XXXX, XXXX, XXXXX, and XXXXX. The initial officers were XXXX and XXXXX. However, it is very clear from this examination that XXXX was and continues to be the force behind and the life blood of XXX.

XXXXX (XXXX) XXXX has worked in the credit industry for over XX years, primarily dealing with debt consolidation. In [year], he started out working on the phones for other people, then managed a few offices, and then became his own boss, starting his own business. His last venture, which started in [year], was XXXX Inc., dba XXXX. That entity stopped operating in [year], so XXXX could devote his full attention to XXX. He stated that he had been making referrals of approximately 50,000 people per year to exempt credit counseling organizations. He questioned why he should be referring all these people to other organizations, so he started XXXX (XXXX). XXXX was re-named XXXX in XXXX. XXXX stated that he has never been involved in any type of credit repair business.

XXXX explained the difference in a for-profit vs. an exempt credit counseling organization by saying that an exempt organization (EO) deals with people in worse financial situations. With that being the case, the EO can work on getting concessions from the creditors, providing more assistance to the clients than what a for-profit can. This is also because a for-profit has to take the profits and pay the owners; they are not reinvested in providing services.

XXXX also indicated that from the time XXX was incorporated in XXXX, until XXXX, he continued working for XXX. He said he didn't feel that if the people could pay their debts, they should be allowed to get the concessions negotiated by XXX.

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He developed software through a company called XXXX (XXX), which he owns 100%. XXX holds all copyrights for the software. This software was being developed in [year], for use with his for-profit companies. This software, in its latest version, runs the entire operations of XXX, and XXX is its only current user.

XXX also produced the XXX budgeting software. This is the personal financial management software provided to the clients and is available from the website. They also claim that this software is used in other educational activities.

XXXX has stated that his passion and main interest in continuing to work (his XX birthday coincided with the start of the examination) was the financial education and financial literacy aspects of the business; otherwise, he stated that he would have retired by now.

**(B) XXX Board of Directors, Officers and Key Employees – Management Structure**

The XX member board of directors is composed of insiders, relatives of the CEO, compensated individuals, long time and trusted friends of the CEO, and 4 other people with unknown relationships to XXX and the CEO.

The following dollar amounts were taken from XXX's Form 990 to which we have added familial relationships to the CEO, XXXX:

Ending June 30,.....	XXXX	XXXX	XXXX	Relationship to CEO
XXXX	xxx,xxx	xxx,xxx	xxx,xxx	-----CEO-----
XXXX	xxx,xxx	xxx,xxx	xxx,xxx	Xxxx
XXXX	xxx,xxx	xxx,xxx	xxx,xxx	Xxxx
XXXXX	x,xxx	x,xxx	xxx,xxx	Xxxx
XXXXX	xxx,xxx	xxx,xxx	xxx,xxx	
XXXXX*	xxx,xxx	xxx,xxx	x,xxx	
XXXXX	X,xxx	x,xxx	x,xxx	Xxxx
XXXX	x,xxx	x,xxx	x,xxx	Xxxx
XXXXX	x,xxx	x,xxx	xx,xxx	
XXXXX	x,xxx	xx,xxx	xx,xxx	
XXXXX	xx,xxx	xx,xxx	x,xxx	
XXXXX	x,xxx	x,xxx	x,xxx	
XXXXX	x,xxx	x,xxx	x,xxx	

\*Cash Payments to XXXX or XXXX PC were \$xxx,xxx, \$xxx,xxx, and \$xxx,xxx for Fiscal Years XXXX, XXXX, and XXXX respectively.

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During the years ending June 30, XXXX and XXXX only 38% were compensated individuals. In the next year, one of the board members who was also the CEO's Xxxx, was hired by XXX, becoming a highly compensated person. Therefore in the last year of the audit 46% received relatively<sup>1</sup> large amounts of compensation from XXX.

In addition to the 46% getting compensated, out of the remaining 54% of people on the board, one is XXXX's relative, XXXXX, and one is XXXX's relative, XXXX.

Of the remaining 38% of members of the board, XXXXX has been the CEO's friend for over 40 years. He was on the original Board of Directors. He is also a person that represented XXX and received commission from at least one of XXX's Real Estate sales. In the building prior to the current one, XXXXX received a commission of \$xx,xxx for the sale of the building. He was also paid as part of the development contract on the current building. This was a 4% fee and included all costs except for the land. Since he only owned 50% of the development company, XXXXX, his portion of this fee would have been around \$xxx,xxx. Therefore, due to his financial interests and his longtime friendship with XXXX, we cannot conclude that he is independent.

This leaves only 31% of board members that would appear to be "independent" of XXX and XXXX; XXXXX, XXXXX, XXXXX, and XXXXX.

XXXXX has published numerous books on Banking, Bank Management, Producing and Selling Financial Products, Financial Services, and Banking Across State Lines. His area of emphasis would be helpful to allow XXX to provide better financial services or in a more efficient manner. Additionally, XXXXX has received some compensation from XXX, directly or indirectly, in excess of his director's fees.

XXXXX is a retired professor, specializing in Adult Education and has been a board member since [year]. XXXXX provided a letter to XXX, then known as XXXX, on XXXXX, XX letterhead dated XXXXX. This document was one of many used by the IRS to determine that XXX would be conducting educational activities.

XXXXX has been a board member since XXXX. He is a retired president of XXXXX. XXXX has been a board member since XXXX. XXX documents list him as a principal at XXXXX.

#### Minutes

XXX provided board minutes for the years XXXX to XXXX for review. Items discussed during the board meetings included the following: the ongoing growth of the company, creditor

<sup>1</sup> Anywhere from 5 to 20 times the average salary paid by XXX of \$XXXXXX for [year] and [year].

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relations, fees, use of investments, D & O insurance coverage, the board's concern on rebuttable presumption and salaries to the chief executive officer, improving the company's ability to recognize fees, and the improvement of delivering DMPs. The minutes were void of how XXX can provide direct education.

**(C) Group Affiliations**

**BBB**

XXX is a member of the Better Business Bureau (BBB). The BBB's overall mission is to promote the highest level of ethical conduct between businesses and the public through voluntary self-regulation, business and consumer education, and service excellence. Any organization can pay to be a member and can continue to be a member if they meet BBB minimum requirements.

These minimum requirements include 12 months of satisfactory operation, supplying required corporate information, having required licenses, appropriately responding to complaints and having a satisfactory complaint record, abiding by BBB decisions in arbitration, adherence to various BBB standards, etc. The BBB does not monitor or require that XXX, or any other organization, be educational.

**XXX**

XXX is a member of XXXXX. The XXX "provides the information and opportunities necessary to help XXXXX organizations succeed - both financially and operationally. They provide a cooperative atmosphere for organizations in XXXXX to excel in total quality management principles and organizational excellence. XXX addresses the very issues of efficiency, productivity, and effectiveness through: XXXXX State Quality Awards Program, Informational workshops, Networking opportunities, An educational library, Conferences, Seminars and Workshops, Dynamic Website and Quarterly Newsletter, and Other topical programs and activities."<sup>2</sup>

The XXX does not monitor or require that XXX, or any other organization, be educational. They are concerned with quality, efficiency, productivity, and effectiveness only.

**ISO**

XXX is an ISO 9001 certified organization.

<sup>2</sup> From the XXX website, [date].

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From the ISO website, "ISO (International Organization for Standardization<sup>3</sup>) is the world's largest developer of standards... ISO standards contribute to making the development, manufacturing and supply of products and services more efficient, safer and cleaner"

"ISO 9001:2000 specifies requirements for a quality management system where an organization

1. needs to demonstrate its ability to consistently provide product that meets customer and applicable regulatory requirements, and
2. aims to enhance customer satisfaction through the effective application of the system, including processes for continual improvement of the system and the assurance of conformity to customer and applicable regulatory requirements."<sup>4</sup>

The ISO certification results in a system that consistently handles the provision of services to a customer base, in a manner that meets applicable regulatory requirements. A key concept is customer service and constantly improving customer satisfaction. The ISO standards are generic, such that the actual service or product is irrelevant in becoming or remaining ISO certified.

To maintain their ISO accreditation, XXX has created and maintains policies and procedures in a manual, or manuals, similar to that used by the IRS. The set of documents designed in a pyramid fashion with different levels of procedures that have been set up. The First level is the XXXX Manual; this is "what they do". This is about 20 pages long. The XXXX Manual is the instructions to management on what they should each do. This is much longer. The XXXX Instructions or XXXX are the "who, what, where, when & how", used by employees to do their work. This set of documents is very similar to the IRS's IRM. The last item in the pyramid is forms and records that support the XXXX Instructions, they are prefixed with XX or XXXX. Each of these levels has a numbering system, for example XXXX or XXXX<sup>5</sup>. We will be providing many cites of this manual throughout this report.

XXXXX, the then current<sup>6</sup> ISO manager, also provided an additional explanation of why ISO was necessary, providing 3 reasons. 1 - XXX was growing at an incredible pace and XXXX wanted a system in place to control the quality during the expansion. 2 - The manuals, instructions and procedures were random, hard to find, and generally consisted of emails; a very bad system. A new system was needed to maintain control of the organization and its

<sup>3</sup> ISO is the English Translated abbreviation. The abbreviation is not IOS.

<sup>4</sup> From ISO website, 10-10-05.

<sup>5</sup> The XXXX has only one XXXX.

<sup>6</sup> He retired in the middle of our audit.

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operations. 3 – Some creditors required that they meet ISO 9001 requirements in order to do business with them.

Note: XXXX, XXX's largest source of clients, requires that credit card companies have rather specific accreditation. XXXX requires credit counseling agencies to be certified by one of a few select accrediting agencies, ISO 9000 is one of those agencies.

So in order to avoid inconsistencies in quality service, XXX needed a way to communicate policies and changes throughout the company. With ISO, XXX has a set of documents, the manuals discussed above, approved by management, that are distributed throughout the company. The most current revisions are always available on the computer system that users have access to.

To further ensure compliance with ISO, they have an ISO department<sup>7</sup> that performs regular ISO audits. XXXXX, explained an ISO audit as a standards based audit, which should lead to a quality product and an efficient organization.

XXXX

XXX is a member of the XXXXX, which represents the newer commercial-type credit counseling organizations.

"XXXXX is the credit counseling and debt management industry's largest trade association with nearly 150 members nationwide. It is an industry education and advocacy organization whose mission is to promote and ensure the continued operation and viability of credit counseling and debt management organizations. XXXXX provides its members and the consumer public with information about the credit and debt counseling industry. XXXX members are debt management organizations, consumer counselors, personal finance educators, credit and debt information publishers, debt pooling organizations, debt negotiators, debt adjusters, credit counselors, consumer lawyers and many others.

XXXX provides timely and important information to members through our newsletter and other publications that tell about the latest developments in sales & marketing, training, economic trends, technology, accounting, legislation, and the topics that impact your organization and its daily operations.

The information that you receive from XXXX is the most up to date information available

<sup>7</sup>The chart below states this department has only one or two employees, depending on the year. However, other individuals seem to have helped with the ISO audits during the years covered by of the audit.

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to help boost your bottom line. Our newsletter gives you important and timely information on what's happening with creditors, the IRS treatment of non-profits, FTC, small business regulation, credit reporting, the states, consumer credit protection laws and debt collection practices.

"XXXXXX", the XXXX newsletter, gives you information about the most important marketing and advertising techniques, growing your organization, customer benefits, changes and advancements in technology, and strategic analyses of the issues that are most important to your bottom line."<sup>8</sup>

XXXX does not monitor, audit, or otherwise ensure that their members conduct educational activities.

XXXXX

XXX is a member of XXXXX. XXXXX is a national membership organization, established to promote quality and consistent delivery of credit counseling services.

The following information was taken from their website:

**Vision**

The XXXXX represents the common interests of member agencies to ensure that all who seek help with their debt problems receive the highest quality of assistance.

**Mission**

The XXXXX is a member-supported national association representing non-profit credit counseling companies that provide consumer credit counseling, debt management, and financial education services.

**THE XXXXX PROVIDES HIGH-VALUE SERVICES DESIGNED TO ESTABLISH EQUILIBRIUM BETWEEN CONSUMERS, CREDITORS, AND MEMBER AGENCIES FOR THE SUCCESSFUL REHABILITATION OF DEBT-CHALLENGED FAMILIES AND INDIVIDUALS.**

The XXXXX meets this mission by:

- o Setting industry standards and providing consumer protection guidelines for its members. It also provides compliance oversight and concentrates its efforts in the best interests of its members and the consumers they serve.

<sup>8</sup> From the XXXX website, [date].

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- o Representing its members before state and federal legislative bodies, supporting consumer issues and industry initiatives with the media, championing consumer financial education, and campaigning for equity and fair interaction between the nation's creditors and the credit counseling industry.
- o Providing informed leadership, advocacy, and value-added services to its members by collecting data on member needs, measuring member satisfaction, and continuously striving to improve association effectiveness.

XXXXX does not monitor, audit, or otherwise ensure that their members conduct educational activities.

Both XXXX and XXXXX represent the newer, commercial type credit counseling agencies.

XXXX

XXX is NOT a member of the XXXX, a trade association that prescribed standards for its member organizations.

**(D) Overview of operations**

High Level Overview:

The following was taken from XXX's XXXX Manual. This was from revision X, dated XXXXX, XXXX.

XXX Purpose of Organization

*"XXXX provides debt management, budgeting and education services for individuals who request the service or are referred by creditor institutions and others."*

XXXX Manual

*"XXXX is a process-based organization in which Customer Service Representatives (CSRs) interface with clients and creditors resulting in a negotiated method of fulfilling the client's debt obligations using single payment methodology. The client initiates contact with XXXX, either voluntarily or by referral. The CSR in New Accounts gathers information; proposes an appropriate solution to the client and establishes a pending account."*

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*When the client returns the signed debt management agreement package, the account is activated / loaded and the system sends proposals to each of the client's creditors to obtain / negotiate creditor approval.*

*The account is then transferred to Client Accounts where it is managed for the first 30-90 days. Client Accounts uses negotiation skills to assist the client and the creditor to re-establish a working relationship.*

*Client payments are accepted through the Payment Processing Department and placed in trust. The payments are then disbursed to creditors either by check or electronic transmittal as described and agreed to.*

*Once the account is stabilized, it is transferred to open accounts. In open accounts, a CSR maintains contact as above with the client in order to facilitate / encourage the payment and debt reduction process throughout the payment period. For the duration of the agreement, the CSR continues regular contact with the client – assisting the client as needed.*

*Quality assurance randomly selects and monitors / measures CSR contact performance on an on-going basis. Support and Payment Processing may intervene as required to perform other services. Technology enhancements are used in telephone, computer and monitoring equipment to continuously improve service efficiency.*

*Additionally, XXXX maintains an expanding relationship with the surrounding community in an effort to provide credit management education at the community college through university level."*

**XXXX:**

*"XXXX, Inc. (XXXX) is committed to maintaining a highly trained professional staff that assists consumers to achieve self-reliance, financial stability and financial independence.*

*XXXX is dedicated to enabling consumers to achieve these goals by providing education in core values of budgeting, short and long term financial planning, and the proper use and management of consumer credit."*

All of the above information, quoted from their XXXX, provides a very high level overview of what XXX does. We will next go into more detail to describe exactly how XXX accomplishes the above day-to-day activities.

Since their manual clearly states the importance of their "single payment methodology", we will take this opportunity to describe a debt management plan (DMP). A DMP is a tool used to

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restructure unsecured debt. Restructuring debt through a DMP allows a consumer to consolidate unsecured debt; ostensibly lower his/her interest rates and monthly payments, obtain re-aging of his/her debts, and/or curtail collections calls, penalties and over-limit fees. Typically under a DMP a consumer signed a contract agreeing to make monthly payments to XXX, which then makes arrangements with the consumer's end-creditors and distributes payments to them. XXX charges consumers an initial fee in addition to monthly processing fees. In addition, XXX receives fairshare payments from many of the creditors receiving payments from XXX through this process.

#### Detailed Description of XXX Operations

The XXX organization and its operations are categorized into departments, subcategorized by exempt (salary) and non-exempt (hourly) employees. The total number of exempt employees is XX and non-exempt, XXX, for a total of XXX employed by XXX during the first fiscal year of this exam. Of these XXX employees, XX were in XXXXX, the remaining were in XXXXX. Currently, XXX only operates in XXXXX.

Percentage breakdown, All years: to determine how XXX structured its personnel each department is analyzed by its percentage of labor for each department:

Dept	# of employees		# of employees		# of employees		Average percentage
	6/30/XXXX	%	6/30/XXXX	%	6/30/XXXX	%	
New	Xxx	15.74	xxx	12.90	Xxx	21.51	16.72
Open	Xxx	41.31	Xxx	46.33	Xxx	45.81	44.48
Training	Xxx	8.52	Xxx	4.69	Xxx	4.09	5.77
Executive	Xxx	0.98	Xxx	1.47	Xxx	1.51	1.32
Support Services	Xxx	10.49	Xxx	9.09	Xxx	5.38	8.32
File/Mail	Xxx	4.59	Xxx	2.93	Xxx	1.72	3.08
Accounting	Xxx	6.89	xxx	7.62	Xxx	5.38	6.63
Quality							
Assurance	Xxx	1.64	Xxx	2.35	Xxx	2.58	2.19
Com/sec	Xxx	0.66	Xxx	1.76	Xxx	1.51	1.31
Facilities	Xxx	0.66	Xxx	0.59	Xxx	0.43	0.56
ISO	Xxx	0.33	Xxx	0.59	Xxx	0.43	0.45
Operations	Xxx	0.98	Xxx	2.05	Xxx	3.23	2.09
HR	Xxx	1.31	Xxx	1.17	Xxx	1.08	1.19
Operators (tel)	Xxx	0.98	Xxx	0.88	Xxx	0.43	0.76
Information Tech	xxx	4.59	Xxx	5.28	Xxx	4.73	4.87
Legal	xxx	0.33	Xxx	0.29	Xxx	0.22	0.28



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For the years of the audit, 89.54% of their activations came in as XXXX referrals. XXX was not able to provide the total number of callers from the various other sources.

XXX has stated that their contract with XXXX a method they used to reach their intended audience in an effective and efficient manner.

**Advertising**

Prior to their association with XXXX, XXX obtained most of their XXXX plus clients per year through advertising. However, this pre-dates this audit and additional information on this was not determined to be relevant.

In late XXXX, also outside of the audit period, XXX aired a single television commercial, but the response, in terms of obtaining clients, was not favorable, and the commercial was dropped after 4 weeks. Overall, they received an insignificant number of clients because of this TV commercial and advertising in general.

**Once calls are received - How are they handled?**

Now that we have determined where XXX obtains clients, we will now discuss what happens when the clients reach XXX. XXX has a flowchart of how clients are processed through the organization, which is XXXX, attached as Item 1.

**New accounts<sup>10</sup>**

When individuals first contact XXX, they are routed to the new accounts area first. The calls are somewhat different, depending on whether or not the calls come in from XXXX or not.

If the client comes in from XXXX, often times the clients budget will have already been input into the XXX system by XXXX personnel. By filling out the software, XXXX makes an initial determination that the person may be qualified for a DMP. The XXX CSR will quickly go over the budget with the client to make sure all items are covered. The CSR will also re-code or otherwise re-work the creditors to make sure the monthly payments to each creditor are correct.

If the client is not referred from XXXX, or otherwise has not provided financial information<sup>11</sup>, the CSR is required to take a budget from the caller. The CSR asks for all items of income and expenses; and obtains information on the caller's unsecured debt.

<sup>10</sup> All references to XXXX in the New accounts area reference items written within the New Accounts box on the flowchart. Page 12 of 118

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The amount of secured debt is not obtained; however, the payments for such debt are requested as part of expenses. Callers are not asked about assets at all. They do not talk about the caller's employment or education. The CSR only requests to determine their monthly income. If a caller volunteers additional information, the CSR will add or delete potential salary changes. They do not discuss buying habits in a meaningful way. The CSR will probe to ask line items related to the budget and will ask "is there anything else". They do not discuss significant past or anticipated changes in earnings, assets, expenses, or liabilities, or the reasons for those changes. Questions are specifically related to line items to the budget. They do not discuss health, habits and addictions, or other life issues that may affect their financial situation. They may ask about tobacco or alcohol use for inclusion into the budget or if they have prescriptions they pay on a monthly basis, but again only to get the information into the budget. The CSR, after reviewing the budget, will set a nominal amount for savings, not an amount that should be saved based on the caller's potential needs for the future.

Instructions XXXX, dated XXXXXX, is attached as Item 2. This XXX provides the procedures CSRs use to qualify a client for a DMP. On page X, it states that "living expenses should not be inflated unnecessarily in order to qualify a client for a DMP." Nevertheless, on page X, it requires the CSR to look at income and expenses to see if any adjustments can be made to qualify the client for a DMP, if it is a borderline case. So after the budget is provided by the caller, the CSR may adjust amounts in order to qualify the caller for a DMP.

The XXX system then determines if the client is a XXXXX client. This is notated as "pre-qualify client for program" on XXXX.

XXX's XXXX system was created to efficiently separate those debtors that will be accepted on a DMP with those that will not. The creditors do not want a credit counseling organization to send proposals on every single person; creditors have made their criteria known as to whether or not a DMP proposal will be accepted. Therefore this provides efficiency for XXX, if they recommend more clients than what will be accepted, they will lose money in the form of additional costs. In the same respect, if they could have recommended DMPs to more clients that would have been accepted by the creditors, they will also lose money in the form of lost revenues. Therefore, XXX created the XXXX system to efficiently refine the clients that XXX will propose a DMP, which will likely lead to acceptance by all creditors.<sup>12</sup>

XXXX signifies that the person cannot pay off their debts with the current levels or combination of income, expenses, and debt. These callers' budgets are not probed to determine if some

<sup>11</sup> Clients have the ability to pre-qualify for a DMP on the internet, by entering their financial information via the XXX website. XXX was not able to provide quantitative data on the number of clients who started the process in this manner.

<sup>12</sup> XXX, of course, has procedures for when proposals are not originally accepted.

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expenses might be lowered. The callers spending habits are not thoroughly discussed to determine patterns of spending, or excessive spending. They are not given advice of a substantial nature that would allow the person to help themselves get out of the situation they are in that initiated the phone call.

XXXX signifies that the credit card companies will not offer concessions to the person because they should be able to re-pay their debts with the current levels or combination of income, expenses, and debt without concessions being offered. As creditors will not provide concessions, they will also not provide fairshare payments. This means it is not cost effective for XXX to put the caller on a payment plan.

Instructions XXXX, dated XXXXXX, provides guidance to CSRs, for when the clients are turned down for a DMP. The CSRs are to advise the XXXX clients to contact creditors to set up payments through an internal hardship program or to contact legal counsel to explore their options. If the caller doesn't have enough debt, they are advised of the DMP fees and that they do not have enough debt to qualify. The XXXX does not require the CSR to provide any advice. If the caller is a XXXX client, they are to be "advised to readjust their household budget, contact the creditors for solutions, and to make consistent monthly payments to their creditors."

Once the caller is determined to be a turn down, the CSR provides almost no guidance to the callers. Even though the caller is in a situation that they felt the need to contact XXX, or they were transferred by XXXX for debt problems, XXX does not offer assistance to these people. As we will show later, the CSRs do not have the capabilities to provide counseling and they are not instructed to provide counseling to the callers.

The XXXX callers are those, based solely on the information provided by the clients, should be able to pay off their debts, but will need concessions from the creditors to be able to do this. Instructions XXXX also states they must have at least 3 creditors, \$XXXX of debt, and at least \$XXX as a monthly payment, otherwise, the fee to debt ratio will penalize the debtor. Once a XXXX caller is identified, XXXX shows the CSR is to proceed to the next step, notated as "Explain services available".

However, if a caller is classified as a XXXX client, the only "service" or "solution" they are offered is a DMP. If the caller does not want to get onto a DMP, the CSR generally tries to persuade them that it is their best option. Different CSRs use different methods to do this and will apply varying levels of pressure to persuade the caller to agree to a DMP. Minimally, the CSR will ask to send them a package to get them started, which they state is not an agreement, but a proposal that they can review and either accept or not. If they agree to consider this, the CSR moves to the next step, notated "spool agreement" on XXXX. Once the

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client agreement is sent to the callers for review, they are generally given 7-10 days to review the information.

The new accounts CSR is then required to call the client to encourage them to sign up for a DMP. Instruction XXXX, dated XXXXXX, describes the courtesy calling procedures that must be done within the 7-10 day time period. This XXXX places a high priority on timely calling the potential clients back. It also indicates that the CSR should always be aware of callers waiting to talk to the new accounts area, which is indicated by signs hanging in the call center where every CSR can see them.

When call volume is high, they are to stop making these courtesy calls and return to "Available" status, which allows the phone system to transfer incoming calls to the CSR. The XXXX informs the CSR, "This is an area of measurement that will be closely followed by management, and will appear on your monthly feedback report to determine how you are doing", again stressing the importance of courtesy calls, while being available as needed based on call volume. This XXXX is providing instructions to the CSRs that will result in the most productive use of time, to meet the fluctuating volume of callers, and to overall create efficiencies in the new accounts area.

Manual XXXX covers "Follow-up w/client for agreement receipt (activation calling)". These calls to and from the client relate strictly to the DMP, and whether or not the client will sign up for the program. These calls will cover the benefits of the program and the requirements of the clients while they are in the program. If the client does not wish to sign up for a DMP, their relationship with XXX abruptly ends.

In addition to the XXX manual sections cited above, the new accounts area has many more XXXXs that are important in doing their job. The following are some of those XXXXs, which XXX considered important enough to provide to the new hires during their initial training:

- Instruction XXXX covers establishing agreements start dates and EFT draw dates.
- Instruction XXXX covers procedures on how CSRs are to retrieve voicemail messages by prospective clients requesting applications.
- Instruction XXXX gives procedures in obtaining missing Debt Management Agreement (DMA), missing payment, or missing XXXX<sup>13</sup> information on new accounts.
- Instruction XXXX describes the credit report ordering process.
- Instruction XXXX describes the procedure for faxing computer generated DMA packets (XXXXXX) to clients.
- Instruction XXXX describes procedures for changing fees if a client moves.

<sup>13</sup> This XXXX refers to a schedule clients fill out and return with the DMP agreement and shows creditor information.

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Instruction XXXX describes how funds are held and released by XXX near the start date of a DMP.

Instruction XXXX tells CSRs what to tell clients about interest rates they will have on a DMP. Instruction XXXX requires CSRs to determine the type of debt and describes the procedure to add loans and lines of credit to a DMP.

Instruction XXXX describes the procedure to handle mailed in DMP applications.

Instruction XXXX describes how to handle XXXX fixed payment requests.

Instruction XXXX describes how to fix payments for medical bills.

Instruction XXXX explains who should be listed on the DMA and how 3<sup>rd</sup> party agencies can represent and or speak on behalf of clients.

These were all reviewed in their entirety; there are no items mentioning providing financial education to the clients in any of these Instruction XXXXs.

Instruction XXXX Review of XXXX documentation standards, dated XXXXXX, was also provided during the initial training. Documentation standards explain how the CSRs will notate the accounts for all situations. It shows the documentation standards are divided into broad categories:

- Identifying the issue(s)
- Call Outcome
- Client Goals & Objectives
- Client Education
- Budget Items
- Credit Report
- If ever on a debt management program before...
- If client left a credit card off the DMP
- Start Date/Changes
- Payment Amounts/Changes
- Alternative Phone Numbers

Of these areas of documentation, client goals and client education categories are to be the most important, from an educational standpoint. However, the XXX sections do not address education in a substantive manner (it states that account documentation should clearly indicate the financial goals of the client and account documentation should clearly indicate any areas that CSR feels client may need additional education on).

Instruction XXXX, additionally states "*if needed notes should indicate that education was given to clients as well*". It then gives examples that are unrelated to providing financial education. Just below this, the standard for client education indicates the CSR should make a note if the

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client needs education in any areas. The example then provided states, "Client not understanding why she needs to include all her debt on program; needs more education on possible implications...". Again, as XXX uses the term "education" in the XXXX, it essentially means the CSRs are to explain the DMP to the client.

This same XXXX provides an example of account documentation. Page X of this XXXX is attached as Item 3. This client happens to be a XXXX client (too much money). It shows they "educated" the client to keep a journal to help track expenses and that the XXX budgeting software was offered but declined. It then notes the person was advised to meet with a certified financial advisor to help adjust their budget to meet their goals. This is a specific case, where XXX is advising its employees to advise the caller to go to somewhere else for financial counseling.

