

**Enhancing Tax-Exempt Bond Compliance Practices in a Time of Increased
IRS Scrutiny**

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Abstract

The use of tax-exempt debt plays a critical role in funding a significant portion of the University of Virginia's capital program. As such, the University realizes the importance of complying with federal and institutional requirements regarding the issuance and ongoing management of its tax-exempt debt. Heightened interest has been placed on tax-exempt bond compliance ("TEBC") over the past few years. The Internal Revenue Service ("IRS") has increased its focus on TEBC with the issuance of borrower questionnaires and the revision of forms filed by not-for-profits to increase its scrutiny of tax-exempt debt usage. The IRS has put tax-exempt issuers on guard, having said they are "... aware of significant noncompliance with recordkeeping and record retention requirements relating to tax-exempt bonds..." (IRS, Schedule K Highlights, 12/20/2007).

The University has addressed TEBC requirements by taking two significant actions. The first was the University's drafting of a TEBC policy that (1) defines compliance practices, (2) identifies responsible parties, (3) describes record retention, data management, and filing requirements, and (4) establishes guidelines for compliance continuity. The second was the creation of a TEBC information dashboard that consolidates disparate TEBC data into one place and allows users to search and drill down into TEBC data elements to perform compliance and reporting on a real-time basis. The TEBC information dashboard contains data on authorizations, private business use, required filings, proceeds tracking, yield and arbitrage compliance, records retention and storage, and responsible parties.

The TEBC policy consolidated, and in some cases created new, compliance practices while helping to clearly define activities and responsibilities. The TEBC information dashboard serves as a single point of information for data related to tax-exempt debt, debt-funded capital projects, and compliance requirements. The implementation of these two solutions has enhanced the University's compliance and data management efforts and left it with a best-in-class solution for addressing TEBC.

Introduction of the Organization

The University of Virginia, located in historic Charlottesville, Virginia, has the distinction among institutions of higher education of being founded by the nation's third President, Thomas Jefferson, in 1819. The University is a public institution with an operating budget of \$2.1 billion. Thanks in part to its devoted alumni and historically strong investment performance, the University maintains an endowment in excess of \$4 billion. It has maintained either the top or second spot among public higher education institutions since *U.S. News & World Report* began ranking public universities. Among all universities, public and private, the University of Virginia is ranked in the top 25.

The University of Virginia is made up of eleven schools in Charlottesville, plus the College at Wise in southwest Virginia. U.Va. offers 51 bachelor's degrees in 47 fields, 84 master's degrees in 67 fields, six educational specialist degrees, two first-professional degrees (law and medicine), and 57 doctoral degrees in 55 fields. In the 2009 academic year, the University conferred 6,262 degrees.

Additionally, the University of Virginia Health System is a nationally renowned academic medical center committed to providing outstanding patient care, educating tomorrow's health care leaders, and discovering new and better ways to treat diseases. U.Va.'s physicians and researchers continue to be recognized for excellence by many publications, and the Medical Center is consistently named one of the top 100 hospitals in the nation.

Statement (restatement) of the Problem/Initiative

With the recent increase in IRS scrutiny of tax-exempt debt issuers, the University of Virginia felt the need to enhance and formalize its TEBC practices. Although the University had successfully passed an IRS bond audit in 2007, the increased focus and scrutiny by the IRS resulted in the University—and higher education in general—placing greater focus on its compliance and reporting practices.

More importantly, the University viewed this as an opportunity to improve upon its data management and reporting related to tax-exempt debt. TEBC records had been maintained by different departments in different physical locations with no comprehensive policy to guide management and compliance. The creation of a comprehensive policy would help to formalize compliance practices, and the ability to consolidate TEBC data in one place and make it available through one user interface would be invaluable.

Design

The University's methodology to develop this best practice can be broken down into four discrete steps.

Step 1 – Identification of Need

As an active issuer of tax-exempt bonds, the University became aware of increasing scrutiny being placed on tax-exempt issuers through discussions with our higher education colleagues and our advisors and bond counsel. The University was first made aware of the questions being asked by the IRS via its 2007 questionnaire sent to select private colleges and universities. By reviewing this and other literature, and by talking with our advisors, we were

able to identify a need to enhance our existing practices. It was also believed that the IRS would soon be sending a similar questionnaire to public entities, such as U.Va. As predicted, the public entity questionnaire was sent to public issuers of tax-exempt debt in January 2009.

Step 2 – Formation of a Compliance Team

Due to the many departments and individuals involved in the University's TEBC efforts, the University formed a TEBC team to develop a comprehensive cross