Instruction XXXX, *XXX Website Application Process* describes how New Accounts CSRs are to handle client applications for a DMP via the internet:

- During the application process, the XXXX states that if a client is not interested in completing the application at all, the CSR will status the account "***Client not interested***" and document the account accordingly.
- A flowchart to show how the application works is enclosed in the XXX. At no point in the XXXX is the CSR required to provide the client with counseling. See flowchart attached as Item 4.

Additional XXXXs were reviewed that provide procedures for situations the new accounts CSRs must deal with. However, we do not know if these were provided to the new hires during training. For example:

In Instruction XXXX<sup>14</sup>, documents XX - New Accounts – Payment Returns (requested by clients changing their mind about the DMP), XX – Removal of Creditors, XX – Removing Duplicate Accounts, XX – New Accounts – Resend EFT only, XX – Spooling Agreements in Error, XX – Transferring Calls, XX – Unassigned Accounts / Reassigns, and XX – New Accounts Call Verification Requirements were reviewed in their entirety. There are no items mentioning providing financial education to the clients in any of these XXXs.

In Instruction XXXX, documents XX – Account Closures: Client Request / Default / PIF / XXX Closure / Letters, XX – Account payoff instructions, XX – Adding a Creditor, XX – Anniversary Date Changes (End Dates), XX – XXXX Macros, XX – Missing Payment Research Procedure, XX – Client Reassignment – Client Request, XX – Correspondence Processing, XX – Creditor Address Changes / Creations, XX – Delinquent Account Courtesy Contact / Retention, XX –

<sup>14</sup> This list of Instruction XXXXs contains Instruction XXXX, Instruction XXXX, Instruction XXXX, etc.

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Documentation Standards, XX – Fair Share Procedure, XX – Loan Letter Processing, XX – Customer LAST name changes, XX – Removing a creditor (Open Accounts), XX – Account Reopens, XX – Splitting Accounts, XX – EFT, XX – Frequently Asked Questions of Payment Processing, XX – Large Item Processing and XX – New Accounts Setup were also reviewed in their entirety. There are no items mentioning providing financial education to the clients in any of these XXXXs.

Instruction XXXX – XXXX Macro's Definition Sheet is 9 pages of macros. This is attached as Item 5. As XXX is very concerned with efficiency, they have created macros that employees use to notate the accounts of clients. Of the 98 macros, only one mentions "education" of a client. However, as we have documented numerous times, whenever XXX uses the term "education", they are generally referring to educating the client on some aspect of the DMP. The remainder of the macros deal with some aspect of the DMP.

In Instruction XXXX, documents XX – Bank-to-Bank Transfers and XX – XXXX Payments were also reviewed in their entirety. There are no items mentioning providing financial education to the clients in any of these XXXXs.

Part of the evaluation of New Accounts CSRs is evidenced by Instruction XXXX - its purpose is to provide feedback to the CSRs on their performance and progress towards stated standards and goals. The related forms used are:

- New Accounts Months End Performance Review-XXXXX
- NA Phone Productivity and Staff Time Reports-XXXXX
- NA- CSR Feedback Worksheet-XXXXX

CSRs are rated on their individual performance on the following areas:

- Phone time-Is broken down into categories of call handling, adherence, service level, quality, portfolio (number of clients, paid, percentage paid, dollars collected, number of accounts, EFT setup and EFT percentage). Employee incentive pay is based on their performance in each area.
- Phone Time- the measurement of the percentage of the CSR's workday spent ready in "Ready" or "Talk" time out of their total schedule work time for the day. The purpose of reliable quality service requires our staff to be at work, available and accessible to assist our clients. The standard is 85% of the net total phone hours.<sup>15</sup>
- Conversion Ratio- is a measure of the total number of agreements an individual CSR has activate out of the total number of agreements generated by the same CSR.

<sup>15</sup> Instruction XXXX, Page X of X.

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- Quality- *"is a measurement of the customer contact experience scored against established criteria. Calls are monitored using the XXX call monitoring software. Five calls are randomly captured by the system, reviewed and scored by a QA analyst to insure that the developed call quality standards have been upheld as well as to identify training needs. Each call receives a score and then the calls for the month are averaged for the individual counselor's monthly score. The monthly scores are averaged into a 3-month rolling average for the individual and the team average"*<sup>16</sup>
- The review then considers the manager's comments factors. That is to provide timely feedback on progress, educational opportunities, and devise plan to achieve improvement in areas where opportunities are found to exist. (The XXXX does not mention financial counseling).
- Other areas of concern in the New Accounts Department are: account management, communication (skills with clients, one another and management); Job knowledge (Each CSR's knowledge of on the job skills and suggestions for process improvements are considered in this category. QA and team meeting involvement can be addressed with the CSR to improve topic knowledge and idea development.)<sup>17</sup>. Leadership & Interpersonal Effectiveness, Dependability, Adaptability, and Attendance.

In summary, the new accounts area is responsible for pre-qualifying callers for a DMP. Once classified in XXXX, XXX has very little contact with the callers, and furthermore, any future contact would only be initiated by the caller, or at the caller's request, a very abrupt ending to their "relationship", as confirmed by Instruction XXXX.

If the caller is classified as XXXX, the DMP is explained and offered to the caller. They will try to sell<sup>18</sup> the DMP to the caller. If the caller wishes to start a DMP with XXX, they sign the contract and send this in to XXX with the first payment. The new accounts department then completes the next step in the flowchart, "Hand-off to Acct. Loading & XXX", as notated on XXXX. Also, proposals are sent out per the "Proposals" block on the flowchart. This is the end of the new account area's involvement with the callers.

Once accounts leave the new accounts area, they are transferred to the open accounts area, where they are handled by XXX CSRs for the first 30-90 days of the DMP. This time varies by how much time it takes for all the proposals to be accepted by the creditors.

XXXXX (XXX)

From Instruction XXXX, Purpose and Use,...

<sup>16</sup> Instruction XXXX pages X and X of X pages.

<sup>17</sup> Instruction XXXX Page X of X.

<sup>18</sup> The person listed as taking the initial interview is listed as a sales person on the software system.

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"The XXXX (XXX) Team was formed to assist our clients through those first several months while getting them accepted and set up on the Debt Management Program and making sure it is operating smoothly before forwarding the clients account to the Open Accounts Department".

By creating the XXX area<sup>19</sup>, XXX is creating a group of people that will specialize in helping clients start the DMP process and ensure proposals are accepted. This specialization allows XXX to efficiently begin this process.

From Instruction XXXX, Purpose and Use,...

"Communication is a key component in order to achieve our goals. We have what we call that "1<sup>st</sup> Critical Client Contact" phone call in which we go over our goal of having them debt free and educated in their finances so they won't find themselves in this predicament again."

Several examples are given about what the CSR should discuss with the clients, including the benefits of the DMP again and providing encouragement to the client to stay on the DMP. None of the examples specifically mention, or hint at, the provision of financial education.

From XXXX, XXX initial client call, checklist, attached as Item 6.

The XXX CSR goes through introductions, explains XXX's mission, and explains that they will soon be assigned a CSR in open accounts. They explain how to contact XXX and what happens when they call (they have an automated call routing system for efficiency). The XXX checklist then has a large section entitled "Educate and Advise". For the most part, the CSR is to educate and advise on the DMP. However, they are also to "explain the educational information available on the website and the XXX Budget software CD (to be distributed soon<sup>20</sup>). More specifically, they inform them of the website's and software's existence. The CSR is then to cover EFT and payment requirements and then do an account review and follow some additional procedures. There are no items mentioning providing financial education to the clients.

XXXX, dated XXXXXX, provides specific guidance to XXX reps in performing their XXX duties. It contains two sections. First is the initial account review, to be done in the first 30-60 days. This is also referred to as a XXX Review or Initial XXX review. In this review, the XXX rep checks for duplicate accounts, account numbers, a trust balance, complete client information, account balances, payment history, creditors and XXX getting paid correctly, proposal

<sup>19</sup> These people are part of the open accounts teams, but they specialize in XXX work.

<sup>20</sup> The revision date of this XXX is XXXXXX. The prior version has the same comment and is dated XXXXXX.

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information, and they are to follow-up on any issues found. A thorough review of the initial account review showed that there are no items concerning providing financial education to the clients.

The second item on the XXX is account maintenance, to be done every 60 days following the initial review. In this review the CSR is to check for low balances, for full payments received, and the account notes. Again a thorough review of the account maintenance procedures showed that there is no mention of providing financial education to the clients.

**Management evaluations of XXX CSRs performance**

XXXX, dated XXXXXX, which is after the audit period, is the review sheet filled out by the supervisor, which is then signed by the CSR when evaluating a XXX CSR's performance. This covers the procedures above that must be performed by the XXX CSR. While there are basically 9 items that are covered, including the XXX initial client call checklist above, there are no items mentioning providing financial education to the clients. While the above XXXX did not exist during the audit years, the checklist did, which are the procedures this XXXX is evaluating the CSRs against.

Items that were in existence during the period of the audit, include XXXX and XXXX, both dated XXXXXX. They are check sheets used by either management or the CSRs to make sure all of the items covered in XXXX are completed properly. Again, these check sheets do not mention providing financial education to the clients.

XXXX, Competency Validation – XXX Review, dated XXXXXX, while dated one month outside of the audit year, reemphasizes the XXX checklist above. There is no part of this review that discusses the provision of financial education or improving the financial literacy of the client.

XXX operations, in general, are a very important part of the DMP process and XXX makes absolutely sure a XXX review is conducted on each account / client. This is ALWAYS notated in the account notes on their account management system. Again, this creates efficiencies for the XXX operation. By making sure the XXX reviews are notated, they make sure the DMP starts smoothly. This entire area is meant to provide efficiencies in the processing of DMPs.

After the XXX CSR has completed working the account and the account is ready to transition to open accounts, the XXX CSR sends a list of the accounts to be transitioned to the Department Coordinator (DC). The DC assigns the account directly to an Open Accounts CSR (Open CSR). The DC informs both the CAM and Open CSRs of the new assignment.

**Open Accounts**

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The open account area is generally where an account/client will remain after going through the XXX process until they finish the DMP and pay off their debts, unless the client stops paying their debts. Since new accounts has a client for generally the first 30 days in a DMP and XXX has them for the next 30-90 days, the remaining time that clients are in a DMP they are in the open accounts area. This period is not supposed to be more than 5 years.

Naturally, this area of XXX contains the largest percentage of employees of any single area; 44% of XXX's workforce is in the open accounts area.<sup>21</sup> Per XXXX, the Open Accounts area is responsible for Accounts Maintenance. This includes Portfolio Reviews, inbound and outbound calls, delinquencies, trouble shooting, and correspondence generation. As noted in the XXX, the Open CSR is to repeat these items until the account is closed.

Instruction XXXX, effective XXXXXX, discusses Key Processes on Competency Validation Audits for both XXX and Open CSRs. While this document is outside of the audit year, all of the processes existed throughout the audit period. By their classification as key processes by management, they have been determined to be important enough to monitor on a consistent basis. The XXXX states its purpose, in part to be, "To review the counselor's complete understanding and adherence with our instructions and procedures and to ensure consistent service representation and proper administration of their job responsibilities." Again, XXX is striving for efficiencies in their operations.

The 6 "key" areas the above XXXX covers are the following: XXXX, XXXXX, XXXX<sup>22</sup>, XXXXX, XXXXX, and XXXXX. While the above XXXX is outside of our audit years, combined with the other manual parts that were in existence during our audit, all of the items covered by the XXXX are valid and important operations and procedures for the periods under audit. We will discuss each separately.

XXXXX<sup>23</sup>

The purpose of the portfolio review is to make sure the DMP is working as it was set up to. This means that the client is correctly paying into the DMP, the trust is properly dispersing to the creditors, the client is receiving the proper benefits through the DMP, and XXX is collecting the proper amount of fees for managing the DMP.

XXXX, dated XXXXXX, is a check sheet used by the supervisors to monitor whether the CSRs are properly reviewing the clients accounts. This check sheet closely follows XXXX, dated XXXXXX, XXXXXX, and XXXXXX on revisions X, X, & X respectively, entitled, "Working your

<sup>21</sup> This percentage includes the XXX area employees, as XXX considers them to be in the open accounts area.

<sup>22</sup> Discussed above in the XXX section.

<sup>23</sup> This is sometimes referred to as a management review.

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Portfolio – In Open”. This provides more detailed explanations on what the individual check sheet items mean, and how the CSRs are to conduct their Initial Account Reviews and how they are supposed to perform account maintenance.

In revision 3 of the above XXXX, they reduce the requirement that CSRs contact the clients from every 6-9 months to every 6 months. They also provide additional detail to explain these regular contacts, in cases where no issues are present with the DMP. Previously, the XXXX stated the CSR should provide encouragement to keep paying into the DMP. In this revision, they refer to this as a courtesy contact, asking the client their satisfaction with the DMP, providing positive reinforcement for continued success in the program, and to encourage continued commitment to the DMP and to remind them of the benefits they receive through the program. A thorough review of Instruction XXXX showed that there are no items concerning providing financial education to the clients.

The above XXXs were updated, renumbered and expanded on in Instruction XXXX, dated XXXXXX.<sup>24</sup> As with Instruction XXXX, there is no requirement that the CSRs provide financial counseling to the clients. Their responsibility is to keep them on the DMP, which will help the clients get out of debt.

In question XX of Instruction XXXX, dated XXXXXX, they created another requirement that the CSR should recalculate the 60-month program guidelines. It indicates that the CSR has the ability to perform a calculation on their system to determine if the client will pay off the debt within 60 months. If not, the CSR is to suggest an increased payment to the CSR. The example shows that the increase in the payment is related to the 60-month requirement, not as a function of the client’s ability to pay. There is no mention of reviewing the budget at a later date, or providing financial counseling with the client that may change the budget so that a higher payment can be made. It is simply a suggestion that an increased payment be made, period.

XXXX, dated XXXXXX, was entitled XXXX. Future versions are entitled XXXX. This document is used by supervisors, as a check sheet, to document whether the CSRs are properly performing the Portfolio Reviews. The items are consistent with those discussed above. This XXX references Instruction XXXX as providing detailed work instructions. Instruction XXXX, dated XXXXXX, also covers the same items as stated above.

XXXX, dated XXXXXX, is entitled XXXX. This contains a flowchart that follows the steps from starting a Portfolio Review to notating the account, “Portfolio Review Done”. Again, the same information, although in less detail is contained in this XXX.

<sup>24</sup> Rev. X, is dated XXXXXX, Rev. X, is dated XXXXXX, and Rev. X is dated XXXXXX.

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XXX obviously has numerous documents covering the Portfolio Review Process. The documents are used by different levels, i.e. CSRs or supervisors or QA, but they are all consistent in the information they contain. They are very clear about what is and what is not required during the Portfolio Review process. Providing financial education or counseling to the client is not a part of this process.

XXXXXX

In section 2, Procedures of Instruction XXXX, XXXXX is discussed. This situation exists when the client needs to lower their payment that they are paying into the DMP. This procedure only covers lowering the payment, not increasing it. There are no procedures for this, even though XXX claims to encourage clients to increase their payments if this is possible. While the CSR is required to request a hardship letter in the procedures, the procedures do not require that the CSR probe their financial situation in an attempt to provide financial education. This certainly would seem to be an appropriate time for providing financial education, yet there are no items in this part of the XXXX that even mention providing financial education to the clients.

Instruction XXXX, effective XXXXXX also covers restructuring payments. Again, this specifically refers to reducing a client's payment based on a client hardship. This XXXX is consistent with the information from the XXXX, Instruction XXXX and again, there are no items mentioning providing financial education to the clients.

XXXX, dated XXXXXX, which is outside of the audit year, provides additional confirmation of the requirements CSRs must perform when "restructuring payments". This document is consistent with the above XXXs and again shows no indication that they are required to provide financial education to the clients.

While XXX has designated this as a Key Process, the CSRs interviewed indicated they rarely restructured payments. Evidently, while this is a rare procedure, it must be important that when this is done, it is done correctly.

XXXXXX

A normal part of the open CSRs' job duties include statement reviews. Every 4-6 months clients are asked to send in their credit card statements for a review by their assigned CSR. Instruction XXXX explains that the CSR is to timely review the statements to make sure the client is receiving all the benefits they are entitled to based on each individual creditor's policy. They are to notate this into the client's notes and update their balances. The client statements are then sent to the file room to be put in the clients file.

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In Revision X of the above XXXX, effective XXXXXX, XXX added an instruction that a follow-up task be set for all items that needed action. The next revision, effective XXXXXX, further adds that any action items not resolved immediately must be followed-up within 14 days. In Revision X, effective XXXXXX, XXX added the comment, "If there are issues needing attention, call client to advise, request missing statements, and advise of any issues of follow up that is pending."

In Revision X, effective on XXXXXX, which is outside of our audit year, they have added a section on the 5-year calculation tool. The XXXX states this "is an educational tool offering our clients timeline information" and "Offers the recommendation to the client explaining the ramifications and then document their response to our recommendation."

In Revision X, effective XXXXXX, also after the audit year, they change the name of the 5-year calculation tool to the Debt Analysis tool. Other than the name, all comments about the tool are the same as for the 5 year calculation tool. This "tool" is simply a tab in their software system that calculates if the client will be done with the DMP within 5 years. It does not lend itself to provide financial counseling to the clients.

XXXX, dated XXXXXX, which is just outside of our audit years, is used by supervisors as an evaluation worksheet to make sure the CSRs accurately perform statement reviews. The supervisor is to make sure the CSRs properly use and follow the statement review procedures as discussed above. There are no items mentioned that show the supervisor is checking to see if the CSR provided any form of financial education to the clients.

The statement review process is simply to review the statements provided by the clients to make sure they are receiving the proper benefits from the DMP. This includes that the creditors are properly getting paid, which includes the debt being reduced.

XXXXXX

XXXX, dated XXXXXX, outside of our audit year, is used by supervisors as an evaluation worksheet to make sure the CSRs are competent in using the XXXX (XXXXXX). It covers items such as searching, sorting, and filtering clients. This form requires that CSRs be able to filter/sort accounts by "unpaid, due accounts", "updated by non-owner", and "promise to pay" status.

This "part" of the CSRs work is not specific to any required actions on the CSRs' part. It is simply an overall check to make sure that they can work with the system, which allows them to assist XXX's clients in an efficient manner. While we did not expect to see education as a requirement in an audit of what is essentially a review of how efficiently CSRs use the

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computer system, it is important to confirm this. There are no items mentioning providing financial education to the clients.

XXXXXX

This is a required procedure CSRs must follow when a payment from a client on a DMP is not received. one CSR we interviewed stated that he works his delinquencies every Monday, Wednesday, and Friday. He filters information out on the system to find what accounts are delinquent. If an account is delinquent on Monday, he will check it on the above days, until it is paid, taking the actions below as necessary. This is a critical process CSRs perform.

Instruction XXXX, dated XXXXXX, provides instructions for the CSRs that must be followed when there is a delinquent account in their portfolio. This XXXX states that it is the CSRs responsibility to call the clients and the responsibility of Call Center Management to monitor the effectiveness of the representative to collect past due payments in an effort to help clients be successful in reducing their debt and achieve their financial goals.

The CSR is to determine when the last payment was received, then must review the notes to see if there is an indication of why the payment is late, and they will call the client if necessary. This XXXX provides a script and suggested guidelines for the CSRs to use when calling the clients. This is attached as Item 7. The XXXX states the objective of this contact is "helping them retain the benefits of our program". The CSR is then to encourage the client to stay on the program, by explaining the benefits of the DMP that the client will lose if they get off the program. They also are to recommend the EFT, if appropriate.

XXXX, dated XXXXXX, outside of our audit year, is used by supervisors as an evaluation worksheet to make sure the CSRs are properly handling delinquent accounts in their portfolio. This XXXX is consistent with the instructions in the XXXX in a general sense, confirming management checks that the CSRs are following the procedures in the XXXX.

There are no items mentioning providing financial education to the clients in the XXXX or that the supervisors are checking to make sure that this is done, per the XXXX during the delinquent account review process.

#### Additional Activities / Procedures

While the above 5 procedures were described as "key" processes, the open accounts CSRs have many additional procedures they are required to perform as part of their duties.

#### Account Follow-up Procedures

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Instruction XXXX, effective XXXXXX, discusses general guidelines on how calls are handled, but especially how follow-up procedures are to be handled. It is applicable to all CSRs and primarily is a XXXX to indicate to CSRs that the person handling a specific call has primary responsibility for the call regardless of which CSRs' portfolio the client is in. All items mentioned in this XXXX deal with the DMP. There are no items mentioning providing financial education to the clients.

#### Account Reopens

Instruction XXXX, dated XXXXXX, is used for reopening accounts that had been previously closed, collecting on accounts that have a negative balance and calling customers that have EFT that has been returned NSF. Procedures are provided for an EFT return (NSF, revoked, stopped, etc.), collection calls, follow-up procedures, and reopen procedures. There is no requirement that the CSR or CSS determine why the client is even in this situation; there are no items mentioning providing financial education of any kind to the clients.

By the X revision of this XXX, dated XXXXXX, the procedure was scaled back to just the reopening of accounts. It described when accounts will be reopened, when they will not be reopened, and the circumstances when a new account has to be created. This 5 page XXXX was thoroughly reviewed and there were no items found mentioning providing financial education to the clients.

When counselors were interviewed, they did not indicate that this was something that was regularly done.

Instruction XXXX is the XXXX for XXX. This covers many of the situations that the open CSRs deal with that may or may not be on a daily basis that do not appear to have warranted their own XXXX. The table of contents is attached as Item 8: This desk guide covers contact information, procedures dealing with the DMP, payment methods to the DMP, creditor policies and miscellaneous items.

When the CSRs were interviewed, they did not bring the Desk Guide up as being a crucial tool in completing their jobs<sup>25</sup>, meaning something they commonly used or used daily. On the other hand, one of the CSRs stated that he was not aware of any situations that exist that are not covered somewhere in the XXXX. So to put this in perspective, these are things CSRs will deal with, so XXX has to put them in the XXXX to met ISO standards, but they only deal with these items occasionally.

<sup>25</sup> We did not ask specifically about this, so as not to "lead them to a conclusion".

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Instruction XXXX, dated XXXXXX, is entitled "Keys to XXX Definitions Document and Achieving QA Success, "Open / XXX Accounts". This is attached as Item 9. This is a document that explains what the QA department is looking for on each and every call, regardless if the call is with a client or a creditor, and regardless of the purpose of the call.

Among the mostly customer service type issues this discusses, in handling every call, the CSR is to determine the current and future needs of the caller. They are then to provide complete solutions to meet the needs of the caller. By determining the future or unrealized needs of the caller and responding to them, they can avoid unnecessary future calls. Again, they are striving to be very efficient.

This XXX also discusses "taking advantage of available opportunities". It explains the CSR must look through the system, viewing F-2, F-3, F-5 client and creditor notes to make recommendations and ask questions based on what was viewed.<sup>26</sup>

The XXX also states, "Describing XXX benefits. Offer information on the program to new and existing customers; remember education is the key to success." In context, education means explaining the DMP process to the client.

#### Retention Group

The retention group is a separate department that reports to the Call Center Director. This area currently has 10 members including the manager. This area is assigned cases to work if they are 31 to 60 days delinquent. The cases are not actually transferred to the retention area, but they are provided lists off the computer of delinquent accounts to call.

The retention group is a special group that works exclusively delinquent accounts. This is a last ditch effort by XXX to contact the clients to encourage them to continue to make payments to XXX in the hopes that they will continue with the DMP. They follow the delinquent account review procedures previously discussed.

#### Hiring

##### Position description

When asked to provide the position descriptions and minimum qualification requirements for their CSR positions, XXX provided numerous versions of what appear to be job announcements and then some actual position descriptions from the current periods. The

<sup>26</sup> In the next revision of this XXXX, dated XXXXXX, XXX has moved the "recommendation and ask questions" statement to the heading labeled, "Provide complete information and solutions".

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information for new accounts and open accounts is different, so they will be discussed separately.

#### New Accounts

The job postings for XXXXXX, XXXXXX and XXXXXX contain the exact same information in the body of the announcements. The essential functions, while brief, match the description of their activities in this fact section.

The Knowledge, Skills, and Abilities (KSAs) required in the announcements cover general computer skills, excellent communication skills, ability to build rapport, ability to collect customer information and analyze needs, problem solving capabilities, patience, comprehension of company procedures and policies, and the ability to work effectively in a team environment.

The Education and Experience requirements include a High School Diploma or equivalent preferred and Industry related experience preferred.

The job posting for XXXXXX showed some changes to the job description and minimum requirements to include, as follows:

In the essential functions section:

- Provides an in depth budget analysis and credit counseling to potential clients
- Provides recommendations based on findings in budget analysis

In Education and Experience:

- H.S. Diploma or equivalent is now required & college course work preferred
- One year credit industry or credit-related experience is now required

There were no changes to the required KSAs.

For the last job posting provided, the following changes were made:

No changes were made in the essential functions.

In the Education and Experience area:

- 12 months of continuous employment with 1 employer is now preferred.

The last change was to the required KSAs, establishing typing abilities at 25 wpm.

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XXX also provided Position Description for XXX Job XXXXX, which was entitled Customer Service Representative – New Accounts on XXXXXX and Counselor – New Accounts on XXXXXX. These are both outside of the audit year and are dated over a year after our first contact for this audit. They will not be considered as relevant.

#### Open Accounts

XXX provided job postings for open accounts dated XXXXXX, XXXXXX, XXXXXX, XXXXXX, XXXXXX, XXXXXX, and 4 postings during XXXX. Through XXXXXX the postings are substantially the same. They are also similar to the new accounts postings, except for the following:

- An essential function includes, "Provides ongoing education with our clients regarding debt management".
- Required KSAs, include excellent telephone skills.
- Education and Experience includes One year call center experience preferred and one year finance, debt management, collections or banking experience preferred.

The job posting for XXXXXX is the same as prior versions, except the Education and Experience requires H.S. or equivalent and college course work is preferred, the work experience that was preferred is now required and they again prefer the one year of continuous employment with one employer, similar to the new accounts area.

XXX similarly provided two versions of their position description for Open accounts. The one dated within our audit period is dated XXXXXX, for a customer service representative. The other, dated XXXXXX, has changed the title to Counselor and the Job to XXXX. The position description dated XXXXXX is pretty much word for word when compared to the job posting of XXXXXX. They contain the exact same information in the body of the announcements as the job postings. The essential functions match the description of their activities in this fact section.

#### Employee Handbook

Like many employers, XXX provides an employee handbook to every employee when they are hired. This handbook provides a brief description of the company, explains numerous personnel and HR issues, and some of the expectations XXX and the employee have after the employee is hired.

On pages X and X of this handbook, XXX describes itself to new hires. This is attached as Item 10. The description XXX gives of themselves is focused on customer service, improvement, and the customers themselves. There is no mention of the provision of financial education to the clients.

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Training

XXX takes great pride in the training it provides to its employees. They expound that they led the credit counseling industry in implementing independent 3<sup>rd</sup> party certification of their counselors. In XXXX, they established a relationship with XXXXX to provide certification for their counselors, which enables the counselors to obtain training credits for the instruction they receive. All classes are held at XXX Headquarters, XXXXXXXXXXXXX. The certification that is provided is a certificate in Credit Counseling Customer Service. It is not a certification in Credit Counseling. There is no educational requirements necessary other than a high school diploma or its equivalent.

XXX is very proud of the fact that in XXXX, they were awarded the XXXXX Quality Alliance honors for its outstanding training and education programs. The honor provided was the Showcase in Excellence Award, which recognizes organizations for excellence in specific processes. This award recognizes the process of their training, not the content of it,

XXX, with few exceptions, hires people in two areas, New Accounts and Open Accounts. Even though some things overlap, like customer service and the computer system, they have different jobs and need to be trained separately.

Training – General

New accounts training is about 10-11 days in the classroom. They then have transitional training which lasts approximately 15 days; a total of 26 days. Open accounts training is generally 14 days in the classroom with transitional training which lasts approximately 20 days; a total of 34 days. Once CSRs successfully pass the classroom and transitional training, they are assigned to their team.

The new hires use the Training Module for the classroom training but they do not keep the Training Module, since it talks more globally and would not be of great help in their actual work. However, all CSRs have access to the on-line manual, XXXX & XXXX etc. discussed above.

Training – New Accounts

In the new accounts training, XXX employees train the new hires on the following subjects, Introduction to the Debt Management Industry and the Credit Industry, Customer Service, Proper use of needed XXX systems, How to handle calls, and how accounts are processed through the XXX organizational structure. Starting with the 5<sup>th</sup> day of the classroom training, the new hires start side by side monitoring of calls and start practicing what they will be doing

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on the phones. For the first 8 days of class, the new hires take a daily quiz. On the 10<sup>th</sup> day, they take a final test. All these must be passed to remain employed by XXX.

Attachment 11 is the XXXXX, Course Syllabus for XXX. This shows that the New Accounts training covers 4 courses and provides each participant with 12 training credits. The official course descriptions emphasize 1) customer service, 2) understanding credit, finance charges and payment history implications, and the last two courses emphasize 3) DMPs.

The syllabus then lists 46 different course competencies; only item 6 of the syllabus discusses the topic of educating the client. Item 6 of the syllabus is directly related to page XX of Module two. These pages are attached as Item 12. These pages show that education, as XXX defines that term, means explaining how a DMP will benefit their clients, as we have stated numerous times. The 45 other competencies have nothing to do with educating clients.

The Training Test for New Accounts is XXXX. This contains 25 true or false questions, a question where you are to circle all items that can be placed on a DMP, 23 questions requiring a written response, and two different questions requiring you to match terms with definitions. There is not one question on the Final Test that assesses the ability of a new hire to provide financial education to a client. This is attached as Item 13.

After they finish this final test, the trainees are moved into transition training for three weeks. Instruction XXXX covers transition training for Open accounts and will be discussed more below. However, transition training for new accounts is similar. This is a phase where they are starting on the phones with very close monitoring. They also are provided additional training during this period, per the syllabus. At the end of the transition period, the trainees are fully trained and are assigned to their team.

#### Training – Open Accounts

In the open accounts training, XXX instructors / employees train the new hires on the following subjects, Customer Service, Legal Issues, Processes, XXXX, and Account Maintenance Procedures. Starting with the 11<sup>th</sup> day of the classroom training, the new hires start side by side monitoring of calls and start practicing what they will be doing on the phones. For the first 14 days of class, the new hires take a daily quiz. On the 15<sup>th</sup> day, they take a final test. All quizzes and the test must be passed to remain employed by XXX.

Attachment Item 14 is the XXXXX, Course Syllabus for XXX. This shows that the Open Accounts training covers 5 courses and provides each participant with 14 training credits. The official course descriptions emphasize 1) customer service, 2) understanding credit, finance charges and payment history implications, and the last three courses emphasize 3) DMPs.

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The syllabus then lists 65 different course competencies; only item 6 of the syllabus discusses the topic of educating the client. Item 6 of the syllabus is directly related to page XX of Module two<sup>27</sup>. These pages show that education, as XXX defines that term, means explaining to a client how a DMP will be beneficial to the clients. The 64 other competencies have nothing to do with educating clients.

The Training Classroom Test is XXXX. This is attached as Item 15. This contains 19 true or false questions, two questions where you are to circle correct answers, 22 questions requiring a written response, two different questions requiring you to match terms with definitions, 5 multiple choice questions, 6 fill-in-the-blank questions, a list that requires prioritizing tasks, 11 questions about a specific credit card statement, and then they are to highlight important items on the credit card statement, as they would in a statement review. There is not one question on the Final Test that assesses the ability of a new hire to provide financial education to a client. After they finish this final test, the trainees are moved into transition training for four weeks.

Instruction XXXX covers transition training for Open accounts. They are assigned cubicles, workstations, and 10% of a normal portfolio, or 60 accounts. This is a phase were they are starting on the phones with very close monitoring. They also are provided additional training during this period, which they are then tested on.

In the transition training phase, XXX tests<sup>28</sup> the new hires in the open accounts area on the following areas:

Week 1 – Apropos, Viewing closed accounts, Customer Service Menu, F Screens, MS Outlook, & Quality Assurance

Week 2 – Internal Customer Service, F Screens, Statement Review, Creditor Information, Quality Assurance, XXX Review, & XXX

Week 3 – Portfolio Review, Funds and Disbursement, Time Management, & XXX

Week 4 – Creditor Information, Time Management, Delinquencies, XXX Review, XXX, & ISO 9001

<sup>27</sup> XXX provided their training modules. Module 1 was the same, except for the name, one was New Accounts, and the other was XXX/Open. Module two was the exact same for both classes, they used the New Accounts title for both. All information in the modules was the same for both.

<sup>28</sup> Per Instruction XXXX, one per week.

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At the end of the four week transition period, the trainees are fully trained and are assigned to their team, receiving full portfolios.

#### Compensation / Bonuses

During the review of employee benefits, we found that non-cash compensation was given to employees for perfect attendance. Non-cash bonuses were items such as gift certificates to Lands End Clothiers, and small gift items. In addition, bonuses had been identified to come from several earnings descriptions that were reported as part of employee wages. The separate line items that allowed employees to receive bonuses include: collection, EFT bonus, and for employees in new accounts, on call, quality, and telephone service. The above areas may relate to various Open, New and XXX groups.

#### New Accounts

Part of the evaluation of CSRs in the New Accounts area is covered by Instruction XXXX, *Quality Process Instruction: New Accounts Month End Performance Review*

CSRs are rated on the following areas:

- Phone time
- Calls per hour
- Conversion Ratio - a measure of the total number of agreements an individual CSR has activate out of the total number of agreements generated by the same CSR.
- Quality- *"is a measurement of the customer contact experience scored against established criteria. Calls are monitored using the XXX call monitoring software. Five calls are randomly captured by the system, reviewed and scored by a QA analyst to insure that the developed call quality standards have been upheld as well as to identify training needs. Each call receives a score and then the calls for the month are averaged for the individual counselor's monthly score. The monthly scores are averaged into a 3-month rolling average for the individual and the team average"*<sup>29</sup>

#### Open

For compensation purposes, the open accounts CSRs are rated for handling, adherence, service level, quality, portfolio size (each employee will handle approximately the same amount of clients based on total debt per client), and attendance.

<sup>29</sup> Instruction XXXX pages X and X of X pages.

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**Handling:** handling is the number of inbound and outbound calls received, percentage of inbound calls completed, talk time for outbound and inbound and is based on an average as well as calls that are re-queued into the phone system. The CSRs are evaluated on how efficient they are in managing a quantity of calls.

**Adherence:** is the ready time of each operator, including talking time, total time available and unavailable, and a formulated percentage. This standard determines how the employee handles and manages his time and if he or she makes herself available to answer calls.

**Service level:** determines the percentage of calls abandoned by the operator. Abandoned calls for each sampled employee are less than one percent.

**Quality:** this standard measures the operator's accounts reviewed (which include follow up on the operator's total client portfolio); this is measured in terms of portfolio and individual calls as well as providing a three month average. Quality is generally measured by the QA staff and looks to make sure the procedures in the quality manual are followed.

**Portfolio:** measures the number of clients, clients that pay, the related percentage and amount collected and EFT setup. The EFT setup measures how many clients are on an EFT payment system (Note: management was question about this area and it has been determined that getting the client on an EFT payment method saves the client monthly money order fees or money gram fees as well as providing convenience). Yes, there is an obvious benefit to the XXX but this method serves the client proportionately more, since a monthly EFT is a savings to the client of \$10 to \$30 per month.

**Attendance:** this measure the days absent from work, approved and unapproved.

All these factors are compiled for each CSR and if they exceed the standard, they are given incentive pay based on each of the standards. This incentive pay is measured and paid each month in all the open account groups.

**Retention**

Retention team audit samples included the following characteristics: 1. call handling, 2. quality, 3. Portfolio- determines the number of DMPs that have paid and the total dollars collected, and the percentage of those DMPs that are serviced through electronic funds transfers (EFT), 4. Attendance- this is a recap of the employees approved absences, tardiness, suspensions, unscheduled absences, and total days work percentage. The retention sheets and statistical data determines that CSRs are being provided incentive pay for their productivity and not directly related to how much they can obtain from the client.

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Overall

Some of the above areas overlap, for example everyone is rated on attendance. It appears that XXX provides incentive pay based on efficiency, responsiveness, and the amount of calls being handled; signs of excellent customer service. While, collections are a part of the bonus calculation, it is not the only or even the primary aspect. Generally, there is no direct bonus earned by employees for getting people on DMPs or for collections as would be expected from a collection agency, where pay is substantially based on collections made on delinquent accounts. However, indirectly efficiency, productivity, and excellent customer service, all the things XXX rates and rewards their CSRs for, all lead to an enhanced DMP operation.

Other claimed educational activities.

XXX claims many additional educational activities as their own. We have confirmed that XXX has sponsored several off-site activities or has otherwise made grants for the purpose of providing educational opportunities. Namely, XXX had provided an endowment to the XXX XXXXXXXX XXXXX and they have collaborated with XXXXX (XXX) and other groups. These activities were not conducted by XXX, its management, employees or at XXX's place of business. These activities include:

\$67X unconditionally, up to \$133X Dollar Donation to XXXXXXXX XXXXX (XXX):

XXX made a commitment to donate \$133X to the XXX for the creation of an endowment fund which will support the establishment of the XXXXXXXX for XXXXX (XXXXXXX). The agreement states XXX paid \$13X upon signing and will pay \$13X annually. The commitment for the remaining \$67X is contingent upon the Company's approval of the progress made by the XXXXXX. No liability is reported on the remaining \$67X.

The promise is reported per (SFAS) No. 116, Accounting for Contributions Received and Contributions Made as Payable in less than one year: \$16X (including 2.5X of additional support and \$44X payable in one to three years for \$59X Total unconditional promise to give (including additional \$3.5X of additional contributions). Additional contributions are reported as "less discounts to net present value (\$6X).

The goal of the XXXXXX is to become the premier institution for development and distribution of research-based educational programs in personal financial management. Materials from the XXXXXXXX will be used to develop peer-to-peer financial counseling programs, similar to XXXXX, discussed later, at colleges throughout the nation. Incidentally, any benefits made by the XXXXXXXX for research based education remain the property of XXX.

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XX.

XX.

XXXXX<sup>30</sup>

XXX has provided grants to support this peer-to-peer student credit counseling which started at the XXXXX. Students apply for counselor positions and those selected are trained and paid to offer services to other students. In addition to one-on-one counseling, the XXXXX also provide group workshops and sponsor student competitions in the area of financial management. In [year], this was expanded to provide services in middle and high schools.

XXXX, XXXXX (XXX):

XXX gave an award of \$1X to the XXX Foundation - to support a new project, the XXXXX (XXXX), in the Department of Health and Human Development to promote personal and family financial literacy in public schools. "This project will allow the development and distribution of K-12 curriculum materials that weave personal and family finance literacy into a variety of curriculum areas"<sup>31</sup>

The initial goal was to have this curriculum available for every student in the state of XXXXX. The curriculum created met all requirements for Family and Consumer Sciences National Content Standards, and since it met National standards, they decided to make it available nationwide. The curriculum has been completed and XXXXX at XXX has coordinated and conducted numerous training opportunities to teach the curriculum both inside and outside of XXXXX.

They have also done extensive research on the success of the curriculum in actual operation.<sup>32</sup> In the tests where students were allowed to take the full semester course, scores improved significantly. From additional interviews, it was determined that what was needed was a presentation for school administration to get curriculum approved in the schools. As of

<sup>30</sup> The XXXXX XXXXXXXX / nickname is the XXXXX.

<sup>31</sup> News, XXXXX, XXXXX New Editor, XXXXX, [date].

<sup>32</sup> From an information meeting held with XXX and XXX at XXX offices in September of [year].

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the September [year] meeting, there were no concrete plans to disseminate or distribute the program, which is basically their next step.

While there is no formal distribution method, XXX or the XXXXX has created a website that allows downloads of the curriculum. As of [date], there were approximately 721 users of the site and 16,928 downloads of the educational materials. The actual use of the materials of the users is unknown by XXXXX, they simply know someone downloaded them.

XXXXX

XXX has provided grants to expand the XXXXX, XXXXX, a project of the XXXXX. XXXXX focuses on the needs of low-income youth and families, working in the most economically challenged neighborhoods to teach specific financial skill, character development and public speaking.

XXXXX Mentors

XXX provides financial and intellectual support for the XXXXX mentors at XXXXX School (XXX). The XXXXX mentors go into area high schools to mentor at-risk students. XXX claims the advice, support, and attention of these students demonstrate the ability to decrease the dropout rate among these students by providing them with insight into matters of money and education.

Other

XXX employees also volunteer to visit local schools on work time to make age-appropriate presentations to students on consumer finance and help with activities dealing with financial issues. This is done at XXXXX Elementary School and XXXXX High School and others as requested.

Financial instruction has also been provided by volunteers on their own time to local religious organizations. This includes Sunday School classes, counseling church members with financial problems. They also regularly teach the financial aspects of the marriage preparation program for the Archdiocese of XXXXX. They have also offered a 3 week program in financial improvement at a local Methodist Church.

XXX employees, usually XXXXX, have appeared in newspaper articles and on radio programs in the local area. They also claim to have participated in a local bank seminar for first-time homebuyers and visited local companies to address financial issues with employees. XXX also claims to allow other community organizations to use their facilities. Most of this volunteer work or "other" educational activities were not documented by XXX.

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Financial Information

Income

XXX's sources of revenue are fair share payments, member fees, interest income and miscellaneous revenue. Almost all of their total revenue, over 90%, is a direct result of their debt management plans offered to clients. Interest on investments and all other sources of income account for less than 5% of their total receipts.

	<u>XXXXX</u>	<u>XXXXX</u>	<u>XXXXX</u>	Total	%
Program Service Revenue	\$XXXXXX	\$XXXXXX	\$XXXXXX	\$XXXXXX	>45%
Membership Dues	\$XXXXXX	\$XXXXXX	\$XXXXXX	\$XXXXXX	>45%
Interest	\$XXXXXX	\$XXXXXX	\$XXXXXX	\$XXXXXX	<5%
Other	\$XXXXXX	\$XXXXXX	\$XXXXXX	\$XXXXXX	<5%
Total Receipts	\$XXXXXX	\$XXXXXX	\$XXXXXX	\$XXXXXX	

Program Service Revenues are Fairshare payments. As described on all returns prior to the return filed in [month, year]<sup>33</sup>, this was described as, "Revenue from Program Services is generated by fees charged to banks, credit card companies, and other creditors on payments collected from members that are then distributed to the members' creditors."

The term "fair share" refers to a payment made by the credit card companies who are receiving payments from their debtors via XXX pursuant to a DMP. Typically, credit card companies pay a fair share, which is a stated percentage of debt, to credit counseling organizations that set up DMPs; the amount paid is determined by each creditor in advance. Credit card companies generally will only make "fair share" payments to organizations recognized as exempt under section 501(c)(3) of the Internal Revenue Code. Credit card companies pay a percentage to for-profit collectors or they will sell the debt out-right for a small percentage of the debt owed.

Membership Dues are described as "Amounts paid by members for creation of Debt Management Plans and to disburse regular payments to members' creditors."

The other income is not significant enough to be relevant for this discussion.

However, it is important to note the lack of contributions from the general public. XXX receives no government grants or donations from private foundations. They receive no donations from community groups, churches, labor unions, or any other groups or private citizens.

<sup>33</sup> On the latest return filed they have changed the wording from fees charged to banks to voluntary contributions.

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Furthermore, they do not seek any type of donations and do not have plans to start a fundraising program.

It should also be noted that XXX does not report amounts held in trust as income on the Form 990, because they are acting as the agent for their clients and the funds are to be paid to the clients' creditors.

### Expenses

The following information was taken from Forms 990 as filed by XXX for the years ending XXXXX, XXXX, XXXX, and XXXX.<sup>34</sup>

Fiscal Year	XXXXX	XXXXX	XXXXX	Totals	%
Comp - officers	\$XXXXXX	\$XXXXXX	\$XXXXXX	\$XXXXXX	XXXX%
Other sal & wages	\$XXXXXX	\$XXXXXX	\$XXXXXX	\$XXXXXX	XXXX%
Other EE benefits	\$XXXXXX	\$XXXXXX	\$XXXXXX	\$XXXXXX	XXXX%
Payroll Taxes	\$XXXXXX	\$XXXXXX	\$XXXXXX	\$XXXXXX	XXXX%
Telephone	\$XXXXXX	\$XXXXXX	\$XXXXXX	\$XXXXXX	XXXX%
Postage/shipping	\$XXXXXX	\$XXXXXX	\$XXXXXX	\$XXXXXX	XXXX%
Occupancy	\$XXXXXX	\$XXXXXX	\$XXXXXX	\$XXXXXX	XXXX%
Printing/publications	\$XXXXXX	\$XXXXXX	\$XXXXXX	\$XXXXXX	XXXX%
Educational Overhead	\$XXXXXX	\$XXXXXX	\$XXXXXX	\$XXXXXX	XXXX%
Business Development	\$XXXXXX	\$XXXXXX	\$XXXXXX	\$XXXXXX	XXXX%
Total From Return	\$XXXXXX	\$XXXXXX	\$XXXXXX	\$XXXXXX	

The expenses on the return are generally operational expenses such as salaries, wages, taxes, telephone, etc., substantially all of which are directly related to the operations of providing the call center and debt management services. These percentages have been somewhat consistent during the years of examination. Some expenses need some additional explanation however.

### Educational Overhead

This is an allocation made by XXX, not a direct expenditure. XXX allocated expenses from indirect DMP costs, which included additional wages, operational expenses, development

<sup>34</sup> It should be noted that not all of the expenses are shown, so the percentages will not equal 100%. However, the Total From Return was taken directly off the return, so the percentages shown are the percentages of the total expenses, as shown on the return.

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costs, electronic media materials (payments to XXXX), printed materials, administrative expenses, etc. This was an allocation of indirect expenses that was computed by management. Development costs included payments to the XXXXX school, XXX Foundation and XXXXX. For the year ending XXXXX, education overhead was \$ XXXXXX of which \$XXXXXX was for the educational institutions mentioned above.

Overhead allocations for XXXX and XXXX are \$ XXXXXX and \$ XXXXXX respectively. In XXXX, Gifts and grants to the XXXXX School Foundation, XXXXX School and XXXXX School totaled \$XXXXXX and in XXXX, \$ XXXXXX to the XXXXX School, XXXXX School, and the XXX Foundation.

**Business Development**

This is a fairly major expense on the return that must be covered. This is the amount XXX pays to XXXX with respect to the contract between the two entities. As was stated earlier, this is how XXX obtains the vast majority of its clients, from the operation of this contract.

**Compensation, Salaries and Related costs**

The chart above shows that over the three year period covering the examination, wages and related expenses, which includes other benefits and payroll taxes exceeds one-third of the expenses on the return. Since we have already shown some of the expenses allocated include wages, this percentage is actually higher.

**Trust Account**

As was stated above, XXX does not report income on the Form 990 for amounts held in trust for their clients that are to be paid to the clients' creditors. However, we still had a responsibility to review the trust accounts to ensure they were being handled properly, as the funds going through the account for the first year of the audit was approximately \$XXXXXX dollars.

XXX has demonstrated proper internal controls and administration of the client's deposits and payments of their debts, without any material mistakes. XXX maintains and reconciles the trust accounts daily, determines each day how much goes in and out of the account. It prepares adjustments each day and prepares reports which are reconciled to the clients' accounts. The trust account appears to be operated properly and there has been no indication of abuse or improper accounting of the trust.

An analysis of the trust account shows that XXX collected and remitted to XXXX \$XXXXXX dollars for the first year of the examination. They also collected and remitted \$XXXXXX for

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XXXXX and \$XXXXXXX for XXXXX. Those were the 3 creditors who received the most from XXX as payments on their mutual clients' debts.

Compensation of Relatives of XXXX, CEO:

XXX was upfront about the relationships of many of the executives at XXX. They include the following relatives of XXXX and where available their compensation for the years of the audit.

Ending June 30,.....	XXXX	XXXX	XXXX	Relationship to CEO
XXXX	XXXXXX	XXXXXX	XXXXXX	-----
XXXX	XXXXXX	XXXXXX	XXXXXX	XXXX
XXXX	XXXXXX	XXXXXX	XXXXXX	XXXX
XXXX	XXXXXX	XXXXXX	XXXXXX	XXXX
XXXXX	XXXXXX	XXXXXX	XXXXXX	XXXX
XXXXX	XXXXXX	XXXXXX	XXXXXX	XXXX
XXXXX	XXXXXX	XXXXXX	XXXXXX	XXXX
XXXX	XXXXXX	XXXXXX	XXXXXX	XXXX
XXXXX	XXXXXX	XXXXXX	XXXXXX	XXXX
XXXX	XXXXXX	XXXXXX	XXXXXX	XXXX
XXXX	XXXXXX	XXXXXX	XXXXXX	XXXX
XXXXX	XXXXXX	XXXXXX	XXXXXX	XXXX
XXXX	XXXXXX	XXXXXX	XXXXXX	XXXX
Totals	XXXXXX	XXXXXX	XXXXXX	

estimated salaries are in italics

XXX also hires other relatives in lower positions. For example, children of the executives work during the summers or in other part-time positions.

Contracts:

XXXX

XXX has two contracts with XXXX. XXX is a software company that is 100% owned by the CEO, XXXX.

The first contract is actually between XXXXX (XXXXX) and XXXX. XXXX and XXXX have informed us that XXXXX merged into XXX.

The contract for this agreement is dated XXXXXX and gives XXXX a limited, non-exclusive,

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and non-transferable right to the XXXXX software; the software that runs the DMP program, from intake to all the payments made and all the notes taken in the system.

XXXX may modify this software per their needs, however, any modifications become the property of XXXXX. The current version of this software is called the Xxxxxxx.

The contract further states that XXXX agrees to pay \$XXXXXX to XXXXX for the use of this system. They are to be paid in XXXX installments in \$XXXXXX with interest at X%.

The term of this contract is 10 years and will automatically renew for successive 5 year terms thereafter, unless 90 days prior written notice is made before the expiration of the contract.

The second contract is between XXX and XXXX and is dated XXXXXX. This agreement gives XXXX a limited, non-exclusive, and non-transferable right to the XXX software package. This software is used as the "educational" budgeting tool provided to XXX clients.

The agreement is for XXXX to purchase a minimum of XXXX licenses per 12 month period at \$XX for the computerized version and \$XX for the non-computerized workbook version.

XXXX is to maintain books of account of all programs distributed for a 3 year period and to provide monthly statements to XXX.

The contract is automatically renewable for additional 12 month periods unless 90 days prior written notice is made before the expiration of the contract.

XXXX

XXX contracted with XXXX, in their words, as a way to obtain access to debtors in need of their services. The contract they provided is dated XXXXXX.

The parties to this Agreement are XXXX and XXXX and the agreement starts with the following as the basis for the agreement:

The contract states that XXXX desires to help borrowers under their loan programs who are experiencing payment problems, by encouraging them to seek debt counseling so a payment plan can be worked out.

XXXX, as an individual has created information collection software that XXXX can use to refer borrowers to XXXX. XXXX acknowledges that if XXXX collects the data, it will save XXXX time, money, and resources and XXXX acknowledges this will enhance their ability to manage its accounts.

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Therefore, the purpose of this contract can be paraphrased as follows:

XXXX has a number of borrowers that are unable to pay the full amount owed to them. XXXX therefore is contracting with XXXX, and providing them with referrals, for the purpose of XXXX putting them on payment plans.

Additional items noted in the contract (the number in parenthesis is the page # of agreement), are as follows:

(X) -XXXX shall gather and compile information for use by XXXX in computing a Payment Plan...if appropriate, XXXX will refer the borrowers to XXXX's Financial Management Services Unit who will collect the information required by the Client Information Referral Form and submit this to the Account System (which is the software developed by XXXX).

(X) -XXXX will access the Account System daily and will prepare a payment plan for each borrower, using its customary and usual procedures.

(X & X) -Both XXXX will use their commercially reasonable best efforts in the performance of their obligations from this agreement.

(X) -XXXX is to pay XXXX, out of its general operating revenues, the Information Compilation Fee, as calculated per Article XXX of the agreement and using Schedule One. XXXX will provide monthly statements detailing the transactions used to calculate the Information Compilation Fee.

(X) -XXXX. Both XXXX and XXXX understand the necessity of maintaining a reasonable constant flow of activity and successful conversion. "In as much as the value of referrals is connected with a reasonable volume, XXXX agrees to provide at least XXXXX Client Information Referral Forms annually."

(X) -XXXX. "With respect to program volumes, XXXX shall use its commercially reasonable best efforts to convert to active accounts at least a minimum level of the referrals received from XXXX." Both XXXX and XXXX understand the necessity of maintaining a reasonable constant flow of activity and successful conversion. "In as much as the value of referrals is connected with a reasonable level of successful conversions, XXXX agrees to convert a minimum of XX% of the Client Information Referral Forms to active status.

(X) -XXXX. XXXX has the right to approve certain levels of mergers, liquidations, sales, etc. before the actions take place. This article gives XXXX the assurance that if XXX is unable to fulfill its obligations, XXXX has some recourse.

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(X) -XXXX. Exclusivity "Subject to the exceptions set forth in the second Sentence of this Section, XXXX acknowledges that XXXX will have a competitive advantage in its industry upon entry into this Agreement, and XXXX agrees not to plan, advertise, sponsor, aid, develop, solicit or enter into any agreement with any other Person to provide services of the same kind, variety or nature with respect to debtors, without the written consent of XXXX." "However, notwithstanding anything else in this Agreement to the contrary, XXXX shall not be limited in any manner from entering into any agreement with any Person which involves a full or partial waiver of fees or contributions which would otherwise be received by XXXX as long as such agreement does not provide for the payment of any fee by XXXX to such Person for services to be provided or for referrals."

(X) -XXXX. The agreement expires on [date], with the last payment being [date].

The subsequent agreement with XXXX is entitled "Administrative Services Agreement" and is discussed below.

The subsequent agreement is dated XXXXXX with an expiration date in Article XX of XXXXXX, with the last payment being XXXXXX. This agreement however may be terminated without cause by either of the parties with 60 days written notice. This was not available in the other agreement.

This agreement was written in a tone much more suitable for a 501(c)(3) organization. The verbiage used is complete with comments about the educational activities of XXX. However, XXX has not represented there was any substantial change in the relationship between the two parties with the signing of the second contract.

In this agreement, for or on behalf of XXX, XXXX will provide the following services:

- Identify distressed borrowers
- Conduct extended information gathering interviews
- Compile detailed financial and household budgetary information, as specified by XXX.
- Provide case-specific advice and counsel to the borrowers on the importance of following sound personal financial management practices and explain the education programs and other resources that are available to the borrowers to relieve financial distress.

For these services XXXX will be paid \$XX per borrower that they perform the services for. Therefore, the contract characterizes the payment as a payment for services.

When discussing referrals, the agreement indicates XXXX may refer a borrower to XXX for

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counseling and other services with or without providing the services referred to in the Agreement. It states specifically, XXXX will not be compensated for any referrals.

XXX. XXXX has and will continue to conduct its consumer lending business in compliance with all material Requirements of Law.

As was stated previously, XXX has made payments of \$XXXXXX in fiscal year XXXX, \$XXXXXX in XXXX and \$XXXXXX in XXXX. In addition to the payment made to XXXX for the contract, the contract also allows XXXX to forego paying any fairshare payments to XXX. If XXXX normally paid fairshare of X%, in fiscal year XXXX, XXX gave up another \$XXXXXX in fairshare payments in that year only, as a result of this contract.

DMP Defaults:

XXX has provided information on their default rate. XXX has defined the "default" as a customer who ceases communication and payment of account without communicating the intentions to XXX. XXX goes on to state that XXX will try to contact the individual and maintain the account up to 60 days, at which point, XXX will deem the account closed. They have provided the following information for the first year of the audit, as follows:

Year Ending June 30, ----->	XXXX	XXXX	XXXX
Active Clients, Beg of Year	XXXXX	XXXXX	XXXXX
Additions	XXXXX	XXXXX	XXXXX
Attrition	XXXXX	XXXXX	XXXXX
Active Clients, End of Year	XXXXX	XXXXX	XXXXX

XXX has provided detail describing the reason for those dropping out of the DMP:

Year Ending June 30, ----->	XXXX	XXXX	XXXX
Client paid in full	XXXX	XXXX	XXXX
Clients on program > 12 mos and pd down debt > 50%	XXXX	XXXX	XXXX
Total Attrition less full paid	XXXX	XXXX	XXXX
Tot. Att. - full pd. As % of Beg clients	36.1%	34.2%	24.9%
Full paid as % of Beg. Clients	3.3%	4.2%	7.1%

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For fiscal year XXXX, XXX has stated that of the XXXX who left during the first year that XXXX left the plan due to paying off creditors early. We assume this includes paying off the DMP over the full period of the DMP, as that is much earlier than if the debtor paid the minimum balances to all their creditors, and those that were able to pay their DMP off earlier. Then, XXX categorized a subclass of XXXX as clients who stayed greater than 12 months and paid down greater than 50% or more. This leaves individuals who left for unknown reasons, totaling XXXX.

The chart above shows, the attrition rate over the number of clients at the beginning of the year to be 36%. The average over the three years is 32%. Another important statistic is the number of fully paid clients compared to the number of clients at the beginning of the year. That percentage is 3.3%. Over the three audit years, the percentage is 5%.

**Fee Waivers:**

XXX charges different amounts for services depending primarily on the state lived in.

The taxpayer stated that the average monthly maintenance fee charged was \$XXX with a maximum fee of \$XXX for account set up and \$XXX for monthly maintenance. Exceptions were in XXXXX \$0, in XXXXX \$0, in XXXXX- \$XXX set up and XX% of payment monthly capped at \$XX and in XXXXX \$XX set up fee and \$XX maximum monthly maintenance.

XXX responded that they had XXXXX clients during the examination year (XXXX) of which XXXXX were established as regulated DMPs; those that had limits to what XXX could charge. This leaves XXXXX clients representing a pool of 86% of the total client. Documentary evidence to this assertion is a prepared spreadsheet which lists all the states with the total number of DMPs that the organization had for that state.<sup>35</sup> No additional documents requested were provided. This response was a management prepared document from a review of their database.

**Relief of the Poor**

XXX has never made any type of claim that their purpose is the relief of the poor. They do not take any steps to focus their services or operations based on the income level of their clients. While they do ask for income levels, they do not request documentation on them. They also do not ask for or maintain any information about family size or compare the geographical location of the family to determine what income level the family may be at. Therefore, we will not discuss whether they are helping low-income individuals within the meaning of § 501(c)(3).

<sup>35</sup> See IDR response, number 7, copy attached.

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**Credit Repair / Debt Settlement / Debt Consolidation**

Credit repair is a service that claims to do one of two things: some credit repair agencies contact the credit reporting agencies and obtain removal of inaccurate or outdated negative items from credit reports; other agencies claim to be able to remove some or all negative items, regardless of their accuracy.

Debt settlement is a service where an offer for less than the amount due is made to a creditor to satisfy a debt in full. This can be done in a manner that is detrimental or beneficial to the debtor, depending on the ethics used in performing the service.

Debt Consolidation is a service where a loan is provided or arranged for a debtor that will be used to pay of most or all of a debtor's unsecured debt. This will allow the debtor to have only one bill and will hopefully lower the overall payment and interest paid by the debtor over the term of the loan as compared to paying off the individual debts.

We have found no information that XXX is involved in any manner with credit repair, debt settlement or debt consolidation. The help XXX provides to debtors is limited to their debt management program.

**(E) XXX's Application for Exemption:**

The Form 1023, Application for Recognition of Exemption, maintained by the organization is grossly misrepresentative of the application on File with the National Office, the approving office of the organization's exemption letter.<sup>36</sup>

Before we were able to locate the application file, we noticed gaps in the letters that were sent back and forth with the organization and letters in chronological order that did not seem to respond to the questions asked in prior letters.

After making additional attempts to get the application, we finally received a copy of the file from the National Office. The file is more than XX pages, 3 to 4 times as large as what we had been provided previously from the organization.

The application shows XXXX was created to provide financial counseling to low income individuals at no charge. It represents that Rev. Rul. 69-441 is "totally on point" and describes what XXXX does. Like the organization in Rev. Rul. 69-441, the application shows XXX

<sup>36</sup> The name of the organization during the application is, of course, XXXX, not XXX. Sometimes the agent and/or TP referenced XXX instead of XXXX. Again, for this report XXX = XXXX = XXX.

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provides free counseling, assists with debt management when necessary, and conducts extensive educational activities aimed at the general public.

The application further states that while the counseling is free in all cases, XXX will charge a fee (substantially below cost because contributions cover about one half of XXX's expenses) for the debt management aspect on a sliding scale. The scale starts at \$0 for those unable to pay and goes in steps of \$XX, \$XX, and \$XX per month, depending on the number of creditors involved. The organization in the Rev. Rul. provided free services and limited it to low income individuals. XXX stated in its application that the fee they charged should not preclude exemption because it is nominal, substantially below cost, and waived when necessary. The assisting of anyone in financial need, rather than only assisting low income persons, should not preclude exemption because these people are distressed financially. XXX represented that the majority of their clients are low income as shown by the fact that even though the charge can go as high as \$XX, XX% are handled for free and more than half pay only the \$XX fee (the lowest), and only XX% pay the highest, \$XX. The average monthly charge for services rendered to all clients is only \$XX.

The application states XXX is not controlled by creditors, not wanting their influence to be a detriment to those in financial need. While XXX works with creditors, its concern is the helping of the financially distressed person. While creditors are asked for contributions to help cover XXX's operations, such contributions are not required and the creditors will be treated the same whether contributions are made or not. The creditor benefit is incidental to the benefit provided to the financially distressed person and the furthering of the exempt purpose of XXX.

The educational materials are available to the general public. A person can specify which items they want and can receive one a month for free. If more are desired in any month, there is a limit of 6 per month, a nominal handling fee of \$XX per item is charged for the extra items (topics). The list of available items (topics) is extensive and growing. While the application represents that XXX is essentially the same as the organization in Rev. Rul. 69-441 doing all the same activities, it goes beyond the organization in the Rev. Rul. in the education / research area.

In an XXXXXX letter from XXX, attached as Item 16, Item 5 of the letter states, "In addition to the debt management services that are offered, all members receive one on one budget planning and general financial counseling at no charge."

In item 6 of the letter, they discuss their nationwide clientele, discuss their reach into rural America (a rural America that can't otherwise be served), they discuss their "cooperation" with the XXXXX @ XXXXX School, and the educational videos they will maintain in a library that will be loaned to schools and professional organizations.

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The XXXXXX letter from XXXX, for XXX, attached as Item 17, states:

"XXXX provides financial counseling to low income individuals and families experiencing financial difficulties. The financial counseling, which is always provided free of charge, includes information on the prudent use of credit, development of a household budget, advice on living within the budget and consumer education on wise buying habits, repayment of debts and numerous other subjects. In each case, XXXX assists the individual in preparing a workable budget. In its brief history, XXXX has been able to help literally hundreds of thousands of individuals progress from insolvency to financial stability through the use of these procedures.

XXXX also provides extensive educational materials to low income and financially distressed persons to increase their knowledge and to nurture the development of a keen interest in their own financial well-being"

XXXXX also writes that XXXX has hundreds of publications and provides a list showing 288 possible publications that can be ordered."

These publications are much of the missing application, as XXX maintains it. These publications and other educational materials are approximately two-thirds of the application.

The agent who reviewed the application file, created a memo explaining why he approved the application. A typed transcript of that memo is attached as Item 18.

Accordingly, XXXX received its letter approving its exempt status, dated XXXXXX.

**PRIMARY ISSUE:**

Should XXXX's tax exempt status under 501(c)(3) of the Code be revoked, because:

Issue 1 – Its primary activities do not accomplish an exempt purpose?

Issue 2 - More than an insubstantial part of XXX's activities are in furtherance of a non-exempt purpose?

Issue 3 - XXX was operated for the purpose of serving private rather than public interests?

Issue 4 - XXX has allowed private inurement to exist in conducting its operations?

**LAW:**

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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.

Section 6001 of the Code provides that every person liable for any tax imposed by the Code, or for the collection thereof, shall keep adequate records as the Secretary of the Treasury or his delegate may from time to time prescribe.

Section 6033(a)(1) of the Code provides, except as provided in IRC §6033(a)(2), every organization exempt from tax under Section 501(a) shall file an annual return, stating specifically the items of gross income, receipts and disbursements, and such other information for the purposes of carrying out the internal revenue laws as the Secretary may by forms or regulations prescribe, and keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations as the Secretary may from time to time prescribe.

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.

Section 1.501(c)(3)-1(c)(2) of the Regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. The words "private shareholder or individual" refer to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations provides that an organization is not organized and operated exclusively for one or more of the purposes unless it serves a public rather than a private interest. To do this, an organization must establish "that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or

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his/her family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.”

Section 1.501(c)(3)-1(d)(2) of the Regulations defines the term charitable to include, in part, relief of the poor and distressed.

Section 1.501(c)(3)-1(d)(3) of the Regulations defines the term educational to include (a) instruction or training of the individual for the purpose of improving or developing his/her capabilities or (b) instruction of the public on subjects useful to the individual and beneficial to the community.

Section 1.501(c)(3)-1(e)(1) of the Regulations provides that an organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purposes of carrying on an unrelated trade or business.

Section 1.6001-1(e) of the Regulations states that the books or records required by this section shall be kept at all times available for inspection by authorized internal revenue officers or employees, and shall be retained so long as the contents thereof may become material in the administration of any internal revenue law.

In Rev. Rul. 69-441, 1969-2 C.B. 115, the Service found that a nonprofit organization formed to help reduce personal bankruptcy by informing the public on personal money management and aiding low-income individuals and families with financial problems was exempt under section 501(c)(3) of the Code. Its board of directors was comprised of representatives from religious organizations, civic groups, labor unions, business groups, and educational institutions.

The organization provided information to the public on budgeting, buying practices, and the sound use of consumer credit through the use of films, speakers, and publications. It aided low-income individuals and families who have financial problems by providing them with individual counseling, and if necessary, by establishing budget plans. Under the budget plan, the debtor voluntarily made fixed payments to the organization, which held the funds in a trust account and disbursed the funds on a partial payment basis to the creditors. The organization did not charge fees for counseling services or proration services. The debtor received full credit against his debts for all amounts paid. The organization did not make loans to debtors or negotiate loans on their behalf. Finally, the organization relied upon voluntary contributions, primarily from the creditors participating in the organization's budget plans, for its support.

The Service found that by aiding low-income individuals and families who have financial problems and by providing, without charge, counseling and a means for the orderly discharge

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of indebtedness, the organization was relieving the poor and distressed. Moreover, by providing the public with information on budgeting, buying practices, and the sound use of consumer credit, the organization was instructing the public on subjects useful to the individual and beneficial to the community. Thus, the organization was exempt from federal income tax under section 501(c)(3) of the Code.

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 counseling 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. The reference to "lending agencies" suggests that what are now called fair share payments were involved.

Rev. Rul. 70-186, 1970-1 C.B. 128, which relates to an organization exempt under section 501(c)(3) of the Code organized and operated to maintain and improve a lake as a public recreational facility. In that ruling, the private benefits derived by lake front property owners were found not to lessen the primary public benefits flowing from the organization's operations. This case is distinguishable from a situation where an organization uses its funds primarily to foster private interests and the benefit, if any, to the general public is only incidental.

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. Treas. 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

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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.

The court held in B.S.W. Group, Incorporated v. Commissioner of Internal Revenue, 70 T.C. 352 that "It is with some reluctance that we conclude that petitioner is not an organization described in section 501(c)(3) because its primary purpose is neither educational, scientific, nor charitable, but rather commercial. Petitioner's officers, at least for the present time, serve without compensation, and there is no indication in the record that their personal motives are different from the stated purposes of petitioner. Furthermore, we are troubled by petitioner's assertion, on brief, that commercial consulting firms have not, in fact, shown any inclination to enter this particular field of consulting. Nonetheless, limiting our consideration to the materials in the administrative record as we must, we are unable to find that petitioner's primary purpose is educational, scientific, or charitable, rather than the conduct of an ordinary commercial consulting enterprise in competition with other commercial firms."

In addition, the court found that the organization's financing did not resemble that of the typical 501(c)(3) organization. It had not solicited, nor had it received, voluntary contributions from the public. Its only source of income was from fees from services, and those fees were set high enough to recoup all projected costs and to produce a profit. Moreover, it did not appear that the corporation ever planned to charge a fee less than "cost." And finally, the corporation did not limit its clientele to organizations that were section 501(c)(3) exempt organizations.

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In St. Louis Science Fiction Limited v. Commissioner, T.C. Memo 1985-162, April 2, 1985, the Court reviewed the annual convention of a science fiction organization. It held that while the conventions may have provided some educational benefit to some of the individuals involved, that social and recreational activities and private benefit predominated.

In Church of Gospel Ministry, Inc. v. United States, 640 F. Supp. 96, 1986 U.S. Dist., due to the taxpayer's failure to keep adequate records, the court held that the taxpayer failed to sustain its burden to show that it was qualified for federal tax exemption as a corporation organized and operated exclusively for religious and charitable purposes, as required under IRC §501(c)(3), and that it was further qualified to receive deductible charitable contributions under IRC §170(c)(2). The court found that the inadequate records failed to show that the taxpayer's operations did not inure to the private benefit of its officers, as provided under IRC §6001. The court found that as a prerequisite to an IRC §6033 filing exemption, it was necessary for the taxpayer to show it qualified as an IRC §501(c)(3) organization, which it could not.

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

Similarly, 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 purposes that was not incidental to the educational purpose and was not entitled to be regarded as exempt.

In Easter House v. United States, 846 F. 2d 78 (Fed. Cir. 1988), aff'g 12 Cl. Ct. 476 (1987), the court found an organization that operated an adoption agency was not exempt under section 501(c)(3) of the Code because it operated for a substantial commercial purpose rather than for the exempt purposes of providing educational and charitable services to unwed mothers and children. The services for unwed mothers and children were merely provided "incident" to the organization's adoption service business. The agency's operation was funded completely by the fixed fees charged adoptive parents. It relied entirely on those fees and sought no funds from federal, state or local sources, nor engaged in fund raising programs, nor did it solicit

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contributions. Moreover, the court found that "adoption services do not in and of themselves constitute an exempt purpose."

In *Airlie Foundation v. Commissioner*, 283 F. Supp. 2d 58 (D.D.C., 2003), the court relied on the "commerciality" doctrine in applying the operational test. Because of the commercial manner in which this organization conducted its activities, the court found that it was operated for a non-exempt commercial purpose, rather than for a tax-exempt purpose. "Among the major factors courts have considered in assessing commerciality are competition with for profit commercial entities; extent and degree of below cost services provided; pricing policies; and reasonableness of financial reserves. Additional factors include, inter alia, whether the organization uses commercial promotional methods (e.g. advertising) and the extent to which the organization receives charitable donations."

The Credit Repair Organizations Act (CROA), Pub. L. No. 104-208, § 2451, 110 Stat. 3009-455 (Sept. 30, 1996), 15 U.S.C. § 1679 *et seq.*, effective April 1, 1997 imposes restrictions on credit repair organizations, including forbidding the making of untrue or misleading statements and forbidding advance payment, before services are fully performed. 15 U.S.C. § 1679b. Significantly, section 501(c)(3) organizations are excluded from regulation under the CROA.

The CROA defines a credit repair organization as:

- (A) any person who uses any instrumentality of interstate commerce or the mails to sell, provide, or perform (or represent that such person can or will sell, provide, or perform) any service, in return for the payment of money or other valuable consideration, for the express or implied purpose of—
- (i) improving any consumer's credit record, credit history, or credit rating, or
  - (ii) providing advice or assistance to any consumer with regard to any activity or service described in clause (i).

15 U.S.C. § 1679a(3). The courts have interpreted this definition broadly to apply to credit counseling agencies. The Federal Trade Commission's policy is that if an entity communicates with consumers in any way about the consumers' credit situation, it is providing a service covered by the CROA. *In Re National Credit Management Group, LLC*, 21 F. Supp. 2d 424, 458 (N.D.N.J. 1998).

Because 501(c)(3) organizations are exempt from regulation under the CROA, organizations that are involved in credit repair have added incentives to be recognized as section 501(c)(3) organizations even if they do not intend to operate primarily for exempt purposes.

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In FTC v. Gill, 265 F.3d 944 (9th Cir. 2001), aff'g 183 F. Supp. 2d 1171 (2001), the appellate court inferred that a credit repair organization that first promised a "free consultation," but charged fees in advance of the full performance of services was being operated as a charity primarily for purposes of evading regulation under the CROA.

In Credit Counseling Centers v. S. Portland, 814 A.2d 458 (S. C. Me. 2002), the Supreme Court of Maine denied state tax exemption to a credit counseling agency that provided significant benefits to creditors. Credit card companies commonly make payments to credit counseling agencies of a portion of the funds they receive from clients of the agencies. These payments are known as "fair share" payments and are a source of substantial funding for credit counseling agencies. In this case, the credit counseling agency received 60 percent of its income from "fair share" payments from credit card companies, at the rate of 8.5% to 9% of debt payments.

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).

In International Postgraduate Medical Foundation, T.C. Memo. 1989-36, one individual controlled both a nonprofit that ran tours aimed at doctors and their families and a for-profit travel agency that handled all the nonprofit's tour arrangements. The non-profit spent 90 percent of its revenue on travel brochures prepared to solicit customers for tours arranged by the travel agency. The tours were standard sightseeing trips, with little of the alleged medical education that was the basis for exemption. The Tax Court held the petitioner was not tax exempt, finding that it was operated for the benefit of private interests, namely the founder's travel agency. The court found that a substantial purpose of the nonprofit was to increase the income of the travel agency. (In this case there was both inurement and private benefit.) Also, its activities were directed at providing opportunities for recreation, not education.

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 (7<sup>th</sup> Cir. 1999). Reasonable compensation does not constitute inurement. Birmingham Business College v. Commissioner, 276 F.2d 476, 480 (5<sup>th</sup> Cir. 1960).

The Tax Court holds in People of God Community, v. Commissioner of Internal Revenue, 75 T.C. 127, that "Part of petitioner's net earnings inure to the benefit of private shareholders or

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individuals. Accordingly, petitioner is not exempt as an organization described in sec. 501(c)(3), I.R.C. 1954."

"The statute specifically denies tax exemption where a portion of net earnings is paid to private shareholders or individuals. We hold here that paying over a portion of gross earnings to those vested with the control of a charitable organization constitutes private inurement as well. All in all, taking a slice off the top should be no less prohibited than a slice out of net."

"In other words, section 501(c)(3) denies exempt status to an organization whose founders or controlling members have a personal stake in that organization's receipts. Founding Church of Scientology v. United States, supra. Such is the case here, where petitioner's ministers, and Donhowe in particular, completely control its affairs. Petitioner therefore fails to qualify for exemption under section 501(c)(3)."

**GOVERNMENT POSITION:**

**Audit Observation Limitations**

Before we discuss and analyze XXX operations, we first need to provide some clarification about what was available to be reviewed. As in most audits, we are not able to go back in time and actually observe an organization conduct the actual activities that they were conducting during the audit period. We must rely on documented evidence to show how they conducted their activities during the period of an audit. We also look at their current activities and try to determine how the prior activities would have been in comparison. This is the historical approach to examinations. This case is no different to other audits in that respect, with a small exception.

XXX as part of their operations constantly records phone calls and the actual computer screens the CSRs use in performing their work in the phone center. However, even though XXX is required to maintain records to show they are meeting the operational tests under 501(c)(3), they chose not to maintain any of these historical recordings. This was undoubtedly a choice they made by considering the costs involved with maintaining such records.

In Church of Gospel Ministry, due to the taxpayer's failure to keep adequate records, the court held that the taxpayer failed to sustain its burden to show that it was qualified for federal tax exemption. Since we are unable to observe the calls in the past, we don't understand how or why XXX is claiming that it is unfair to listen to the current phone calls to determine what they did in the past. Their argument seems to be that they don't have records to adequately prove what occurred on the phone calls to show how their call center operations worked, which as we will show is a critically important part of their operations.

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However, during the audit, we did have access to a great volume of the manual XXX uses which documents how XXX was operated. We were provided various versions of the manual, as it is constantly being updated. The number of documents or versions we didn't have access to is unclear to either XXX or to us, but we feel it provides a fairly complete picture of how XXX historically instructed its employees to perform their duties.

Additionally, upon interviewing the executives early in the audit, and the CSRs much later in the audit, we were told that XXX's activities have pretty much remained constant over the years, as far as the phone center operations go. XXX has just become much larger because of the agreement entered into with XXXX, which occurred before the audit periods. The individual phone calls with the individual clients have remained the same from the periods under audit to the current period.

We also had access to the client files and the notes taken in the XXX computer system. At the suggestion of the XXX's CFO, we looked at client files from the time period covered by the audit and compared them with the client files of current clients. We also looked at the notations made in the past and compared them with notations made currently. While every single client they talk to is different, we were able to determine that the same basic documentation was available for the past and the current clients. This led us to the conclusion that it would be appropriate to listen to calls from the current period to determine how they were operating in the years under audit.

Therefore, during our audit, we felt that we were able to get a full understanding of how XXX was operated from July XXXX to June XXXX, and into the present.

Another observation that should be made is the "image" projected by XXX during our audit. They have consistently represented that they were educational, above and beyond, the rest of the industry. They have constantly tried to set themselves apart from other credit counseling agencies, as the model in the industry; a truly educational organization.

XXX executives have been on notice since before<sup>37</sup> this audit began. The CEO and XXXX, are both members of XXX with the CEO being on the Advisory Board of XXXX. Their in-house counsel and XXXX, XXXX, is the chairman of the XXXX for XXXX. Throughout the audit, XXX executives made several trips to Washington DC to keep informed of Industry developments. When the July 2004 Office of Chief Counsel Memorandum 200431023 was issued, XXX executives were immediately aware of this and even discussed it with us briefly.

<sup>37</sup> We use the term "before", meaning XXXXXXXXXXXXX.

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XXX has always been fully aware of the guidance that was available indicating how they should be operating, mainly the two rulings and two court cases. They were also aware that the probability of an examination of their organization due to their size was extremely high. They were actually anticipating the initial call informing them of the audit. From the time we first sat down with them in the initial interview, they have stressed education as their main goal, knowing that was the key to their exempt status.

So if there had been any change in the method in which they have done business since the periods covered by the audit, it would surely be in favor of providing education. It is unconscionable, that with the scrutiny this industry is under and the awareness of XXX of both this scrutiny and of the educational requirements to remain exempt, that they would possibly change their operations to be less educational.

Therefore, we have full confidence that whatever observations we made during the audit, would show XXX to be as educational or more, than the actual operations in the periods covered by the audit.

**Issue 1 – XXX's primary activities do not accomplish an exempt purpose?**

To meet the requirements of *section 501(c)(3)*, an organization must be both organized and operated exclusively for charitable and other enumerated purposes. The term charitable includes relief of the poor and distressed. Section 1.501(c)(3)-1(d)(2), Income Tax Regulations.

XXX provides its services to the general public regardless of income. They have also never claimed to be operating for the benefit of the poor, so this will not be discussed in any detail. Additionally, the class of people XXX provides services to, debtors, have never been determined to be a charitable class and XXX is not making this claim now. Therefore, they are not operated for the benefit of the poor or any other charitable class. Section 1.501(c)(3)-1(d)(2) of the Regulations.

However, educational organizations are also classified as charitable. 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. Section 1.501(c)(3)-1(d)(3). In other words, the two components of education are public education and individual training.

Whether an organization operates exclusively for charitable purposes depends on the application of the operational tests set forth in the income tax regulations. The regulations provide:

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An organization will be regarded as "operated exclusively" for [charitable] purposes only if it engages primarily in activities which accomplish one or more [charitable] purposes specified in *section 501(c)(3)*.

Since XXX's operations are so overwhelmingly consumed by the call center operations and support for the call center operations, both in terms of time involved, employee resources, and in terms of both revenue and expenses, this is clearly their primary activity. Therefore, we must look at that activity to determine if it accomplishes an exempt purpose. We have previously shown that 80% of the employees at XXX perform direct work and almost exclusive work in the call center and the support for the call center. The other 20% perform work either as a result of the call center operations, like the accounting department, or so the call center can operate, like the Communications & Security, Facilities, H.R., & I.T. Instruction XXXX shows how the entire XXX operation supports the New, XXX, and Open Accounts areas. Therefore, almost all of their employees, directly or indirectly, work to run the call center operations. We have also shown that 99% of the revenues and substantially all of the expenses are spent on the call center and its operations related to the DMPs. Looking beyond this to determine their primary activity or purpose is not logical in this case.

XXX cannot argue that the intake of callers, the handling of callers, the processing of DMPs, the servicing of the DMPs, and all the support services directly related to DMPs is the overwhelming majority of the operations that XXX performs. Therefore, for XXX to be exempt, we must find that the call center operations, and its supporting departments, are educational.

As we have indicated above, XXX is a member of several different organizations, including the BBB, XXX, ISO, XXXX and XXXX. We have described what each of these organizations' activities and purposes are. For the purposes of this discussion, we simply want to re-emphasize what they do not do. None of the organizations have the authority or responsibility to monitor and ensure that XXX is conducting educational activities. While membership in these organizations may seem to be impressive on some level, the memberships have absolutely nothing to do with whether or not XXX is actually conducting educational activities or operating in an exempt manner, period.

Additionally, while it is commendable that XXX is a member of the BBB, this simply means they have been able to meet the requirements of the BBB, specifically in terms of complaints from the public. This is certainly more than some CCC organizations can claim, and does provide evidence to separate XXX from the fraudulent and abusive credit counseling organizations. Again, however, this does not make them an educational organization.

The high level overview provided in the fact section was taken directly from XXX's own Manual. While they describe the purpose of XXX as providing debt management, budgeting

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and education services, we have found that what they actually provide is debt management services only, a service that does help many of XXX's clients get out of debt.

When XXX describes what it actually does in the Manual, they describe only their debt management plan, not budgeting or educational services. They state they are a process-based organization acting as a liaison between client and creditor to obtain concessions whereby the client makes one payment, instead of many. They describe how the new accounts area screens callers for DMPs, proposes an appropriate solution and establishes a pending account. Since pending accounts are only established for DMPs, XXX is stating in their Manual that DMPs are the only proposed solution. It is actually more correct to say that the only solution XXX helps clients with, in order to get them out of debt, is the DMPs.

The Manual then goes on to briefly describe the DMP process. In the simplest terms, XXX's Manual acknowledges that the primary activity of XXX is the DMP. Again, a DMP is a tool used to restructure unsecured debt, which allows a consumer to consolidate unsecured debt; lower interest rates and monthly payments, obtain re-aging of debts, and/or curtail collections calls, penalties and over-limit fees. The concessions and guidelines are pre-set by creditors, which any consumer credit counseling (CCC) organization then uses to provide benefits to their clients and to distribute payments to the clients' creditors.

DMPs have been around in this industry for some time. They are referenced in both rulings covering the credit counseling industry, Rev. Rul. 65-299 and 69-441. They were also mentioned in the two main cases dealing with the credit counseling industry, CCCS of Alabama and CCCS of Oklahoma. The simple fact that DMPs are offered is not the determining factor, but in what context are they offered. This is what we will look at to determine if XXX is operated primarily to accomplish exempt purposes, and we will have to look at numerous factors to make that determination.

#### Counseling Sessions

We will start by looking at the counseling sessions directly. At XXX this starts in the new accounts department or at XXXX. However, since we don't have access to XXXX operations, we are unable to evaluate those sessions. Since XXX doesn't control those operations, we simply cannot assume that XXXX's, one of the largest for-profit unsecured credit issuers in the United States, operations will be more "educational" than XXX's own operations.

Additionally, XXX did not provide any information to support that XXXX was conducting educational activities. As is required by Regulations Sections 6001 and 6003, XXX has the responsibility to show it is operating in an exempt manner. Since they have provided no information to show XXXX is conducting their educational activities, they cannot now say, this is how they meet their exempt purpose. Additionally, since they do not control XXXX

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operations, they cannot claim credit for any claimed educational activities of XXXX<sup>38</sup>. XXX activities will have to show they are educational on their own.

#### New Accounts

The operations in the New Accounts Department were reviewed by interviews with the customer service representatives, supervisors, and officers of the organization. We also reviewed manuals (XXX, XXX, XXX and XXX), client folders, account notes and other source documents. We also listened to a number of calls between new accounts CSRs and callers. All of this information was used to create this analysis and to come to our conclusion.

In the fact section, we established that clients come into XXX either with<sup>39</sup> or without<sup>40</sup> financial information already on the software system. If the financial information is not filled out, the new accounts CSR does this immediately. When the items of income, expense, and unsecured debt are covered, the software system determines if the caller is a XXXX client. XXX refers to this as "pre-qualifying the client for a program".

The financial items are accepted as given by the caller; they are not questioned at all. XXX does not get a full financial history of a client, for example, the CSRs do not ask about assets or secured debt balances. There is no discussion with the caller about spending habits. There are no discussions of how the budget may change in the future, concerning either increased or decreased income or expenses. There is no discussion of the client's educational background or the client's health or other life issues that could impact the financial situation.

If the client is determined to be XXX or XX, and is close to being XXX, the CSRs are required per their manual to go back over the budgets to look at possible adjustments that can be made, in order to get them into XXX. From the top down, XXX feels that they can help people out of debt, if they can get them on a DMP. Therefore, the CSRs are to look for "adjustments" that could be made to get them on a program, without being over zealous about doing so. We listened to several phone calls where this occurred. This was not part of an educational process, but simply a query to lower expenses or increase income, to qualify them for a DMP. For example, a CSR might ask can we lower your clothing budget. They do not discuss the clothing budget, to determine if it can or should be lowered. The CSR only wants to know, if the caller will allow the CSR to lower the itemized cost of that item in the budget, to qualify the client for a DMP. This certainly is not part of any educational process.

<sup>38</sup> XXX also claims that the true education doesn't really start with the initial phone call, as we will discuss later, so claiming XXXX activities as their exempt activities is unlikely.

<sup>39</sup> From XXXX or from the Web application form.

<sup>40</sup> All others.

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XXX knows that if the caller is too far out of the XXX ranges, they have little hope of being accepted on the plan by creditors, if XXX, or have little hope of staying on a DMP for any meaningful amount of time, if XXX. Having said this, we believe XXX operates basically in an ethical manner, and truly attempts to help their clients out of debt. We have never stated that XXX signs up, or attempts to sign up every single caller. However, they do try to sign up every caller that is XXX and do make attempts to move XXXX and XX callers that are borderline, into the XXX category.

After the CSR attempts to adjust the budget to qualify the XXX<sup>41</sup> caller and he is unable to do so simply by asking them to increase expenses or lowering income, the CSR is instructed to dismiss the caller by telling them that they do not qualify for a DMP, to review their budget closely for possible lifestyle adjustments, contact their creditors for a solution, and to make consistent monthly payments to their creditors.

Again, this XXXX caller is calling because they believe they are having financial difficulties. By operating in this manner, XXX does not probe the spending habits of the caller to determine if education may be the only need of the caller. This really applies to all callers regardless of the XXX they are classified in. There are many areas of education that could be provided to all their callers to help improve their financial literacy and financial situation. Instead, XXX does not offer assistance to these people. Again, the CSRs are not trained to or told to probe the budgets to look at spending habits or discuss excessive spending.

The XXXX caller receives essentially the same services as a XXXX caller; XXX gets their income, expenses, and unsecured debt and inputs this into a budget, the computer then assesses them as a XXXX client and the CSR then recommends the caller seek legal advice.

While XXXX<sup>42</sup> callers may be asked if some expenses might be lowered<sup>43</sup>, for the purposes of qualifying them for a DMP, the callers spending habits are not thoroughly discussed to determine patterns of spending or if excessive spending can be found, as part of an educational process. The caller's assets are not reviewed to determine if a sale could be a solution to their debt problem. There is simply no full discussion of all aspects of the callers' financial situation that a true financial counselor could use to provide specific guidance or education tailored to that individual. The CSRs are told, through their training and instruction, and by the XXX manual, they are only to recommend the client seek legal counsel. That is the end of these callers' relationship with XXX.

<sup>41</sup> Too much income for a DMP.

<sup>42</sup> Too little income for a DMP.

<sup>43</sup> Or possibly if income can be increased.

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For both XXXX and XX callers, the XXXX suggests that the CSR should offer additional assistance, but does not state what that assistance should be. The caller at this point realizes that a DMP will not be provided and that whatever options may be available will not come from the CSR. The document expressly tells the CSR that although XXXX and XXXX callers may not receive a DMP, they are instructed that the caller need to look elsewhere for financial counseling.

Additionally, XXX claims that all XXXX are provided a 1) copy of the financial assessment, which is really just the income and expense figures that the caller gave to the CSR, and 2) XXX's financial management software through their website. However, based on Instruction XXXX it does not appear that they started doing this until 11/2/XX, which is after the audit period. We also found that the current website states that only active clients can download the software for free. Therefore, just like any member of the general public, the only thing that it appears all XXXX get from XXX is access to their website, which has limited use for the purpose of providing education to financially distressed persons.

If after taking the budget, the caller is classified as a XXXX client, there is no additional information discussed about the budget, spending habits, or financial situation of the caller. They are simply offered a DMP. They are immediately explained that they qualify for the DMP, and are explained the benefits of a DMP. Even though XXX calls this "Explain services available", we have already established that XXX has only one service, one solution, a DMP. From here it is up to the client to decide if they want to be in a DMP or not.

Another area that XXX falls short in, is the options that it presents to the callers. As we have stated before, the CSRs only option to help a client with, is the DMP. Unless, the caller outright refuses to sign up for a DMP, they would never be given another option. If a XXX caller just decides not sign up, they might never talk to a XXX CSR again<sup>44</sup>.

Here are some examples of some additional options that XXX CSRs do NOT generally discuss with clients:

- Coaching clients on negotiating directly with creditors.
- Discussing the mechanics and advantages of creating and maintaining a budget.<sup>45</sup>
- Recommending changing buying habits or strategies for saving money.
- Discussing custom-designed payment plans.

<sup>44</sup> XXX procedures certainly provide that XXX will attempt to talk to the caller to encourage them to sign up for a DMP but it is not guaranteed the caller will ever be reached again.

<sup>45</sup> Remember, the budget that the CSR takes is simply Income and Expense information with limited analysis as to the preparation of the budget; used only to identify the caller as a potential client.

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- Presenting advantages and difficulties of all options including bankruptcy, DMPs, self-administered payment plans, etc.

We did not hear any of these, or other options, offered to any caller, no matter the XXX that XXX placed them in. There is no mention of any of these, or other options, in any of their manuals. XXX simply has one solution, the DMP.

While the entire intake process may occur over one or more phone calls, this is what occurs in the initial phone call that XXX claims is 45 minutes to an hour long, or as XXXX claimed in XXXXX up to 2 or 3 hours long. We certainly do not have anything to refute that some calls last 2 or 3 hours, but we believe a 2 hour call would be extremely rare and a 3 hour phone call would certainly be the subject of discussion with a supervisor. They are not the norm!

The new accounts CSRs are evaluated on phone time and calls per hour. The average call times for a new accounts representative is approximately 24 minutes in length. Based on our audit though, that is just an average time. From our observations, we believe that a full intake session, which may be one or more phone calls combined, does last 45 minutes to over an hour. While this amount of time would indicate XXX allows adequate time to discuss education, we did not find that the CSRs used this time to obtain a full financial picture of a client and provide financial education. Instead, we found that the CSRs obtained enough financial information to properly classify the caller into XXXXs, and then offer a DMP if XXXX.

In our review of the many, many XXXXs that cover the new accounts area, none of the XXXXs contained any instructions or guidance for the CSRs to implement true education. The XXXXs provide guidance in how the CSR obtains efficient call management by following a specified procedure, not provide education. As we have stated several times, the only time education is mentioned in the performance of any CSR duties, is in explaining the DMP. This was corroborated by the XXXX standards. For example, Identifying the issue, Call Outcome, and Client Goals & Objectives,<sup>46</sup> in reviewing these items listed in the XXXX, we found they state the priority of management of phone calls, and the lack of instruction on how and why to educate. XXX clearly demonstrates its primary object (DMP vs. education) by stating "Ascertain and document any problems or concerns that the client may have", "Approved client for DMP, spooled agreement, sent EFT form" ... "Informed client that a DMP may not be in their best interests as they have too much income left after paying debt", and Account documentation should clearly indicate the financial goals of the client"... "Client wants a debt management program so that he can be debt free and financially stable within 5 years", respectively.

<sup>46</sup> Instruction XXXX, page X of X.

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As it relates to the XXXXs and new accounts, we also want to go back and make some additional comments about XXX's manual and the statements in them. In Instruction XXXX, XXX emphasized the wording "if education is needed". Not only were they only talking about a DMP, but they are limiting this education, to only times when it is needed for time savings or efficiency purposes.

Another statement that demonstrates XXX's lack of providing meaningful counseling is in this same manual; they provide an example of notes written about a XXXX client. The example shows they "educated" by telling the client to keep a journal to help track expenses and that the XXX budgeting software was offered but declined. It then notes the person was advised to meet with a certified financial advisor to help adjust their budget to meet their goals.

While the journal suggested certainly could be part of an educational process, they are not telling the caller to call in to discuss the journal after the debtor maintains it over some period. This is where the education would come in. XXX then actually instructs their CSRs to tell callers to go to a certified financial counselor to help them adjust their budget to meet their goals. This is precisely what XXX should be doing with every single caller. Instead XXX is teaching and instructing the CSRs to tell financially distressed callers to go elsewhere for this education and guidance.

The XXXX and XXXX are the reference points for all CSRs. These manuals, whether XXXX or XXXX, are extremely detailed about every single aspect of a DMP, yet they have no procedures that require any CSR to provide financial education, they are only to facilitate, in a cost efficient manner, to determine if a DMP will fit each client (not due to educational or financial preference of the caller) but to determine if the total income to debt will meet the creditors' acceptance. Surely, this is evidence that XXX's primary purpose is the DMP, not education.

All of this is further emphasized in the XXXXXX. This XXX multi-page document is a guide to "complement the monitoring form by detailing our standards, providing rationale for each statement, and offering examples of positive verbiage that exemplify the standard", as revised on XXXXXX. This document provides insight to the communication between the new accounts CSR and client. The document provides a flow of communication to the caller. It tells the CSR what should be said in each phase of the call. It also provides the detail and rationale. Clearly, XXX has put a great deal of functional information together for the CSR, including the details, and rationale, all of which excludes financial counseling or education.

The document instructs the CSR to suggest to the caller that they track daily expenses for the purposes of evaluating where you may be able to reduce your spending. While we reviewed actual new accounts calls (we will refer to these as samples), no education was provided. The CSRs did not even suggest the most obvious advice i.e. "spend less". The samples did verify

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however that the job of the CSR is to determine income and expenses and evaluate the caller to determine if they will qualify for a DMP.

The rationale of the document, as stated for a XXXX client is: "As a counselor, you have the unique opportunity to educate our customers and help them attain success. Sharing all pertinent information with a customer that affects his or her account satisfies their apparent and unrealized needs and decrease future unnecessary calls"...

However, the rationale, as stated by the document is different than its true emphasis. The document's emphasis is on efficiency and the focus of limiting time with a caller who will not qualify for a DMP. The document discusses the phases of a XXXX caller into a DMP and the success of the new accounts CSR is getting that person into a DMP. To look at it differently, consider Instruction XXXX which emphasizes a DMP to anything is stated on page X, "*The determining factor in qualifying for the XXXX debt management program is for the processing agent to determine if the client has too much income to need a debt management program. In certain cases, the client may have more income than what is required to meet the creditors minimum payments through such a plan....*" And "*the creditors will not accept a debt management plan, in most cases, if the client can meet the normal monthly payments to them. Therefore, the client is **turned down on the basis of having too much income** and advised to readjust their household budget, contact the creditors for solutions, and to make consistent monthly payments to their creditors*". What more can you deduce from this other than, the DMP reigns and its implementation done as efficiently as possible? By reading the XXXXs, XXX is foremost providing DMPs and instills the procedures necessary to efficiently implement them as the most important thing. Why else would procedure after procedure to provide guidance to the CSR to operate and maintain the workload of each client's DMP, so vital? The mere mention of "readjust their household budget" is in the most exaggerated way providing education. By stating in the procedure to instruct the CSR to tell the client, "don't spend as much" is not providing education.

As we stated above, we also listened to a number of calls between new accounts CSRs and callers. This was the subject of IDR 7, dated 3-9-XX. XXX responded on 7-25-XX with a 3 part response. One part discussed our sampling techniques, one part summarized<sup>47</sup> and analyzed the calls and the last part summarized their response. XXX has stated that our sample does not reflect their communications with clients in New Accounts, yet every call listened to was homogenous and supported the contention that XXX's instruction to their employees and their employee's adherence to its manuals support the company's objective, which ultimately is to provide clients who qualify, with a DMP. Since we feel this is an extremely important aspect of the examination, we are now submitting attachment 19, as a rebuttal to the XXX response dated July 25, XXXX. The summary of the attachments and our review of the 31 actual phone

<sup>47</sup> Their summaries of the calls were more detailed than the ones we had provided to them.

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calls between the new accounts CSRs and callers that we reviewed, confirmed that the new accounts area was basically an area that pre-qualifies callers for a DMP. We found no substantive educational aspects to any of the phone calls. The foremost objective of these calls was to obtain potential DMP clients. This contradicts statements made by XXX executives verbally and in letters to us during the examination.

XXX states in their July 25, XXXX response, that the goals of New Accounts calls include establishing a relationship, assessing the client's financial situation, setting up a budget, making appropriate recommendations, and to the extent possible, helping the clients obtain short-term relief for their short-term financial problems.

We agree that the new accounts area establishes relationships with callers, takes a budget from the callers, and classifies them into XXXXs. As we have stated before, there is no assessment of the financial situation though, the CSR simply takes the numbers as the clients provide them. We do not agree that the CSRs make appropriate recommendations. Their recommendations are based on the software generated determination of which class of client they fall into. XXX offers a DMP and little else, which we also agree is short-term relief for what we believe is a long-term financial problem in most cases. The CSRs do not probe enough to determine if something is a long or short-term problem. It is not what they are hired for, trained for or retained for. If they did probe this further, and found some true short-term problems, most likely a DMP would not be the appropriate solution, unfortunately that is the only solution XXX gives its CSRs to help the callers.

While, they again claim that they provide counseling, budgeting, educational materials and access to educational materials to clients not recommended a DMP, we have already covered the fact that they do not do this in any meaningful manner.

We also need to respond to additional comments made by XXX. They stated that when clients first call into the organization, they are simply not at a point where they are receptive to education. This statement by XXX provides confirmation of our discussion above, that education is not provided to clients in the "intake" process. So regardless if the caller is determined to be a XXXX, XXX, or XXX individual, they are not provided with education. If a XXXX individual is not in a good position to be educated, XXX is not in a position to claim XXXX or XX callers are in a better situation to be educated, especially when they are dismissed so quickly by XXX after they are found to be XXXX or XX.

Therefore, even though XXX has stated numerous times and documents on their Form 990 that they "reach" XXXXX to XXXXX clients in a year, this does not mean they educate that many clients every year. By their own admission, XXX agrees that the "real" education doesn't start until a client is on a DMP and continues through the long-term relationship they have with the client as they are on the DMP. This "behavior" modification is more forced than taught.

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Clients who accept the DMP are asked not to take on new debt since their accounts will be closed except for one major credit card for emergencies. New accounts CSRs' duties are not designed to provide valuable education on consumer debt.

In summary, by interviewing CSRs, supervisors, and officers of the organization, reviewing manuals, client folders, account notes and other source documents, and in listening to 31 open accounts calls we have determined that the new accounts area pre-qualifies callers for a DMP, explains the DMP to the callers and attempts to get them to sign up for a DMP. We conclude that the counseling sessions and contacts made during this period are not educational activities or in furtherance of education as defined by the Code. New Accounts is the "Gateway" of the distressed borrower to XXX. If they qualify for a DMP they are admitted for a 5 year relationship interested in the management of their debts. The rest unfortunately, after receipt of the XXXX and XX brochures and the self directed invitation to their website, are locked out. They in fact need to find their questions and needs answered elsewhere, hopefully by a 501(c)(3) charity that performs counseling or by other qualified financial counselors.

Nevertheless, this does not conclude XXX's involvement with a client, we must look at the next series of contacts a caller may have with XXX. These contacts are in XXX's XXX area.

**XXX contacts**

The primary purpose of the XXX area is to make sure the clients' creditors all accept the proposals sent out by XXX and that the client fully understands what to expect when being the DMP. The XXX area emphasizes the clients making timely payments and reviewing their monthly statements. In order to reduce unnecessary phone calls, the XXX area also covers numerous areas that will likely be of concern to the clients as the DMP gets started. For example, they inform them the APR's on some credit cards might not be reduced or the accounts will not be re-aged for some time. They also let them know collection calls may continue for a short period as well.

As we have stated in the facts section, the XXX manuals, checklists, and the reviews done by QA do not discuss the XXX CSRs providing any type of counseling, discussions of buying habits, discussions on the budgets or anything remotely resembling financial counseling or education.

In our review of recorded calls, we were able to listen to 2 XXX calls. While those calls were not from the years of the audit, the CSR we interviewed confirmed that the job of a XXX CSR has been consistent over the time she has been with XXX, which goes back XX years covering the period of the audit. Our review of the XXX calls showed that the calls closely followed the requirements in XXX manuals and training materials.

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As a normal part of their duties, XXX CSRs do not dig into the financial situation of the clients. They do not discuss their employment, education, buying habits, significant expenditures, any significant past or anticipated changes in their earnings, assets, expenses and liabilities, or the reasons or causes for those changes. Remember, XXX has told the CSRs that , XXXXX we are not concerned with the reasons our customer's are in debt. Our goal is to provide quality service and assistance to help them manage their debt. Without discussing this information, the XXX CSR is unable to provide basic financial counseling.

Further without this information, they are unable to recommend additional help that may be needed to help the client, which may or may not be directly related to their financial problems. For example, the client may have a drinking, drug or gambling habit. They may need employment assistance or training to obtain better employment. The list is veritably endless on the other causes of their debt that XXX simply does not deal with.

In summary, in interviewing a CSR, a supervisor, and officers of the organization, in reviewing manuals, client folders, account notes and other source documents, and in listening to 2 XXX calls we have determined that XXX CSRs make sure all proposals are accepted and the DMP is operating smoothly before they transition the clients' accounts to open accounts. Furthermore, we conclude that the contacts made during this period are not educational.

#### Open Accounts

After clients make it through the XXX department, the clients remain with the open accounts until they get off the DMP, for one reason or the other.<sup>48</sup> Since, XXX claims that the education they provide is a result of their long-term relationship with the clients; this is an area that demands a very close examination and analysis. Since this relationship covers such a long period, and covers so many situations, we feel being thorough in this analysis is required.

In the facts section, we listed numerous XXX manuals, checklists, forms and flowcharts that explain how an open account CSR is to perform their job. We went into detail of how they are to conduct portfolio reviews, statement reviews, delinquent account reviews, and many other procedures. We found that there are no instructions that require or indicate that a CSR should attempt to provide financial education to the clients. However, we need to be very clear here, as XXX puts it, the CSRs are required to "educate" the clients.

This may sound like we are splitting hairs here, but this is simply not the case. There is a great difference between providing counseling or financial education and "educating" clients as this term is used by XXX. The best way to explain this, is simply by providing examples of how XXX uses that term.

<sup>48</sup> This generally means they are paid in full or they stop making payments, either timely or at all.

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While some of the XXXs indicate that CSRs should educate the client or indicate that education is the key to success, this must be viewed in the context in which it is used. For example, Instruction XXXX discusses this in several places. It explains the CSR should use the F-2 key, F-3 key, F-5 key (client and creditor notes) to make recommendations and ask questions. The description of the function keys was found in Module 4, page X, of the open accounts training manual, attached as Item 20.

The F-2 Key is for Creditor File Inquiries. The purpose of this key is to view the client's creditors and the last payment amounts. So here the CSR could educate the client on their balance being reduced, that payments are being made timely to the creditors, or similar items. This is not financial education or counseling.

The F-3 key is for Customer Receipts Inquiries. Here the CSR can see the client's payment history. The CSR can thus educate the client that they are making payments timely and encourage them to continue or they can educate them to make more regular payments. This is not financial education or counseling.

The F-5 key is the notes inquiry. This allows the CSR to review all the notes on the account. They will be educating them on the progress of the DMP or possibly creditor issues. As with the other times the word education is used by XXX in the XXXX, they are to be "educating" the client on some aspect of the DMP.

All of the function keys discussed deal with XXX's financial success just as much as the client's success in paying off their debts. Any "education" provided as a result of following that XXX deals directly with the DMP. This is not financial education or counseling.

This same XXXX under a different heading simply states "Describing XXX benefits. Offer information on the program, ... remember education is the key to success." Again, they are equating education of the client to explaining how the DMP will benefit them. Moreover, they describe this as XXX benefits, not DMP benefits. This is at the core of why XXX should not be exempt. In their own view, XXX = DMP; their main purpose is to help people through DMPs, not through education. The benefit of being a XXX client is the DMP, not education. This is just one of many instances where this can be seen in the XXX manual.

In later versions of Instruction XXXX, discussed above, they have cut and pasted some of these phrases to other sections to make it appear as if XXX does require the CSRs to provide financial counseling. However, both the XXX executives and the CSRs interviewed have stated the CSRs jobs have not substantially changed over time. As we clearly show, there is no evidence whatsoever those CSRs provide any type of financial counseling required to maintain XXX's exempt status.

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Instruction XXXX, states "Our purpose at XXX is to better the lives of our clients. If the CSR's are not addressing and resolving the clients concerns, have we served our purpose?" This is another example that confirms the purpose of XXX is to help the clients; it is NOT to educate them.

Instruction XXXX, in question 10 concerning the XXX review portion, states "without this initial/on-going conversation, XXX most likely will miss opportunities to educate the clients. The information outlined in XXXX is critical information, which will help the client in the success of the program." We have previously reviewed this XXXX, and have stated that all items in the QF deal with the DMP, and not with providing financial education to the client.

Another example of their use of the term "educate" meaning educating the client on the DMP is in question 13 of Instruction XXXX, dated XXXXXX. The rationale for contacting the client every 6 months is, "Through open communication, the clients can feel more comfortable in discussing financial situation with XXX and in turn XXX can begin to educate our clients about how to hand these issues and begin to plan for the future."

The example that XXX provides to support their rationale discussed the DMP and stating that providing a little education over the last 6 months could have avoided some missing payments by the client. Again, this is an example of XXX's use of education consisting of explaining the DMP to the clients.

One of the standards the CSRs must meet is labeled "Took advantage of all available opportunities". Since it is not evident what "opportunities" XXX is discussing, further clarification is needed. This is provided in Instruction XXXX, dated XXXXXX. The details on the XXXX clarify that the opportunities and information provided to the client is to ensure success with the DMP.

Additionally, the example provided with the XXX states the following, A client call in to advise they have just sent a Western Union payment. You take and notate the payment information, but by not educating the client on missed and shorted payments from the past months, you have missed the opportunity to offer EFT as a possible solution." This is another example of education meaning explaining the DMP.

Instruction XXXX, dated XXXXXX, also refers to "opportunities" while discussing satisfying customer needs, giving the standard, "Takes advantage of available opportunities before concluding call". It then describes the rational as reviewing the account for opportunities to correct standing issues or errors and/or anticipated future customer issues. Furthermore, the examples provided discuss making sure the agreement is received, missing creditor information or payments, or checking on requested lower interest rates.

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Instruction XXXX, dated XXXXXX, has many additional details that if not completely understood, could be mistaken as describing, or potentially describing, educational activities. This XXXX is entitled XXXXX.

On page X of the above XXXX, a standard is presented as "Provides complete information and solutions to customer needs". The rationale also uses the terms educate and information. This has been attached as Item 21. As can be seen on the attachment, in making these references, XXX is discussing the DMP or items dealing with the DMP only. There are no items mentioning providing financial education to the clients.

In this same XXX, on page X, a standard is presented as "Documents completely and accurately". This should specifically be mentioned as this standard is grayed in, indicating this is a critical step, per page one of the XXXX. It explains that in every call, the CSR is to document: Who, What, Where (when applicable), When, Why, and How. As this is considered a critical step, it is assumed that everything will be documented.

The next 4 ½ pages of this XXXX relate to "communication". In this sense, communication means verbal and nonverbal communication skills that related to effective communication. It is certainly not referring to information that would be communicated that could by any stretch of the imagination be termed, "education". It covers items such as tone and pitch, Volume and Grammar, and appropriate word choice. This "communication" is simply part of any good customer service, and has nothing to do specifically with education.

We have found over and over references to the word educate or education from XXX in their manual or in letters provided during this examination; only a few have been presented above. Whenever, XXX uses those terms, they are referring to explaining the benefits of the DMP or how the DMP works for the benefit of the client.

While there are numerous examples of educations used in the sense of explaining the DMP vs. providing financial education in the XXXXs, there are also many examples of the omission of an educational element in certain XXXXs, where it would naturally be expected. For example, in Instruction XXXX we found XXX's desk reference guide.

In section 2, Procedures of Instruction XXXX, account closures are discussed. "\*\*\*Our objective is not to let the account close, so first try to get their issues resolved and assure them that they are a valued customer of XXXX." This is a situation where a client that is on a DMP is trying to close the account. The procedures are clear that they are to try to keep the account active. They do not discuss probing the situation to see if education is needed. There concern is primarily the DMP. Again, there are no items mentioning providing financial education to the clients.

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In section 2, Procedures of Instruction XXXX, Loan Letter Requests are discussed. The procedures are limited to explaining how to provide a loan request letter, what it contains, and determining whether any of the loan will be paid to XXX through the DMP. First, this goes against XXX's claim that they encourage their clients not to obtain additional credit while on the program. There is nothing in this procedure to instruct the CSR to determine if obtaining additional credit is a good financial decision. They are not supposed to even probe for this type of information. This is a sure sign education is not a priority. Again, there are no items mentioning providing financial education to the clients.

In section 2, Procedures of Instruction XXXX, Re-opens are discussed. This situation exists when a client on a DMP has stopped paying for some reason. The procedures here cover if an account can be re-opened and how to get this client back onto a DMP. They are not even required to find out why the person fell off the DMP. There is no attempt to find out the problem and no attempt to determine if education is required. Without this knowledge, it is impossible to provide education to the client. Again, there are no items in this procedure requiring the CSR to provide financial education to the clients.

In section 2, Procedures of Instruction XXXX, Restructuring Payments is discussed. This situation exists when the client needs to lower their payment to the DMP. This procedure only covers lowering the payment, not increasing it. There are no procedures for increases, even though they claim to encourage clients to increase their payments if this is possible. While XXX requests a hardship letter, the procedures do not require that the CSR probe their financial situation. This certainly would seem to be an appropriate time for providing financial education, yet there are no items in this part of the XXX that even mentions providing financial education to the clients.

Instruction XXXX, revision X, effective XXXXXX also covers restructuring payments. Again, this specifically refers to reducing a client's payment based on a client hardship. This XXXX is consistent with the information from the Desk Reference Guide, Instruction XXXX and again, there are no items mentioning providing financial education to the clients.

In section 2, Procedures of Instruction XXXX, Splitting Accounts is discussed. This is an issue in a divorce or a separation, a life altering event that has severe financial ramifications. The procedures do require a new budget, but they are to advise the clients to fax this in to XXX. In this case, XXX is trying to avoid discussing the budget with the client by having them fax it in. This is a cost savings measure of XXX. There is no requirement that the CSR go through the budget with the client. Again, there are no items mentioning providing financial education to the clients.

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In section 2, Procedures of Instruction XXXX, EFT NSF<sup>49</sup> and Restarts are discussed. This situation occurs when the client doesn't have enough funds in their account to cover their EFT payment and may be indicative of additional or recurring financial problems. Another ideal time or opportunity for a financial counselor to provide education to a client; unfortunately, XXX does not do this. Again, there are no items mentioning providing financial education to the clients in this procedure.

This entire desk reference guide was reviewed. Since this XXXX is to provide procedures to the CSRs in some common situations, either each section should have specific guidelines on providing education or they should refer the CSR to another XXXX(s) that discusses providing education to the client<sup>50</sup>. There is no such reference, which is again indicative of the lack of importance that education plays in the day to day operations at XXX.

In section 4, Creditor Policies of Instruction XXXX, on page XX, there is a short discussion about advising clients not to accept additional lines of credit. The reasons they discourage this is some combination of the following: 1) Obtaining additional credit often times makes it harder for the client to get out of debt, 2) it may increase the clients debt service payments making it less likely for the client to be able to pay off or qualify for the DMP, or 3) the creditors already on the plan may decide to drop the DMP, because they will assume the client has the ability to pay them in full without concessions. Therefore, while this discouragement may help the client, it likewise helps XXX and its revenue producing capabilities. While this may seem to be the provision of financial education, it falls short of this, because it is not put into context; it is just a statement that they are to discourage this. It is possible, based on a client's complete financial situation, which XXX never obtains, that obtaining additional credit would be an intelligent thing to do.

Another telling quote from the same page is, "The goal of a consumer credit counseling program is to help the client repay their debts, not to create more." This comment also speaks to the core of XXX, they are helping clients repay their debts; they are not providing counseling or education to their clients.

We reviewed XXXX after XXXX, as mentioned in the fact section. We found no XXXs that discussed providing financial education or counseling to a client.

In addition to all the XXXXs that provide procedures for how a CSR is to perform their work, we also reviewed how the CSRs were evaluated and reviewed by their supervisors, QA and management. This again is a formal process covered by the XXX manual. None of the reviews or evaluations cover the financial advice that CSRs are supposed to be providing for their

<sup>49</sup> EFT is Electronic Funds Transfer and NSF is non-sufficient funds.

<sup>50</sup> There is no XXXX or other manual section that covers providing financial education to clients.

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exempt status. It is simply not required to be done by any CSRs. So not only are they not required to provide financial education by their manual, or as far as we found, any other source, they are not evaluated on it either. If they aren't required to do it, and they don't get evaluated on it, it seems to reason that it simply does not happen.

During our audit, we also listened to 41 open accounts calls, which included 3 retention calls. For detailed descriptions of those calls, please see attachments 22, 24, and 19.<sup>51</sup> In listening to these calls, we determined that the XXXXs are very complete in covering the type of work done by the open CSRs and of the actual call content of the calls.

From attending training classes in the new accounts area and in reviewing the XXXXs, we found that generally the CSRs are well trained, and perform their jobs in a manner that is very consistent with the XXXX. In that respect, XXX has trained their employees very well and we certainly understand how they consistently do well in their quality reviews for their ISO certification.

Unfortunately, because our review showed that the CSRs so closely follow the XXXXs, we found that the CSRs did not provide financial education or counseling. In a few cases, the CSRs struggled to provide some advice to clients who desperately needed some guidance. This was as much a result of the individual CSR's compassion for the customer and their stress on customer service as anything. Even situations like these generally ended with comments like, I don't know what else to tell you, just do the best you can or you might want to consider trying to get some help with some free counseling<sup>52</sup>, or you should really look at your budget to see if you can cut back anywhere. Ultimately though, the CSRs do not have the training or experience to provide financial counseling. This is the blind leading the blind.

What we did find is that the CSRs are well trained on DMPs and are willing, able, and eager to "educate" the clients on different aspects of the DMP. For example, they often remind the clients to pay timely and consistently, they ask them to review their statements every month to make sure the creditors are still on the DMP and providing concessions, they recommend EFT to make the DMP easier, better, and cheaper for the client, or simply provide encouragement to continue on the DMP. Again, this is not financial education or counseling.

In reviewing the calls from open accounts, CSRs do not dig into the financial situation of the clients, their employment, education, buying habits, significant expenditures, any significant past or anticipated changes in their earnings, assets, expenses and liabilities, or the reasons or causes for those changes. Just as was discussed under the XXX area, XXX has told the

<sup>51</sup> Attachment 22 is IDR 7 issued on March 9, XXXX with 4 attachments, 24 is XXX's response labeled Attachment: Summary and Analysis of Counselor Calls, and 19 is our rebuttal to XXX's response (Item 24).

<sup>52</sup> For example, Call dated XXXXXX between CSR XXXXX and Client XXXXX.

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CSRs that , "As an organization we are not concerned with the reasons our customer's are in debt. Our goal is to provide quality service and assistance to help them manage their debt." Without discussing this information, the CSR is unable to provide basic financial counseling.

As before, without knowing why they got into debt, they are also unable to recommend additional help that the client may need, which may or may not be directly related to their financial problems, i.e. drinking, drug or gambling habit, etc.

All CSRs – New to Open

Another item we had access to were the client notes in the XXX system. While we only listened to a small percentage of calls, we looked at many more accounts. About 2 ½ days were spent thoroughly reviewing accounts on their system.

The first ½ day that we were given access to the accounts, we reviewed 37 client folders, having access to many of their client notes on the system. The objective was to determine if the records maintained currently were substantially similar to the records maintained during the year of the audit. This was done with the full knowledge of XXX, and the TP agreed that this may be a way they could show their activities have not changed substantially over the years, as they were representing to us. After this review, we agreed that the documentation was substantially similar, giving some credence to their statements that their activities have not changed.

The last two days were spent reviewing 12 different clients' accounts, having full access to the XXX system. This was an in depth review of the accounts, the payments, and especially the notes. While we asked for the ability to print out the notes, we were not provided with this, and because we continued to ask for this, we eventually lost access to their system based on their POA's recommendation that they have access to everything we viewed<sup>53</sup>.

In the review of the notes on the accounts, we were unable to find that any of the CSRs, whether New, XXX, or Open, documented that they provided basic financial education. There is simply no proof of this.

Again, we refer back to Instruction XXXX and Instruction XXXX that explain to CSRs that everything occurring during a phone call must be documented. We are also certain this is in a number of other XXXXs too. In the initial training all CSRs receive before getting put into the call center, they are told that everything must be documented. Additionally, supervisors' evaluate the CSRs on how well they document the phone calls. In interviewing the CSRs, they indicated everything was documented. There was no evidence that this is untrue. The folders,

<sup>53</sup> They also felt this enabled us to look at information until we found a problem.

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as we have ascertained were essentially, complete. Our analysis did not "miss something" of material importance to show counseling took place. This again supports our analysis that financial education is void.

With all of that information, there is only one assumption that can be made, that the CSRs do not provide meaningful financial education to the XXX clients. Certainly if this was the primary activity of XXX, it would be documented.

Instead, we found comments and notations in XXXXs and in the client account notes that a CSR "educated" the client on reviewing their statements, or that they might get calls from creditors when starting the DMP. The most regular "education" provided to clients was that they should pay XXX every 30 days. This "education" is what anyone would find in any financial agreement, "payment terms". We are very sure that every single creditor told the debtors they should pay them every billing cycle too. None of this is education, within the meaning of § 501(c)(3).

Since we had already determined that the CSRs had been trained well, and perform the duties as they have been trained, consistent with their written procedures, as well as in their evaluations by supervisors, we know that if they are required to completely and accurately document the accounts, the CSRs do this.

Therefore, in reviewing all aspects of the open accounts duties, by interviewing CSRs, a supervisor, and officers of the organization, in reviewing manuals, client folders, account notes and other source documents, and in listening to 41 open accounts calls, we have determined that clients are not provided with education in this area either. The primary purpose of this area appears to be to keep the clients on the DMP, to encourage them in their success or to succeed, and to handle general customer service calls as they relate to the DMP.

In conclusion, we have determined that XXX does not educate its clients or the general public through its counseling sessions. In the counseling sessions, XXX obtains just enough financial information from the clients to determine if they qualify for a DMP. They do not discuss any types of assets which could be used by the clients to help them get out of debt. They limit the discussion of liabilities to determine if it is a debt that can be placed on the DMP, or if it simply can or should be considered an expense for DMP purposes.

The budget is taken from the clients, it is not discussed with them. They do not probe the budget to determine spending habits. They don't consider past or anticipated changes to the budget. They don't even investigate why the person got into debt.

Based on the budget that the client provides, XXX determines if they qualify for a DMP or not. They do not evaluate the situation further to determine if there are other options for their

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clients. If XXX is to help the client, XXX's only solution is the DMP. If they determine they do not qualify for a DMP, they will suggest legal help. If they make too much money, they actually suggest they seek financial counseling.

The discussions with clients do not include any educational material or counseling component. Your primary focus appears to be helping debtors with the "sale" of debt management plans, rather than the provision of substantial education to your clients. Therefore, in evaluating your counseling sessions, we believe this is a strong factor showing XXX does not provide financial counseling as its primary activity.

#### Counselor Education and Training

Another factor that we believe is important is the education and training of the CSRs. If the CSRs are not able to provide financial counseling before they are hired by XXX, XXX would have to train them to do this, before they start to perform in their jobs.

In the periods at the start of the examination, XXX did not even require a High School (H.S.) diploma or its equivalent, although they did prefer it. Starting sometime between October and December of XXXX, XXX required H.S. or its equivalent for any new hires. Though not required, they would prefer if the new applicant had taken some college courses. Even with these limited requirements, there is no requirement that the people XXX hires have any H.S. or college courses in any field related to finances, whatsoever.

XXX has different requirements for work experience in hiring its New and Open Accounts CSRs, nevertheless both are deficient. Prior to the end of XXXX, XXX preferred the new accounts recruits to have industry experience. This could pretty much be anything. After XXXX, it was required that they have one year of credit industry or credit-related experience.

As part of our audit, we were able to attend the first week's worth of training for the new accounts CSRs. During the class, the new hires were asked their backgrounds. The most common work experiences provided was from a credit card company or simply customer service, working on the phones. We asked the trainers what the minimum requirements were to be hired, and they explained they should ideally have one year experience at either a credit card company or in some type of customer service capacity.

They actually stated they preferred not to have their trainees have credit card experience, because they generally need to be retrained because they had picked up bad habits from their previous jobs. The trainers preferred if the trainees simply had customer service experience and / or good customer service skills.

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Therefore, we can state that the new accounts hires do need education or experience in financial counseling or related fields that would prepare them to be able to provide financial counseling to people with financial problems. This education is not required to be hired for a New Accounts CSR position.

To be hired for an open accounts CSR position, the requirements for experience prior to the end of XXXX, was that XXX preferred the recruits to have one year of call center experience and one year of finance, debt management, collections or banking experience. Again, this means there really aren't any minimum requirements, because they were only preferences. After XXXX, it was required that they have one year experience in any of the above areas. However, there is no way that this requirement could possibly mandate that the new hires in the open accounts area have the ability to provide financial counseling.

For example, a person that has worked in a bank as a teller would qualify or someone that worked telemarketing for a credit card company would qualify or someone that worked for a bail bondsman would qualify, as that is a Form of credit. The possible qualifications are endless. There is no specific requirement that they must have experience in providing financial counseling. However, the requirements XXX has established to work in Open Accounts, is enough that the new hire should be able to facilitate the DMP operations.

Therefore, we can also state that the open accounts hires do not need education or experience in financial counseling or related fields that would prepare them to be able to provide financial counseling to people with financial problems, such as the people calling into XXX for help.

With a complete lack of required education or experience in financial counseling before a person is hired by XXX, you would assume their training would be quite extensive. As XXX would have you believe, their training is much more extensive than many in this industry. The CSRs actually earn training credits for attending this in house training. We agree that the training is quite extensive, but that is not what is relevant. The question is, Does the training that XXX provides and requires its CSRs to attend and pass, provide the CSRs the ability to provide financial counseling to XXX's clients?

First, as stated in the fact section, the certification that is provided from this training is a certificate in Credit Counseling Customer Service. Even the certificate they get describes that the training is for customer service. It is not a certification in Credit Counseling. The new account CSRs also become certified for Consumer Data Industry Association- Fair Credit Reporting Act. This training allows them to be able to pull credit reports.

While the New and Open accounts training is somewhat different, the official coarse description of both emphasize 1) customer service, 2) understanding credit, finance charges and payment history implications, and 3) various aspects of DMPs.

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The entire training modules for both groups of CSRs were reviewed. The coarse descriptions are 100% accurate. They primarily get trained on customer service and qualifying, marketing, and setting people up on DMPs. In open accounts, the CSRs are trained on customer service and maintaining their portfolio of clients on a DMP.

What the CSRs do not get trained in is any type of counseling skills, personal finance, or budgeting tactics to help educate consumers. While they are exposed briefly to bankruptcy information (in the class we attended this was less than 10 minutes of exposure) they are simply taught that they do not and will never offer legal advice.

They are also exposed to debt negotiate, settlement, credit repair, etc. Again, these are covered in a few minutes; just enough so the CSRs know what they are and that XXX does not offer any of these as possible solutions to debt. They are not trained to develop options or recommendations that specifically or generally address any of the circumstances that any of the XXX clients may be experiencing.

None of the CSRs are trained to identify underlying personal problems that might contribute to financial problems and on making appropriate referrals. As a part of signing people up for a DMP, they are required to ask the client why they got into financial difficulties, but they do nothing with that information other than to put it into the client notes.

As we have mentioned previously, the CSRs are actually told it is not their concern why the people are in debt, their job is to help them by getting them in a DMP, if they qualify.

When we interviewed the CSRs, they made comments about attending continuing professional training. They described the training as financial education, implying this was financial training that they could use to educate the clients. Since this is current training, we did not attend any of these classes or try to determine the purpose of the training. It is simply not relevant to our audit years.

However, the need for this additional training may actually re-emphasize the fact that the CSRs are not trained or experienced enough to provide financial education or counseling. While they are very good at customer service and seem to truly care about their client's success, they simply aren't equipped to provide the necessary education to their clients.

However, just because we are not considering the current additional training the CSRs may be getting, we did cover this topic early in the audit. We discussed the training provided by XXX

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with XXXXX, who has been the training manager since at least XXXXXX.<sup>54</sup> She stated that historically they have concentrated on new hire-training, but they also do what she called "up-training" or continuing training.

She then gave me some examples of this continuing training. As internet applications for DMPs started, they had to train the New Accounts CSRs to work those. When XXX decided they wanted the Open Accounts CSRs to stress EFT as the preferred payment, they had to be trained on this subject. She did not mention any type of "financial training" as the CSRs indicated in their interviews.

Additionally, in our initial request for information, we requested all employee training materials used in FY XXXX, XXXX, and XXXX. We were only provided with the training materials for the new and open accounts training discussed above. Based on the comments from the training manager, we understood that the up-training sessions that were held during the periods of the audit did not have formal training materials, which explains why we were not provided with them.

Since we are discussing training, we believe some additional comments should be made about the XXX training. CSR training module 1, page X, indicates, "As an organization we are not concerned with the reasons our customers are in debt. Our goal is to provide quality service and assistance to help them manage their debt." This is attached as Item 25. This same statement was also found in different locations in their manual. By not concerning themselves with the reasons their customers are in debt, it is almost impossible for them to provide relevant education to the consumer to teach them how to stay out of debt in the future. Again, this emphasizes XXX's objective is the DMP, not providing education.

In module 1, page X, they discuss the structure of XXXX. This "structure" is how DMPs are processed through the XXX system. It does not describe how clients will be educated. This module then goes on to discuss customer service details, fairshare payments, types of credit and whether it can be put on a DMP, finance charges and fees, account liability / ownership, billing statements, and misc. items on the credit industry. These are not items that would need to be taught a person that is qualified to be a financial counselor. These are introductory items that are taught to individuals with no experience that would allow them to provide DMPs to the general public, not to allow someone with no experience to be able to provide financial counseling.

Also, since this is the introduction of the employee to XXX, if education was at the core, or even if it was an important part of what they did, wouldn't this concept be introduced in the very

<sup>54</sup> The earliest dated Organization Chart showed her in this position as of XXXXXX. We found no earlier charts showing anyone else in that position and all later charts show her as the training manager

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first module. As we have shown, it is not anywhere in the training materials that XXX uses to train its new employees. It seems evident from this alone that education is not the primary drive of this organization.

In conclusion, XXX does not require that the CSRs they hire have any education specifically in providing financial education. They also do not require that they have work experience in providing financial education. XXX then trains them primarily in customer service and to either qualify people into DMPs or keep them in a DMP as long as they can, in hopes of getting the person out of debt<sup>55</sup>.

XXX CSRs therefore, do not have the abilities required to actually provide financial counseling to XXX clients. Therefore, in evaluating your educational and experience requirements and the training provided to your CSRs, we believe this is a strong factor showing XXX does not provide financial counseling as its primary activity.

#### Outreach and Advertising

Other factors that should be considered to determine if XXX is primarily conducting exempt activities are their outreach and their advertising. The reason this needs to be considered is whether or not these are done primarily to bring in potential DMP customers, or whether they emphasize the educational aspects of the organization. This will provide an indication of its true primary purpose.

For this discussion, we need to consider their website, any mass media advertising, and direct mailings made to advertise XXX and whether they primarily discuss the educational aspects of the organization or whether they mainly discuss the DMPs.

In this case, XXX does not regularly advertise or send out direct mailings. As for advertising, XXX simply has not had to do this, since it obtained the agreement with XXXX to obtain XXXX's clients that were having debt problems as a ready source of potential clients for the DMP. Therefore, we believe their practically non-existent advertising is a neutral factor.

The XXX website<sup>56</sup>, during the audit period, contained numerous educational articles that appeared to be easily accessible without registering i.e. available to the general public. In numbers alone, there website contained more articles than anything else. However, another question that needs to be answered is whether or not the articles provide objective and useful information on personal finance, credit, and budgeting.

<sup>55</sup> This also makes XXX the most amount of income possible.

<sup>56</sup> The website has been updated drastically since we have started the audit.

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This requires a bit more analysis. The articles cover or are titled: purchasing stocks, protecting yourself when purchasing online, getting turned down for a loan, have you checked your credit report lately, choosing the right credit card for you, questions to ask about credit cards, FDIC insured deposits, Are you better off today, Internet Banking, Mutual Funds, what is the best way to pay, etc.

These articles certainly deal with various areas of personal finance and some deal with credit. What they do not deal with is issues of importance to the debtors that XXX is supposed to be educating. There were no articles about spending habits, budgets, etc. Therefore, even though they provided numerous "canned" personal financial articles, they did nothing to further the educational purposes of the organization.

The website also contained information explaining what XXX did and how to contact them for an evaluation. The website, as it was first available in XXXX to XXXX, was mostly the educational articles that had nothing to do with the educational purposes of the organization. On the other hand, the website was clearly not a blatant attempt to obtain additional DMP clients. This was fairly neutral as well.

The website, as it was accessed on XXXXXX provided subtle information asking people to apply for a "Free Debt Relief Analysis". The "Apply Now" link was the middle and top link of most pages of the XXX website. The main page also mentions all the benefits of a DMP. If you remember, the XXX training manager told us the new accounts CSRs had to be provided "up-training" in order to learn how to handle applications that came from the internet. So the website does generate clients for XXX.

However, overall we believe the website was NOT just an advertisement for DMPs. On the other hand, we do not believe that the few static articles, that were mostly unrelated to their exempt purpose, provided meaningful education to distressed debtors either. Therefore, we believe this is a neutral factor.

Another aspect to consider in their outreach and advertising is simply to determine where XXX gets its clients from. In analyzing this, we would look at referrals from employers, unions, churches, other community organizations, or even creditors as being a positive aspect, if no payments are made to obtain the lists of names or for referrals or the like.

In this case, XXX receives substantially all of its contacts from XXXX through the negotiated contract it has with them. Due to this contract XXX pays XXXX millions of dollars and foregoes millions in fairshare, based on the amounts collected for and paid to XXXX.

The relationship between XXX and XXXX must be looked at to determine the contracts purpose. As XXX has indicated, it allows them access to the class of people they are looking to

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serve. On the other hand, we must weigh that against whether or not XXX has contracted with XXXX to attract and sell DMPs to as many people as they can reach.

Since we believe that XXX is not providing education to its clients, the argument that they are trying to reach a certain class of people, so they can conduct their exempt activity does not make sense.

Looking at this from the opposite side of the coin, there are many indications that the intent of XXX was simply to obtain as many clients as possible. For example, the statistics that the CSRs are evaluated on generally are related to efficiency and production. The organization is highly sensitive about attendance and tardiness (defined as one minute late). Every CSR can see the signs in the call center, indicating the call stats for their group. XXX has created 98 macros for the CSRs to use in various aspects of their job. Macros are created to save keystrokes in entering commonly used items. The Macros are essentially all related to the DMP. The items discussed in the board minutes discussed the growth and expansion of the organization. The entire culture of XXX is surrounded by efficiency, statistics, production, procedures, and the like.

Additionally, and this is very important, in their original contract with XXXX, dated XXXXXX, there are two very telling sections to the contract.

XXXXX. ... "Both parties understand the necessity of maintaining a reasonable constant flow of activity and successful conversion. In as much as the value of referrals is connected with a reasonable volume, XXXX agrees to provide at least XXXXX Client Information Referral Forms annually."

and

XXXXX. "With respect to program volumes, XXXX shall use its commercially reasonable best efforts to convert to active accounts at least a minimum level of the referrals received from XXXX. Both parties understand the necessity of maintaining a reasonable constant flow of activity and successful conversion. In as much as the value of referrals is connected with a reasonable level of successful conversions, XXXX agrees to convert a minimum of 30% of the Client Information Referral Forms to active status."

These clauses in the contract, are fairly specific about the nature of the contract between the two entities. This contract is not about providing education to debtors; for XXX, it is about paying for referrals and obtaining potential DMP clients, which XXX hopes to convert into DMP clients. A person can come to only one conclusion, which is that XXX's intent in contracting with XXXX for their debtors was a method XXX used to obtain large quantities of clients for the DMP program.

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Therefore, in looking at outreach and advertising, we have two neutral factors and one strong negative factor. Therefore, when combining the factors in our evaluation of your advertising and outreach, we believe this is a factor showing XXX does not provide financial counseling as its primary activity.

### Governance

Another factor to be considered, in determining if an organization is primarily conducting exempt activities, is how the organization is governed. We will need to decide whether the board is independent and community-based or whether it is a small, related board or a board dominated by creditors or others with financial interests in the organization. This will give an indication as to whether the board is looking after the welfare of the public the organization is supposed to be helping vs. persons with financial interests in the operations of the organization.

This company was founded by XXXX<sup>57</sup>, who has worked in the credit industry for XX years, primarily dealing with debt consolidation. Its first Board of Directors consisted of XXXX, XXXX, XXXXX, and XXXXX. XXXXX is the only original director not on the board, as he passed away in March XXXX.

Currently, the XX member board of directors is composed of insiders, relatives of the CEO, compensated individuals, long time and trusted friends of the CEO, and X other people. As was shown in the facts section, 62% of board members are either relatives of XXXX, receive over \$100,000 per year from XXX directly; and 4 meet both of those criteria.

XXXXX has received some compensation over the years, from real estate dealings of XXX, but more so, he is a board member because he had been a trusted and respected friend of XXXX's for over 40 years. The common man would question whether XXXXX would be more apt to represent his trusted friend or the general public.

This leaves only 31% of board members that would appear to be "independent" of XXX and XXXX; XXXXX, XXXXX, XXXXX, XXX XXXXX. Based on XXXXX's experience and all the books he has published, he would be a great board member for any organization that offers financial services, but he doesn't seem to have a background in financial counseling of the type needed for an exempt credit counseling organization.

We have very little information about the other 3 board members. Based on just job experience alone we feel that they may be independent and representative of the community.

<sup>57</sup> The organization report indicates it was Formed by XXXX and XXXX.

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On the other hand, XXXX made it clear that he chose only trusted and respected individuals for his board.

Certainly, the fact that XX of XX members, 62% of the board is made up of family and persons making over \$100,000 a year causes concern. The additional fact that there are clear and close relationships between some of the remaining board members with the CEO also causes concern.

The only conclusion that can be reached is that the board is not an independent community-based board. While this is not conclusive proof that the board and therefore the organization cannot possibly be looking out for the best interests of the general public, it certainly gives the appearance that it is not.

In the interests of providing a full fact pattern, we were told by the executives of XXX that XXXX had attempted to put one or more representatives on the XXX board. While this information was not verified, it is logical since XXX has such a close relationship with XXXX. XXX refused to allow this to happen, indicating they did not want creditors to have too much influence over the corporation.

In reviewing the minutes, we were able to establish how this small, related board actually operated. Based on the review of the minutes, the organization's primary focus that was identified in the organization's meetings was not the furtherance of charitable activities as defined by IRC § 501 (c)(3); the meetings conducted emphasized the ongoing growth of the company, and this was discussed on an on-going basis. The board discussed and was concerned with the dialogue of creditor relations, fees, use of investments, D & O insurance coverage<sup>58</sup>, the board's concern on rebuttable presumption and salaries to the CEO, and improving the company's ability to recognize fees. Of the minutes reviewed from XXXX through XXXX, the minutes were void of how XXX can provide direct education, other than the improvement of delivering DMPs. The board had shown an alliance toward banks and creditors rather than the consumer; which is, counter to the assistance and help to consumers. The consumers are not represented, either by the board or by their attempts to form special committees. There appears to be an organizational motivation to profit (increasing resources). The organization's focus leans toward good creditor relations as opposed to hearing the voice of consumer activists. From the available minutes, the organization did not seek the input and assistance of consumer groups as it did national banks.

<sup>58</sup> Directors and Officers Liability Policy: coverage includes \$XXXX maximum for aggregate limit of liability for all claims in any one year. Directors and officers are provided \$XXXX for each claim (retentions).

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On April 12, XXXX, we held an informal meeting with several executives of the taxpayer which was informative as to their intent and philosophy in operating XXX. The purpose of this meeting was to discuss education in general, provide feedback of our examination to date, and to be a format to discuss potential solutions to the general lack of education in their operations that we noted in IDR 7, issued to XXX just over a month prior to the meeting. It should be noted that our audit was not finished at this point, and our investigation into their operations was not complete. The individuals present at the meeting were XXXX, XXXX, XXXXX, XXXXX, XXXXX and XXXXX.

We will limit our discussion to some of the important topics covered during the meeting, as they are relevant to this issue. We explained that what we were seeing in our examination, as confirmed by our review of the recorded calls, was that we perceived XXX as an organization that offers DMPs as its primary activity with education as an afterthought. We further explained that in order to be exempt, it must be an educational organization first and foremost that uses DMPs as an afterthought. I explained that is basically how the two main revenue rulings and two main court cases have described exempt credit counseling organizations.

In a prior meeting, March 29, XXXX, XXX essentially asked us for a definition of education and asked how they might change their operations to more fully comply with their exempt status. It has always been their contention, that they are following the laws as they see them. They have also indicated that if we feel anything needs to be changed for them to be an exempt organization, they were more than willing to do this, however, the IRS has not provided enough guidance for them to determine how they would be required to change.

So for the April 12, XXXX meeting, we suggested a solution of creating another department with the remaining space available in their building, which would be a pure educational area. We explained it would have to be filled with individuals with more training, education, or experience with financial counseling.

XXXX said they had thought about that, but basically that it was not economically feasible. Additionally, he saw another department as being a disconnect, throwing the clients to another person, separate from the other CSRs. He indicated that while he is willing to work with us, he has to work with reality.

They then also explained that they have considered many similar types of additional systems to perform their job better. They state they are in a constant state of change and feel they have always had education at the heart of what they do. One example that XXXX did bring up later in the conversations was possibly hiring 8 CFP's to help out at a high level in the organization or of hiring a CFP, or other more highly trained individual, and attaching them to each of the current teams. While we were not sure our suggestion would even

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provide enough education, it appeared obvious that their suggestions would allow for even less.

An analysis of this part of the meeting indicates that XXX has thought about this. They have already concluded that it was not economically feasible to do this. Rephrased, it was too expensive to provide too much direct education to their clients.

However, when you consider the fact that on the Form 990, XXX has shown profits of \$XXXX over the last 3 years and \$XXXX over the last 5 years, the statement that providing more education is not economically feasible seems to be a little ridiculous. If you throw on top of those XXXX in reported profit, XXXX in depreciation, XXXX in XXXX Family compensation, XXXX in payments to the CEO's wholly owned software company, and that statement starts to sound just plain greedy.

In the April 12, XXXX meeting, we also discussed the funding of the organization, being almost all from DMP fees and fairshare. XXXX stated that without fair share payments, a credit counseling company would fail financially. He replied to the Service's comment that a charity be funded by the general public or through grants is unrealistic. He stated that the general public or grants received from organizations such as the United Way, frown on providing funding to "your neighbor's spending problem that he got himself into and shifting the individuals burden to the general public"; this type of funding mechanism would take away from other charitable funds for homeless shelters, curing diseases, etc., or other general well known charitable causes. He stated that the credit industry has taken a role as to meet this challenge by developing relationships with credit counseling organizations to provide some sort of solution to debt management. Debt management per se, is not a viable charitable purpose that the general public would be willing to donate to.

While much of what he said seems to be logical, and may have some truth behind it, it also speaks to his philosophy in operating XXX. If you realize that XXXX was talking about his organization specifically, XXX, it makes perfect sense. We would agree there would be very few individuals willing to donate to XXX, if they knew that it was being operated as we have come to realize, that it is a commercial operation, signing every qualifying person onto a DMP that they possibly can, while benefiting numerous private individuals along the way, with profits in the millions, with a state-of-the-art facility, with millions going to insiders. Why would anyone want to donate to this organization?

What XXXX fails to understand, is the nature behind a truly exempt credit counseling organization. This organization has the support of the community, is run by community members; it may have both volunteers and paid employees that seek to educate people with debt problems. This would be an organization that may suggest one or several combined solutions to help a person get out of debt, in a manner that doesn't always enrich the

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organization or otherwise seek to maximize profits. This may be a social service worthy of support from the community. XXXX, and therefore XXX, just doesn't think in that manner.

In summary, we find that the board is full of family members and individuals with financial interests in XXX. The remainder are mainly close associates of the CEO. Only one of the board members has a background that is conducive to educating debtors or consumers in general. The minutes of the board indicate they are more interested in making the organization grow and in creating profits than they are about educating XXX's clients. Therefore, we find that the governance of XXX, in composition and in their actions, is a factor highly in favor of XXX not operating primarily to further education within the meaning of 501(c)(3).

#### Funding Sources

In analyzing funding sources, we are trying to determine whether the sources of funding compromise the independence of the organization or compromise its focus on education and the needs of the clients.

Over the period of the examination, XXX has obtained over 45% of their income from creditors from fairshare and over 45% of their income from fees from the debtors.

With over 45% of the fees coming from creditors, the creditors are in a position to influence the operations of XXX to a large extent. Furthermore, each creditor sets their own policies for the DMP, which XXX must accept and pass on to its clients. An indication of this, was seen in the training and in the manuals, which state how CSRs are supposed to explain the benefits granted by creditors. CSRs are told they can provide estimates only, and not to provide specific creditor benefits, because the creditors can and do change their policies constantly.

Additionally, since over 45% of XXX's income comes from client fees, they are in a position that they must constantly obtain additional clients to maintain their current levels of funding. Since XXX operates with about a 30-35% attrition rate, they must constantly obtain new clients. As we discussed above, the contract with XXXX specifically points out that XXX must constantly turn over clients.

This constant turnover of clients certainly seems to suggest that DMPs are a primary objective of XXX. Also, as XXX is operating with the intent of realizing high turnover and attrition, and continually obtaining additional clients, it plays against the notion that they are attempting to provide education to their clients.

The flip side of having over 90% of their funding coming from DMPs, in fees and fairshare, means they receive very little in the form of contributions, in this case, absolutely nothing. XXX receives no government grants or donations from private foundations. They receive no

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donations from community groups, churches, labor unions, or any other groups or private citizens. Furthermore, they do not seek any type of donations.

The credit counseling organizations that were found to be exempt, including those in Rev. Rul. 69-441 and 65-299 (and remember this one is a 501(c)(4)), and in both the CCCS of Alabama and CCCS of Oklahoma, as well as the numerous rulings where individual (non-credit) counseling is provided for free, the organizations were all supported by contributions from the public.

For-profit business enterprises are supported by fees paid by those who receive services. While charitable institutions often do provide services to individuals; the cost is generally subsidized by contributors who do not receive anything in return. In B.S.W. Group, Inc. v. Commissioner, supra, the court cited lack of solicitation and sole support from fees as negative factors for exemption. See also, Easter House v. United States, supra.

Due to those three reasons, we believe XXX's funding sources are clearly indicative of a for-profit operation and not those of an exempt organization. Therefore, in evaluating your funding sources, we believe this is a strong factor showing XXX's primary activity is the selling of DMPs in a for-profit business venture. It is not consistent with an organization that is providing free counseling as its primary activity.

#### Educational Materials and Seminars

Other factors that must be considered in determining if XXX is primarily an educational organization include their educational materials and seminars. There are many sub-factors we will be looking at to make this determination. In making our determination, like many of the previous factors, we will be comparing and contrasting the provision of the materials or seminars as part of an exempt educational activity or whether its purposes are related to the selling of DMPs. Do they promote exempt or non-exempt activities?

First we will look at seminars. XXX does not generally hold seminars as part of their operations. Therefore, this can not be classified as an exempt or non-exempt activity, it is either non-existent or insubstantial in nature.

Another item that we should consider is the publications<sup>59</sup> that XXX distributes and whether or not they contain material on financial management and budgeting or whether they primarily promote DMPs.

<sup>59</sup> We will be using this term loosely to cover numerous items XXX distributes or holds out to the public as educational aspects to their activities.

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XXX has numerous publications and educational materials. The first educational source we will discuss is the XXX website. As was discussed above, the education materials on the website deal with various areas of personal finance and some deal with credit. On the website, as of [date], they had articles on, or titled, purchasing stocks, protecting yourself when purchasing online, getting turned down for a loan, Have You Checked Your Credit Report Lately, Choosing the Right Credit Card for You, Questions to Ask About Credit Cards, FDIC insured deposits, Are you Better Off Today, internet banking, Mutual Funds, What Is The Best Way To Pay, etc.

Additional articles are shown on attachment 26. The articles are many of the same articles that existed on the website in XXXX and XXXX, indicating they have had the same articles on their website essentially since it was created. Also, as we have stated before, most of the articles do NOT deal with issues of importance to the debtors that XXX is supposed to be educating. There were no articles about spending habits, budgets, etc.

For example, in the article Shopping for a New Vehicle, it gives advice on how to choose a new vehicle. While there are two sentences about not buying more of a car than you need, it is mainly about choosing a new vehicle properly, and contains a lot of good advice about shopping for a new car. Why would XXX want to encourage or provide information about buying a new vehicle at all to anyone with serious financial problems? So while this is an informative article, it just is not consistent with their exempt purpose.

Therefore, even though they provided numerous "canned" personal financial articles, they did little to further the educational purposes of the organization.

Another portion of the XXX website that they are extremely proud of, is their XXXXX series. As of [date], the only information that was available from the XXXXX was the "Diaries" on the Website. These 13 articles discuss specific advice for a situation that is brought up in the Diary. The Diaries discuss the following things:

- People getting married should have common goals and it discusses creating common goals
- A person wants to move, but he hasn't considered the financial aspects of the move, or the fact that he would be moving from family and friends. It gives advice to consider.
- A person without any credit history wants to buy a car, house, and business soon. The diary provides advice on establishing credit.
- An elderly couple is given advice not to play golf at \$100 per round, if they can't afford it. The XX. gives them advice on the difference between entertainment and exercise.
- The XX. gives advice on the costs of raising a kid, so a person can make an informed financial decision. He also provides advice on other areas that will have to be budgeted, like sleep.

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- The XX. gives helpful advice for someone purchasing a car. They discussed a budget and made sure the budget allowed for insurance and other necessitates.

While most of the Diaries contain sound advice, and may be helpful if you are in that specific situation, they still aren't necessarily the education needed by someone that is drowning in debt. However, this is at least personal financial advice, and not the mostly irrelevant stuff, from a distressed debtor's viewpoint, as in the other educational articles on the website, like FDIC insured bank accounts and mutual funds. Based on the WayBackMachine.com, the XXXXX Diaries first hit the Website in March of XXXX.

Therefore, in the 36 months of the audit period, they had these diaries available on the website for 3 months. Since they were on the website less than 10% of the audit period, and the articles are only vaguely helpful for individuals suffering a severe financial hardship, we would have to say, the educational aspects of the website provide a very weak, but positive factor for XXX.<sup>60</sup>

Unfortunately, the website also has DMP aspects. The website, as it was accessed on [date], provided subtle information asking people to apply for a "Free Debt Relief Analysis". The "Apply Now" link was the middle and top link of most pages of the XXX website. The main page also mentions all the benefits of a DMP. In checking with the Waybackmachine.org, you were able to apply online, as of XXXXXX.

We also discussed above that the XXX training manager, XXXXX, told us the new accounts CSRs had to be provided "up-training" in order to learn how to handle applications that came from the internet. So the website does generate clients for XXX. It also seems evident from and efficiency and production standpoint, if XXX did not believe they were going to get a steady flow of applications from the website, they would not have spent the time or money to train the CSRs how to deal with the website applications.

As we have previously stated, we believe the website was NOT just an advertisement for DMPs. On the other hand, we do not believe that the few static articles, that were mostly unrelated to their exempt purpose, provided meaningful education to distressed debtors either. Therefore, we believe this is a neutral factor.

Another "publication" that XXX sends out is the folders, or packets of information, that are sent to the callers after they call into XXX, and XXX has determined they are in a certain XXXX. Instruction XXXX, dated XXXXXX, was updated to include "financial assessment and financial software" for XXXX and XXXX. Therefore, XXX did not provide this information to all clients

<sup>60</sup> As has been noted, XXX has expanded the website greatly, especially in XXXX. Since this information is outside of the audit period, we did not review this information.

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during our audit years. Prior to this date, they only sent these folders to the XXXX, potential DMP clients.

Since XXX now distributes these to all callers for XXX services, we feel we need to make some brief comments about the relevancy of these educational materials. A major concern with these packets of information is that it's a static product, not an interactive product for the consumer. It would seem to be a fair question to ask, if the caller is a XXXX or XXXX person, will they read the packet of information? Was the content helpful? XXX simply has no way of knowing. It may know if the packets were accompanied with one on one instruction. This however, is not a past or current XXX practice. These non clients are certainly individuals that could benefit from some financial education and advice, whether they spend too much or will be filing bankruptcy. Their habits or personal situations are inherently the basis for their financial distress. After it has been determined that XXXX and XX callers will not become clients with XXX, and since XXX does not substantially educate them during the phone call, it appears that these individuals will not receive the financial counseling necessary for their needs.

By excluding this larger population of individuals from XXX's primary purported education, they have effectively stated that education is a pay as you go plan. Why else would XXX exclude them? This supports the appearance that XXX works as a for profit enterprise. XXX spends a great deal of resources for the perfection of the DMP delivery. We agree, to help all those individuals without a DMP would be costly. XXX's management has determined it is not economically feasible to educate them. Therefore, those individuals will need to look elsewhere for assistance. After all, XXX is not running its organization as a charity. Additionally, XXX does not attempt to keep records on XXXX and XX education feedback, especially when XXX does not contact either the XXXX or XX people again. Call returns are only for XXXX or potential XXXX clients.

The fact that XXX did not send these packets of information to the XXXX and XX clients during the years of the audit, shows XXX's bias towards serving potential DMP clients only. Since it is also unknown if any of the non-DMP specific items in the information packet were read by the XXXX persons, we can hardly classify this as educational material for this test either.

The fact is that providing packets of financial information to current members does not demonstrate that education provided to this category of callers is a direct, educational activity. Furthermore, since this didn't occur until after the years of the audit, it cannot be determined to be an exempt activity for the purposes of this report. Since during the years of the audit, the packets were reserved for the potential DMP clients, we must conclude that this is a negative factor in that the distribution of these packets of information was used to further their DMP business, rather than to provide education to the general public.

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Another potentially educational factor to consider is whether classes are open to the public. In this case, XXX does not generally conduct classes for the general public. However, if we consider some of the volunteer work done by XXX employees, we could answer this in the affirmative. If some of the educational grants that XXX makes could be attributed to XXX activities, we could certainly answer this in the affirmative.<sup>61</sup> However, as we have stated, these are activities of other organizations, not XXX.

Based on the few "classes" that are available to the general public, we would have to qualify this as a positive factor. When compared to the other activities of XXX, these classes that might be open to the general public are completely insubstantial and were not worth requiring proof of the educational nature. Therefore, we would consider this a positive factor, but a very weak positive factor for XXX.

Another factor that needs to be considered is the general assistance and education callers receive, regardless of whether or not they sign up for a DMP. As we have stated above, if a client does not qualify or chooses not to enroll in a DMP, they do not receive substantive educational services. We have previously discussed that the initial call with the client is not educational. Further, the information packet that is sent out is lacking in educational content and actually was not sent out to the non-DMP callers during our examination period. The website, which is available to the general public, does not offer substantive financial education. They do not receive additional counseling or other services. XXX is not set up to allow callers to simply call up and get advice from a counselor on financial matters, regardless if the caller is a client or not.

If we go back to the experience and training of the CSRs, we know that they lack the necessary abilities to be able to provide meaningful and substantial credit counseling. The extremely limited suggestions that CSRs offer to clients that do not qualify for DMPs, can in no way be considered as providing financial education.

Another factor to consider is whether all DMP clients become assigned to a financial counselor who provides continuing counseling and support during the plan? All XXX DMP clients become assigned to a CSR who regularly checks the client's account and updates the client's file. A client will be able to depend on his or her CSR to maintain the account, encourage the client to pay off the debts in the plan. XXX sends monthly statements showing the monthly flow of money in the account and the progress of debt elimination. However, the client will not receive financial education, advice or other educational information other than the dialogue related to the DMP.

<sup>61</sup> Grants used by a School to teach others, for example.

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On the other hand, those clients who decline or fail to qualify for the DMP are not assigned counselors. This decision is not arbitrary, but by design. The decision making process of XXX to not assist clients who either fall out of the system for default or decline the service is substantiated in the XXXs of XXX. XXX in making a profit motivated decision has decided the less effort they expend on clients not on a DMP, the more profit they will make. Again, XXX is extremely concerned with efficiency in its operations. Unfortunately, this means the non-DMP clients will receive little or no attention or education.

Therefore, in determining whether XXX's provision of educational materials and seminars are more related to performing an exempt educational activity or are in furtherance or related to the selling of DMPs, we have considered many items.

The neutral factors:

We determined that XXX's seminars are either non-existent or insubstantial in nature, and therefore not a factor. Then we looked at the XXX website and determined that it contains many informational articles, but that most are not relevant to educating distressed debtors. We also found that the XXX website advised viewers about Debt Management, the benefits of debt management, and allowed them with an online application, as well as their toll free number. However, we also did not feel it was blatantly an advertisement for DMPs, we also believe this is a neutral factor for XXX.

The positive factors:

XXX has volunteers, some during work hours and some on their own time, that could be seen as offering "classes" open to the public. We do not believe these were substantial in nature; so we think this is a very weak positive factor for XXX.

The negative factors:

We analyzed the packets of information sent to callers requesting XXX services. We found that since XXX sent these only to potential DMP clients, and was not part of a direct, participatory educational activity, this was another negative factor in that they were used to further XXX's DMP business, rather than to provide education to the general public. Then we considered the general assistance and education callers receive, regardless of whether or not they sign up for a DMP. We determined that callers who are not potential DMP clients receive no measurable or substantive financial education; another strong negative factor. We also considered whether DMP clients receive financial education. While we found that they receive excellent customer service, XXX CSRs are not qualified to provide financial counseling; another negative factor. Finally, we looked at non-DMP clients and whether or not they are assigned counselors. They are not. We found that in order to increase profits, these clients will receive little or no attention

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or education from XXX, a negative factor in considering if their purpose is to educate the public.

Overall, in both quantitative and qualitative terms, the negative factors far outweigh the positive in regards to their educational materials and seminars.

Summary of Analysis – Issue 1 Do XXX's primary activities accomplish an exempt purpose?

Therefore, we find that it is clear from our audit and review of the available information that XXX does not meet the operational test required by Section 1.501(c)(3)-1(a)(1) of the Regulations.

We determined that substantially all of XXX's revenue and expenditures and employee workforce hours related directly to their call center and DMP operation making this their primary activity. We have established that their counselors ask only enough financial information to pre-qualify callers into the DMP. The counselors do not discuss budgeting and finances, except to collect this information for DMP purposes. They do not discuss employment, education, buying habits, significant future changes in finances, assets, or secured debt in any meaningful manner. The counselors do not develop options or strategies tailored to the needs of clients, and therefore are unable to discuss the advantages or disadvantages of those options. The only option at their disposal to help clients is a DMP. Furthermore, they are not trained to probe for or recognize other potential causes of debt that should be referred to other appropriate social services or programs that may be needed by clients.

Before they are hired, CSRs are not required to have education or experience in providing financial education. While the CSRs are trained extensively on customer service and DMPs, they are not trained in subjects that would allow them to provide financial education. They are not trained to identify the causes of an individual's debt or other personal problems that may contribute to the situation. Additionally, counselors are not evaluated on how thoroughly and effectively they develop and present options to match the particular circumstances of any client. While they are not compensated based solely on DMPs, they are compensated based on efficiency, productivity, quality, and customer service, all related to the sale or retention of DMP clients.

While XXX does not use the Internet, mass media and direct mail to advertise its DMPs to the general public, XXX has contracted with one of the largest issuers of consumer debt specifically for the purposes of obtaining potential DMP clients.

Our review of XXX's governance shows the board of directors is not an independent community-based board, but a small, related board with a majority of the board being family

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members or persons with a financial interest in XXX. In operation the board's primary focus was growth, creditor relations, fees and improving the company's ability to recognize fees. Overall, the board was motivated by profit and growth, and rarely considered their stated exempt purpose of providing education to the public.

XXX's funding sources establish that 99.7% of their income relates to their sale and retention of DMP clients. They receive no charitable contributions and have no aspirations of attracting charitable funding.

This fact pattern shows a clear and decisive difference between XXX operations and those organizations that have been determined to be exempt in the past.

**Issue 2 - More than an insubstantial part of XXX's activities are in furtherance of a non-exempt purpose?**

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.

Only an insubstantial portion of the activity of an exempt organization may further a nonexempt purpose. As the Supreme Court held in *Better Business Bureau of Washington D.C. Inc. vs. United States*, supra, the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. Even if we agreed that you were organized and operated for an exempt purpose, the fact that you also have a substantial non-exempt purpose would be sufficient to deny recognition to you. Specifically, the court in *Better Business Bureau* held that if education is conducted for a non-exempt purpose, the organization will not be recognized as exempt. Based on all the facts and circumstances of XXX, its operation of debt management plans is so pervasive that its activity of providing DMPs demonstrates that you operate in a commercial manner.

No court or IRS ruling has indicated that the sale of debt management plans is a charitable activity. Since the sale of these services to the general public has been established to be one of your substantial purposes, in fact your primary purpose, we cannot conclude that you are operating for charitable purposes.

Section 1.501(c)(3)-1(e)(1) of the Regulations provides that an organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's

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exempt purpose or purposes and if the organization is not organized or operated for the primary purposes of carrying on an unrelated trade or business.

Any activities involving "authentic" credit counseling provided to a genuine charitable class or the provision of credit education to the general public, would be purely incidental to your predominant non-exempt purpose of operating and carrying-on an ordinary for-profit debt management business. Since we have previously determined your call center and DMP operations are not educational, we are unable to say that those operations are in furtherance of an exempt purpose.

In addition, your organization shows none of the public involvement that characterizes organizations serving a public interest. Your activities are carried out by paid employees rather than volunteers.

Your board has a majority of members that are family members or those with a financial interest in XXX, only a few members are selected from the business community. Your board members are unlike the organization described in *Rev. Rul 69-441, supra*, in which the organization's Board of Directors is comprised of representatives from religious organizations, civic groups, labor unions, business groups, and educational institutions. In fact, your April 4, XXXX board meeting discussed "Outstanding action items continued from the previous meeting: Develop an advisory board including creditors, educators and current supporters". The advisory board was not developed and was discussed with bankers and creditors but there has been little response or acceptance. Director of XXX, XXXXX stated a consumer based advisory panel could be a helpful format with clients/consumers. XXXXX questioned organization officer XXXXX "are there any constraints to board members regarding the addition and composite of board that requires us to represent consumers. XXXXX responded that we do represent the consumer because we are aware of the client needs and we do offer a cross representation of the industry". XXXX, legal advisor and director stated that XXX has no legal requirement for a board make up of consumer/credit industry". In addition to other comments made about the board previously, this provides insight into what XXX's actual intent is. It appears from the evidence that XXX's primary objective is to avoid public involvement in XXX's decision-making process and that XXX is carried on with more than an insubstantial non charitable intent and furthermore, is carried on in a commercial, rather than a charitable manner.

Similar to the organization in Easter House, which operated an adoption agency, we have found that your organization is operated for a substantial commercial purpose rather than for the exempt purposes of providing educational and charitable services to the portion of the public you serve. Any educational activities that you do conduct are merely provided "incident" to your operations related to DMPs. Your funding is also similar to that of Easter House. You are completely funded by fees related to your DMP operations and seek no funds from federal,

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state or local sources, nor engaged in fund raising programs, and do not solicit contributions. Also like Easter House, no court has found your services in and of themselves to constitute an exempt purpose.

Similar to Airlie Foundation, we believe you would fail the "commerciality" doctrine in applying the operational test. Because of the commercial manner in which you conduct activities, we believe you are operated for a non-exempt commercial purpose, rather than for a tax-exempt purpose. Your multi-million dollar contract to obtain potential DMP clients with XXXX, your efficient pre-qualification process, your concern for efficiency and productivity in your operations, your emphasis on and evaluation of your employees using statistics on efficiency and productivity, your boards emphasis on growth and profits, your payment of millions of dollars to Family members and to the CEO's software company, your concern about competition and obtaining and keeping a competitive edge, and your realization of extensive profits, as well as other factors allow us to conclude you have a substantial commercial purpose.

We believe your situation is also similar to FTC V. Gill. We believe a substantial purpose of the organization obtaining exempt status was to avoid regulation under CROA.

Reviewing the history of the organization and its Founder, XXXX, we see that he was involved with the for-profit credit counseling industry since the early XXXX's. At the time XXX was created, he continued in this portion of the industry up to XXXX, the same time as when CROA became effective. In XXXX, XXXX closed his for-profit business to concentrate his efforts on XXX.

Since, XXX charges initial fees which result in millions in revenue; they had a substantial motive to avoid CROA. Therefore, we believe that a substantial purpose of obtaining its exempt status was to avoid regulation by CROA, which would be a substantial non-exempt purpose.

In XXXX and XXXX, XXX's growth skyrocketed as a result of its multi-million dollar contract with XXXX. Without this 501(c)(3) status, XXX's growth would not have been possible. In the contract with XXXX, XXX had to represent and warrant on a continuing basis that it was a 501(c)(3) organization. If XXX was not able to maintain its exempt status, we do not believe that XXX would have been able to either obtain or maintain the contract with XXXX. Therefore, we believe that a substantial purpose of maintaining its exempt status is to ensure its ability to contract with XXXX to obtain an almost unlimited supply of potential clients on a continuing basis. We believe this is also a substantial non-exempt purpose.

The XXXX contract and collection of debt for XXXX is a substantial non-exempt purpose. This will be covered in more detail in the private inurement section below. In the fact section

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and the analysis below, we determined that XXX formed a "strategic alliance" with XXXX. The purpose for XXX was to obtain a constant flow of potential DMP clients and the purpose for XXXX was to obtain a cost effective method to collect payments on their debtors at risk of not paying amounts due to XXXX. The contract is obviously commercial in nature for both parties. Therefore, the contract that provides 90% of XXX's DMP activations was found to be of a commercial, for-profit nature; or another substantial non-exempt purpose XXX.

Additionally, as a result of this contract, not only is XXXX paid millions in referral, and/or service fees, as the later contract states, XXXX has negotiated savings in the millions of not having to pay fairshare payments for their clients that are referred to XXX for a DMP. Last, but not least, through its operations, and as a result of this contract, XXX collects about \$1334X a year for XXXX for some of its doubtful collections. Even though XXXX is a very large creditor, XXX's collections for XXXX are disproportionately high compared to other creditors.

Overall, the contracts were not entered into and do not appear to benefit a charitable class; we have already established that an educational purpose is not accomplished. They are simply a for-profit trade or business contract, whereby XXXX will substantially benefit from XXX acting as a collection agency for XXXX; again, a substantial non-exempt purpose of XXX operations.

A substantial purpose of XXX is to employ XXXX and his family members. Again, this will be discussed in more detail in the discussion of private benefit. To summarize that section, we found that XXXX Family members and relatives earned in excess of \$XXXXXXXX, \$XXXXXXXX, and \$XXXXXXXX in fiscal years XXXX, XXXX, and XXXX, respectively. Of the Senior Vice Presidents, 80% are family members. The only Senior Executive VP was the CEO's relative, XXXX. His duties do not appear to be as extensive or involved as those of the Call Center Director, who is a non-relative VP.

One of the CEO's relatives, paid as a Senior Vice President (SVP) operated the mail and file room, with absolutely no executive duties. Another relative, who is over 65, also has a SVP title; but performs essentially clerical work. Another brother is paid \$.67X and \$.80X in fiscal years [year] and [year] for research duties that any intern could perform. Finally, XXXX's elderly relative, still works at XXX. He is XX years old, getting paid twice the salary of the average XXX employee. Even though XXX has policies prohibiting relatives to report to other relatives, XXX ignores those policies and allows XXXX Family members to report directly to other Family members.

Therefore, we find that another substantial non-exempt purpose it to provide employment to the XXXX Family members and that some of the pay provided to relatives is highly questionable. The employment and hiring of relatives is a substantial non-exempt purpose.

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Another part of XXX operations results in substantial payments to the CEO's fully owned software company, XXXX. XXX purchased the software, the software system, which is the backbone of XXX operations for \$XXXXX to be paid in XXXXX installments of \$XXXXX with interest at X%. For a software contract, a product that becomes outdated very quickly, the 10 year contract is an extremely long contract period.

Additionally, XXX sold the XXX budgeting software to XXX to use as an "educational" budgeting tool for XXX clients. The result of these two contracts is that during the periods of the audit, around \$26X per year is paid to the CEO's company. Since we have determined that XXX does not provide exempt educational services to its clients, we believe these contracts provide a substantial benefit to XXXX, another non-exempt purpose.

In summary, we conclude that XXX is operated for numerous substantial non-exempt purposes, including the following: 1) Your operations of a commercial, profit-motivated DMP program, 2) Your avoidance of CROA by obtaining exempt status, 3) Your maintenance of your exempt status to ensure your commercial contract with XXXX remains in effect, 4) The operation of the contract furthers the non-exempt purpose of paying XXXX for referrals and acting as a debt collector for them, 5) Your employment of numerous family members, some with inflated wages, and 6) Your payment of millions of dollars to the CEO's software company.

We believe that each of the above aspects of your activities is a substantial non-exempt purpose, each of which preclude your organization from being regarded as "operated exclusively" for one or more exempt purposes within the meaning of Section 1.501(c)(3)-1(c)(1) of the Regulations.

**Issue 3 - XXX was operated for the purpose of serving private rather than public interests?**

Section 1.501(c)(3)-1(c)(2) of the Regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. The words "private shareholder or individual" refer to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations provides that an organization is not organized and operated exclusively for one or more of the purposes unless it serves a public rather than a private interest. To do this, an organization must establish "that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his/her family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests."

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Creditors in general

We must consider whether XXX provides substantial benefits to creditors, in general. As we have stated, a result of the operations of XXX is the payment of large sums of money to the creditors. They certainly have a private interest in its operations. Additionally, the individual creditors set policies for the DMP clients that XXX must follow. Therefore, they exhibit at least some indirect control over portions of XXX operations.

In considering this further, XXX provides substantial private benefit to credit card companies in a manner similar to the organization in Credit Counseling Centers v. S. Portland. Fair share is commonly defined as "that amount the organization receives from the creditors for each payment remitted to them." In the absence of any charitable or meaningful educational activities, which we have established, you are operating as a collection agency for these companies. The "fair share" paid by the credit card companies would undoubtedly result in significant savings over the possible costs of not recovering any of the unpaid debt owed them. Thus, these companies clearly realize substantial financial benefits through their business relationship with you. We note that your contract with clients' provides that if they drop out of the DMP, they are still obligated to pay their debts to the credit card companies. This illustrates the close business relationship you have with these companies.

Your board minutes also stress the emphasis and management of the organization is geared more towards continued dialogue with creditors, and good creditor relations, showing an alliance toward banks and creditors rather than the consumers. This emphasis of the board was also done with almost an exclusion of discussions on your purported exempt purpose of providing financial education.

Since XXX has collected on debts of approximately \$400 million dollars per year during the examination period, as compared to clearly insubstantial educational activities, we believe the benefit to creditors through your operations far outweighs any exempt purposes that are being achieved. Therefore, the relative benefit to creditors compared to the benefits to charity or charitable classes is substantial. They are also substantial in the qualitative sense because no education is provided to your clients or the general public.

XXXX

In particular, we find your association with XXXX to be very troubling. In a letter, dated XXXXXX, from a special committee of the XXX board of directors, they refer to this association as a "strategic alliance". We need to analyze this relationship to determine if this is an impermissible private benefit. First, let's consider the contract.

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The contract states that XXXX desires to aid borrowers under various XXXX loan programs who are experiencing trouble making payments by encouraging them to seek debt counseling so a payment plan can be worked out. XXXX acknowledges that the availability of up-to-date information concerning its distressed borrowers will enhance XXXX's ability to manage its accounts.

While this is stating XXXX wants to help its clients, the contract also states and is intended to get their clients into a payment plan, not to get them to get credit counseling. As a result, the contract will enhance their ability to manage, or in other words "collect on", its accounts. Therefore, this contract for XXXX is a method to collect from its own distressed borrowers.

The contract also requires both XXXX & XXXX to use their commercially reasonable best efforts in the performance of their obligations of the contract. The contract also states, both XXXX and XXXX understand the necessity of maintaining a reasonable constant flow of activity and successful conversion.

"In as much as the value of referrals is connected with a reasonable volume, XXXX agrees to provide at least XXXXX Client Information Referral Forms annually."

"In as much as the value of referrals is connected with a reasonable level of successful conversions, XXXX agrees to convert a minimum of 30% of the Client Information Referral Forms to active status.

"Subject to the exceptions set forth in the second Sentence of this Section, XXXX acknowledges that XXXX will have a competitive advantage in its industry upon entry into this Agreement, and XXXX agrees not to plan, advertise, sponsor, aid, develop, solicit or enter into any agreement with any other Person to provide services of the same kind, variety or nature with respect to debtors, without the written consent of XXXX."

This contract is clearly very favorable to XXXX. XXXX, like any other large creditor, will have a small percentage of their customers, who become unable to pay the amounts owed. Through this contract, XXXX has found a method to collect on doubtful debts in a manner that has a competitive advantage in its industry. Not only is XXXX paid to provide clients to XXX, they have arranged to forego having to pay fairshare payments to a credit counseling organization, like so many of its competitors do, and that they themselves pay to other credit counseling organizations who collect payments for them. XXXX has found, or was presented with a system, that essentially allows them to benefit from the exempt status of XXX.

Overall, the contracts were not entered into and do not appear to benefit a charitable class; we have already established that an educational purpose is not accomplished. This is simply a for-profit trade or business contract, whereby XXXX will substantially benefit from XXX

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acting as a collection agency for XXXX. While the contracts assume XXX will also collect for XXXX competitors, because XXX has an exclusive contract with XXXX, XXXX has negotiated what amounts to a negative fair share payment. No other creditors get this same deal from XXX.

XXXX receives a substantial private benefit from its association with XXX and this is documented by this agreement and per XXX's tax returns. During the period covered by exam, the returns show XXX paid XXXX \$88X, \$108X, & \$70X in fiscal years XXXX, XXXX, & XXXX, respectively. On top of this, XXX has collected around \$4000X dollars for XXXX over the period covered by this audit. If we provide a low estimate of 7% fairshare, this is an additional benefit of \$280X, the total combined benefit for XXXX is about \$4533X over the 3 years covered by this audit.

Another point that needs to be made is the substantial nature of the benefit to XXXX in comparison to XXX operations. The percentage of XXX payments to their total expenditures was 25.2%, 21.8%, & 15.2% for fiscal years XXXX, XXXX and XXXX, respectively. In all respects, this is a substantial benefit to XXXX.

In Rev. Rul. 70-186, private benefits of property owners were found not to lessen the primary public benefits flowing from the organization's operations. The ruling went on to distinguish a situation where an organization uses its funds primarily to foster private interests and the benefit, if any, to the general public is only incidental. We believe, XXX is more similar to the second organization, in that the private interests are primary, and the benefit to the general public is incidental.

In determining if an organization serves a public rather than a private interest, the private benefit must be considered incidental. To be considered incidental, it must be incidental in both a qualitative and a quantitative sense. In order to be incidental in a qualitative sense, the benefit must be a necessary concomitant of the activity which benefits the public at large, i.e., the activity can be accomplished only by benefiting certain private individuals. In this case the operation of a true credit counseling organization would require creditors to be benefited, because the education that is provided would hopefully lead to creditors that were paid back. However, not in the sense that the credit counseling organization would collect the money for them, as XXX does, but in that the consumers would learn how to properly manage their finances and credit.

To be incidental in a quantitative sense, the private benefit must not be substantial after considering the overall public benefit conferred by the activity. This is a straight comparison of the private benefit, in this case the \$4533X received by XXXX, with the public benefit conferred by XXX, in this case we have shown that XXX has failed to perform its exempt function, educating consumers. Therefore in a quantitative sense, the benefit to XXXX is substantial.

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XXXX Family Benefits

In the fact section of this document, we have established that XXXX has many family members employed at XXX. In more than one public relations "bios", we found the following comments, "Xxxx and his family are still the heart and core of the business. Averaging over 20 years of service, every one of the original XXXX family employees is still working hard on behalf of the many clients XXX now serves."

XXXX relatives earned in excess of \$14X, \$16X, and \$20X in fiscal years XXXX, XXXX, and XXXX, respectively. While XXXX is the CEO of the company, his XXXX is the COO. Both his XXXX and XXXX report directly to his XXXX. XXX does not follow its policy on the employment of relatives when it concerns relatives of the CEO. Page XX of the employee handbook, states, "...relatives may not be hired or transferred to positions where they directly or indirectly supervise or are supervised by another relative."

His XXXX, XXXXX, being the COO, has three Senior Vice Presidents (SVP) of Operations reporting to her. Until just recently, one of those SVPs was XXXX's XXXX, XXXX. XXXX was in charge of the mail and file room, essentially working in a middle management position, with absolutely no executive duties. As we mentioned, he recently stopped reporting to XXXX. In making this change, another of the SVP of Operations took over all his prior duties, further evidencing the lack of duties he previously performed.

As of the end of the audit period, XXX had X VPs. Of the X VPs, 72% were SVPs, where 57% were relatives of XXXX. The only Senior Executive VP was his relative, XXXXX. At the end of the audit period, XXXXX was in charge of the New Accounts area, an area with about 18% of the workforce. The only VP, that is not an SVP or an SEVP, was XXXXX. He was the Call Center Director, an area with over 44% of the workforce. Based on Responsibility Matrixes for ISO and the Decision Matrix, XXXXXXXX had similar if not more responsibly than XXXXX. They are paid similarly, although their positions and responsibilities are not. The difference seems to be XXXXX's relationship to the CEO. It also seems apparent that XXXXX is being set up to take over the business for when his relative retires.

XXXX's XXXX, XXXX, who is over 65, also has a SVP title. He performs work in a limited capacity making some basic data entry into the computer systems that any clerical employee could do. He is getting paid based on his title not his duties.

Another of XXXX's XXXX, XXXXX, got paid \$.67X and \$.80X in fiscal years [year] and [year], respectively for researching the credit counseling industry. He was not paid this much to research and analyze, but simply to research and pass the information on. He is getting paid for being XXXX's XXXX, not for his job duties, which any intern could perform.

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Finally, XXXX's elderly relative, still works at XXX. His XXXX is paid over \$67X is each year of the audit. He is XX years old. He gets paid twice the salary of the average XXX employee. His hours of work and job duties are unknown, as there seemed to be absolutely no reason to find this information out, as arguing that a XX year old was receiving unreasonable compensation at around \$.67X would not likely be upheld at any level in or outside of the IRS.

While, we are not arguing that any XXXX Family members receive unreasonable compensation, we do know that they are well paid. Regardless of duties, they are well paid for their titles. As we have stated earlier, the entire family made in excess of \$14X, \$16X, and \$20X in fiscal years XXXX, XXXX, and XXXX, respectively.

In addition to the numerous relatives of XXXX working for XXX, XXX has also contracted with XXXX, a software company that is 100% owned by XXXX. One contract is for the use of the debt management software used by XXX for which XXX agreed to pay \$XXXXXXX in XXXXX installments of \$XXXXXXX with interest at X%.

The term of this contract is 10 years and will automatically renew for successive 5 year terms thereafter, unless 90 days prior written notice is made before the expiration of the contract. In terms of computer software, a product that becomes outdated very quickly, this is an extremely long contract period.

The second contract is for the software used as the "educational" budgeting tool provided to XXX clients. The agreement is a minimum of XXXXX licenses per 12 month period at \$XX for the computerized version and \$XX for the non-computerized workbook version. Since the primary form that XXX distributes, this contract has a minimum value of around \$XXXXXXX per year.

This contract is automatically renewable for additional 12 month periods unless 90 days prior written notice is made before the expiration of the contract. XXX has automatically renewed this contract with little or no documented discussion from the board of directors.

The payments to XXX during the periods of the audit average around \$26X per year. Without a discussion of the reasonableness of the payments to XXX, this is another substantial benefit of \$80X dollars to XXXX during the period of the audit.

In terms of determining if public rather than private interests are served, we must again weigh the benefits the family receives with the benefits received by the general public and we must consider the private benefit in both a qualitative and a quantitative sense.

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In order to be incidental in a qualitative sense, the benefit must be a necessary concomitant of the activity which benefits the public at large, i.e., the activity can be accomplished only by benefiting certain private individuals. In this case the operation of a true credit counseling organization would not require family members to be benefited. As XXX became more profitable, more members of XXXX's family were hired and they were paid at increasing rates. In a qualitative sense, we do not believe that true credit counseling agencies require the extensive software package that runs the XXX DMP program, the software system. We must remember, this program does not help XXX provide educational services, it keeps track of the DMP clients and their accounts. We are also unsure if true credit counseling would require such a large purchase of budgeting software, since the financial counseling they provide is generally performed by counselors. Therefore, in a qualitative sense, these payments to Family members for wages and XXX for the software programs are not incidental.

To be incidental in a quantitative sense, the private benefit must not be substantial after considering the overall public benefit conferred by the activity. This is a straight comparison of the private benefit, in this case the \$51X received by XXXX family members and an additional \$80X to XXXXs 100% owned company, with the public benefit conferred by XXX, which again we have shown that XXX has failed to perform its exempt function, educating consumers. Therefore in a quantitative sense, the benefit to the family members is substantial.

In summary – Issue 3 – Private Benefit

In conclusion, we find that when looking at the benefits provided to 1) creditors, in general, 2) XXXX in particular, and 3) the XXXX Family; the benefits are substantial in nature. All of these, separately, when considered in a quantitative sense and compared to the benefit received by the general public through your exempt activities are substantial.

Any activities involving "authentic" credit counseling provided to a genuine charitable class or the provision of credit education to the general public, would be purely incidental to the private benefits your organization confers to the above "private shareholders or individuals" having a personal and private interest in the activities of the organization.

Therefore, XXX is not operated exclusively for one or more exempt purposes, because of private benefit pursuant to Section 1.501(c)(3)-1(c)(2) of the Regulations.

**Issue 4 - XXX has allowed private inurement to exist in conducting its operations?**

Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations provides that an organization is not organized and operated exclusively for one or more of the purposes unless it serves a public rather than a private interest. To do this, an organization must establish "that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or

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his/her family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests."

The inurement prohibition provision "is designed to prevent the siphoning of charitable receipts to insiders of the charity . . ." United Cancer Council v. Commissioner. "In other words, section 501(c)(3) denies exempt status to an organization whose founders or controlling members have a personal stake in that organization's receipts. Founding Church of Scientology v. United States,

XXXX as the creator, CEO, and Director of XXX is considered an insider for the purposes of the private inurement prohibition. Since he owns 100% of XXX, XXX is also considered an insider for the purposes of private inurement.

In this respect, we have concerns with one of the two contracts XXX has with XXX, the one for the budgeting software, dated XXXXXX. This agreement gives XXX a limited, non-exclusive, and non-transferable right to the XXX software package. The agreement requires a minimum payment for XXXXX licenses per 12 month period at \$XX for the computerized version and \$XX for the non-computerized workbook version.

As we have previously stated, the contract is automatically renewable for additional 12 month periods unless 90 days prior written notice is made before the expiration of the contract. XXX has automatically renewed this contract with little or no documented discussion from the board of directors, and for a contract that could, and has, generated millions of dollars in fees per year.

The software that is purchased is described on the XXX website as a "software program that will allow you to develop your personal budget, analyze different debt liquidation strategies, and simulate debt within your overall budget for long-term planning, plan for short-term emergency savings, and plan for long-term retirement savings." The website indicates that only active clients (DMP client) are able to download a free copy of the software.

Additionally, during our initial meeting with the XXX executives, we were told that all callers will be provided with copies of the software, regardless of whether or not they become an active DMP client. While the records to establish the actual number of callers they receive per year is not maintained by XXX, they believe this number is over 100,000 per year.

Based on the contract with XXXX, they were required to convert 30% of the XXXX referrals. Since they averaged about 24,000 new clients over the audit period, we believe this total may be closer to 75,000 than 100,000 per year.

Since the costs to copy the software on to a CD or to have the software downloaded from the

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website are much cheaper than a paper copy of the software would be, we believe that most of the copies distributed by XXX will be for the higher cost software version, per the contract.

Therefore, XXX is now indicating that the costs for this contract will be closer to \$XXXXXX per year, which will be more than the amounts that were paid during the year of the audit, which averaged closer to \$XXXXXX per year.

XXX distributes this software for free to its clients, which certainly seems to be a common price for this type of software. In a Yahoo! search for "Free Budgeting Software" on [date], we got 2,580 hits. In a Yahoo! search for "Free Debt Elimination Software" on [date], we got 1,090 hits. Some of these were undoubtedly duplicates.

Budgeting software can be obtained from a variety of other credit counseling organizations too. Access to free budgeting software does not seem to be at issue. So why is XXX willing to pay \$XX to XXX for each copy, simply to give it to their clients who could get other free versions of budgeting software? We will come back to this.

In comparing budgeting software that is purchased at a retail store, Quicken Basic and Microsoft Money Standard are two such budgeting software applications. Those are about \$30 in the stores or over the internet. However, XXX is purchasing in bulk, anywhere from 20,000 to over 100,000 based on XXX estimates, which should be much cheaper on a per copy basis.

It is very concerning that XXX's board is renewing the contract on an annual basis, at a cost of around \$13X per year, if comparable products can be obtained for free or at very minimal cost. The answer could certainly be the reason is because this is XXXX's business. Remember, XXXX stated on trusted and respected friends are on the board of directors. Even still, there is no evidence in the minutes that the board knows the nature of this contract, since it is not discussed in the board minutes. It is simply allowed to renew.

XXX has generally been very interested in making sure that they are protected from the standpoint of rebuttable presumptions. For example, the board of directors has a rebuttable presumption committee.

As we stated this contract was created in [month] of [year]. During the course of this audit, XXX has provided several letters for various contracts to show their due diligence in determining the reasonableness of those contracts.

In [month] of [year], Arthur Anderson wrote them a letter concerning the reasonableness of the XXXX contract. This letter mentions a prior letter Arthur Anderson sent to XXX specifically mentioning actions XXX should take to qualify for the rebuttable presumption with respect to

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the XXXX contract.

In [month] of [year], the board of directors of XXX created a Special Committee on Software License Agreement Valuation to determine the value of the contract XXX, then XXXX, had with XXXXX. This letter limits its valuation to the software system, unrelated to the budgeting software contract. This letter also discussed the rebuttable presumption requirements.

In [month] of [year], Arthur Anderson again wrote XXX a letter concerning the reasonableness of the XXXX contract. This letter is substantially similar to the prior one for this contract, also mentioning the rebuttable presumption. Another similar letter from Arthur Anderson was written in [month] of [year].

It is obvious that XXX was well aware of their responsibilities with making sure they paid reasonable amounts for their contracts, especially when insiders are concerned.<sup>62</sup> XXX also has an in-house counsel that has been with the organization since its inception. Any claim that they could make that they did not know about the rebuttable presumption would be purely frivolous.

Finally, on XXXXXX obtained a letter from Deloitte Tax, which covers the budgeting software contract. This letter specifically states that it covers the contract with XXX, effective XXXXXX. While they analyzed the agreements and determined the payments were reasonable, it indicated that they could not determine that XXX meet the rebuttable presumption requirements, because they were unaware of how the board determined the reasonableness of the contracts at the time they were signed.

Note: This letter refers to both contracts as XXX contracts. The actual contracts are with XXX and XXXXX and I will refer to them as such. The contract at issue here is the XXX contract for the budgeting software, whereas the XXXXX contract is for the software system.

However, a review of this XX page<sup>63</sup> letter leads to more questions than answers with respect to the XXX contract. The letter discusses this contract up to page X, as if they were going to value the contract. However, our review of the letter indicates in their analysis, Deloitte only considered the contract with XXXXX. They completely dismissed the contract with XXX in their analysis. This letter is clearly in error. Therefore, XXX has never received an opinion on the valuation of the XXX contract.

This contract is clearly overvalued and is used by XXXX to increase his income from the

<sup>62</sup> XXX also obtained studies to show compensation paid to Family members was reasonable, also showing their knowledge of their requirements in this regard.

<sup>63</sup> XX pages with attachments XXXXX.

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substantial profits earned by XXX.

XXXX has created an incredibly profitable organization in XXX. The profits from XXX have been \$80X, \$55X, \$78X, (\$13X), 55X in fiscal years XXXX, XXXX, XXXX, XXXX, and XXXX, respectively<sup>64</sup>.

As we have stated earlier, XXXX has paid his family millions per year to work for XXX. He even employs his XX year old relative at XXX. He has shown a propensity to increase his, and his family's wealth steadily in the forms of salary and in the amounts he pays through these contracts, especially for this contract.

Based on the analysis above, we have determined that the contract price of at least XXXXX licenses at \$XX and \$XX per license and the millions that XXXX has been paid through his S-corporation, a flow-through entity, exceeds the FMV of the contract. Similar software could be obtained for from a multitude of places for free.

Over the counter software, with Brand names such as Quicken Basic and Microsoft Money similarly priced as the XXX software, but that price is for a single copy, not purchased in bulk as the XXX software is.

The fact that XXX has not been able to provide any documentation to support the valuation of this contract with their extensive history with working to fulfill the rebuttable presumption in other issues is also indicative of the overvaluation.

Lastly, we have not been provided any evidence that the board has considered this contract on any of the renewal dates during the period covered by the audit. By its non-action, the contract is automatically renewing annually, per the contract, and XXXX's income is increasing rapidly on an annual basis. Therefore, we believe that the amounts XXX pays to XXXX, via XXX, his 100% owned S-Corporation are in excess of the FMV of the contract.

Furthermore, since XXXX is an insider, XXX is not being operated exclusively for one or more exempt purposes because it is allowing its net earnings to inure to its founder and CEO, XXXX.

**Taxpayers Position:**

The position of taxpayer has been presented in oral and written responses to the examiners, in particular, and to our Washington Office, as well. There are many points of contention with

<sup>64</sup> The loss was because they booked a \$XX million pledge, which is to be paid out over the next X years, which was made after XXXX XXXXXXXXXXXXXXX.

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the Service and the results of the examination and will be addressed in part here and in XXX's Responses to Information Document Request No. 7 (attachment 23), Summary and Analysis of Counselor Calls (attachment 24), Letters written to the revenue agents (attachment 27), and XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX (attachment 28), prepared by XXXXX, Ph.D., Department of XXXXXXXXXXXXX, XXXXX University and XXXXX, M.S. Department of Psychology, XXXXX University, which addresses the science of determining an appropriate sample size and various communications with the agents handling the examination.

First, and probably the most contentious issue is regarding the standpoint on what education means. The taxpayer believes that their activities are educational under Internal Revenue Code 501(c) (3). Once XXX determined that the Service had an issue with its activities, they requested what that definition is and how it applies to the services they provide. XXXX, the taxpayer's attorney, wrote on their behalf, to the revenue agents. This letter is dated January 28, XXXX, (Attachment 29). XXXXX stated the letter was to:

"address industry issues raised by IRS, including whether debt management plans are charitable activities and whether payments to creditors confer a private benefit. We also hope to convince you that many XXXs do operate in a manner consistent with their tax exempt status and hold out our company, XXXX (XXX), as an example of a truly charitable organization dedicated to educating and counseling consumers and conforming in every way to all of the 501(c)(3) requirements."

The taxpayer also believes their method of delivering "education and counseling" leads the industry. This letter further states:

"As an industry leader, we at XXX decided more than a year ago to become actively involved in attempting to guide our industry down the right path. As you well know, this is a difficult and often frustrating project. During this time period, we worked with state and federal regulatory agencies, congressional committees and consumer advocacy groups. We are strong proponents of increased regulatory oversight of our industry and support the adoption of consumer protection legislation at the state and federal levels."

It is also their position that they work with all regulatory agencies and promote adherence to all necessary rules and regulations. It their position therefore, they are compliant and proactive in staying that way.

**Educational Aspects of Debt management Plans**

XXX believes that the services they provide are essential in the development and education in helping distressed consumers. Consumers are in need of assistance and to help them,

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relief is necessary from the immediate need from their debts...“It is difficult to teach long term financial accountability to people in short term, immediate financial distress. Distressed consumers typically seek immediate relief from their financial crisis, but what they really need is long-term behavioral change. Behavioral change is undeniably an educational goal. A debt management plan, when used appropriately, can service both these short-term and long – term goals and is the best available educational tool for credit counseling.”

XXX states how necessary debt management plans are as they give debtors the opportunity to catch their breath. The taxpayer explains that the debt management plan provides a meaningful way to provide individuals a way to become in control of their lives.

XXX claims, “In the short-term, the debt management plan provides a “safe harbor” for the distressed consumer, who is otherwise consummated by fears over unpayable bills, creditor calls, collection agency calls, legal actions, late fees, over the limit fees, “default” credit card interest rates and, more generally, the fear of being financially out of control, in free fall, and on the verge of bankruptcy. This “safe harbor” gives the consumer the short-term practical stability necessary to begin to take long-term responsibility for the consumer’s financial situation, with the hope for the future. This stability extends to all aspects of the consumer’s life, including the consumer’s family and employment...”

As stated by the taxpayer, debt management plans modify the distressed borrower’s habits, which are part of the educational process.

#### Beneficiaries of Debt Management Plans

This letter also states, “Through payments from creditors, often called “fair share” payments, creditors who have aggressively marketed consumer credit share some responsibility for the explosive increase in the number of consumer in financial distress. It is perfectly appropriate for these credit card issuers, as opposed to the public at large or charities such as the United Way, to take financial responsibility for funding the efforts of creditor counseling agencies. The voluntary agreement by credit card issuers to take financial responsibility for a side effect of the product they market is certainly preferable to the approach of others, for example the tobacco industry. who denied the existence of a problem caused by their product, and let the public pick up the tab until they were forced to take responsibility”

“When XXXs (in general) were first approved for 501(c)(3) status, XXXs were heavily controlled by creditors, creditor representatives sat on XXX boards of directors, and creditor “fair share” payments were typically set at 15 per cent of revenues paid through debt management plans . Today, credit counseling agencies have never been more independent of creditors. Creditor representatives typically do not (and should not) sit on XXX boards. Creditors pay fair share or provide grants that are not only at an historic low percentage, but

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also based on a wider range of factors more directly focused on the XXX's commitment to education."

#### Corporate Governance at XXXX

In the correspondence dated December 28, XXXX<sup>65</sup>, XXX's corporate governance was discussed, demonstrating its high standards of governance. This is attached as Item 29. The taxpayer features a board of XX members, of which 62% are outside directors. The directors provide a wealth of experience with backgrounds in financial management, business and education. The board takes a hands on approach to overseeing the operation of the company and that it functions as a group. Additionally, special committees are held to include executive, audit compensation, education, rebuttable presumption and creditor and public relations. Its governance also includes a conflict of interest policy; its current policy requires annual disclosure of actual and potential conflicts. XXX also certifies its financial statements annually with an independent audit; the chief executive officer and the chief financial officer sign a document certifying the accuracy of the financial statements.

#### Arguments Related to the Exam Itself

There is an area of contention on the methods used by the government to select, sample, identify and determine the content of education found in the taxpayer's phone calls with clients and non clients. Once the examiners had selected and evaluated the phone calls, the taxpayer had stated a disagreement with the analysis and methodologies; this was stated in "Response to Information Document Request No. 7 (see attachment 23). In IDR No. 7, it concludes that none of the calls selected contains educational content (and, by implication, that the debt management plan does not serve an educational purpose). XXX's response was to look at each of these components individually, and make some additional observations.<sup>66</sup> The taxpayer states there was no scientific method of selecting calls from the new or open account teams. The sample selection was improvised and not scientific. They believe providing a larger sample, with a more formal approach, would provide a more accurate outcome. Additionally, in reviewing the same calls, XXX did find educational content. The taxpayer also states "XXX's Educational Intent Cannot be Questioned"- it has demonstrated its intention and commitment to provide education. In *Attachment: Summary and Analysis of Counselor Calls* (attachment 24), XXX provides its own summary and analysis of the 35 calls and provides a contrary position taken by the examiners.

As part of XXX's position on January 20, XXXX, the taxpayer provided their conclusion as

<sup>65</sup> XXXXX, Re: Corporate Governance at XXXX, Inc., December 28, XXXX.

<sup>66</sup> *Response to Information Document Request No. 7, page 1 and "Summary and Analysis of Counselor Calls"*.

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well as recommendations.<sup>67</sup> "There are a number of credit counseling organizations that, like XXX, are properly focused on the educational mission of their work and that help thousands of consumers in progressing from insolvency to financial stability and even prosperity. These are organizations that do things the right way and are effective models of credit counseling performed in a manner that is entirely in accord with the requirements of Section 501(C)(3). We believe that when IRS examines in detail some of the model organizations that exist within the overall group of XXXs, you will conclude, as we have, that credit counseling and tax exemption are a good fit. We hope that this review will also clearly demonstrate to you that the loss of tax exemption would undermine the effectiveness of the entire process, eliminating the education and counseling that millions of consumers desperately need.

We recommend the following:

1. Ratification and endorsement of the conclusion that credit counseling, when performed properly fits within the requirements for tax exemption;
2. The issuance by IRS of a comprehensive and practical guide to tax exemption for credit counseling;
3. Continued aggressive examination of XXXs for compliance and revocation of tax exemption for those that do not meet the 501(c)(3) requirements; and
4. The adoption of preemptive federal legislation focused on consumer protection to create a tight new regulatory structure for credit counseling."

In conclusion, XXX believes that their operations fall within the meaning of Section 501(c)(3). A consumer who gets on a DMP learns that they must live within a budget, they learn to live without a dependence on credit cards, and they learn to pay off their debts. In doing so, they not only get out of debt, but through the behavioral change brought about by the DMP, they have learned how to stay out of financial problems in the future.

XXX is claiming the consumers learn by doing. XXX is also claiming they provide their clients with "education" throughout the DMP process. From the first counseling session, a working budget is created with the client and continuing into the DMP process, the clients have ongoing access to educational resources. This combination of living within a budget and being constantly provided with education allows the clients to get out, and stay out, of their financial distress.

## Conclusion

Based on the examination of your actual activities in light of the applicable law, we find you are not operated for exempt purposes.

<sup>67</sup> January 20, XXXX XXX letter to IRS, XXXXX and XXXXX, on Page 20.

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Section 1.501(c)(3)-1(a)(1) of the Income Tax 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 of such section. If an organization fails to meet either the organizational and operational test, it is not exempt. Your organization has failed to meet the operational test since you function for the intake and servicing of debt management plans. This is your primary activity, which is non-charitable. This activity does not accomplish an exempt purpose, to provide education and financial counseling. Further, your debt management activities are not an integral part of providing education or financial counseling.

We have also determined you are operated for numerous substantial non-exempt purposes, including operating a commercial for profit business, operating to avoid regulation by CROA, operating for the benefit of XXXX and other creditors and for the benefit of the XXXX Family. As these are all substantial non-exempt purposes, your organization is precluded from being regarded as "operated exclusively" for one or more exempt purposes within the meaning of Section 1.501(c)(3)-1(c)(1) of the Regulations.

We have also determined you are operated for impermissible private benefits for several private shareholders or individuals having a personal and private interest in the activities of the organization such that XXX is not operated exclusively for one or more exempt purposes, pursuant to Section 1.501(c)(3)-1(c)(2) of the Regulations. These private shareholders or individuals include XXXX and creditors, in general, and the XXXX Family.

It has also been determined that you allowed private inurement to exist in conducting XXX's operations through its contract with the CEO's software company, XXXX.

Therefore, for the reasons stated above, your charitable exempt status should be revoked.

Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Internal Revenue Code and you must file federal income tax returns. Contributions to your organization are not deductible under section 170 of the Code.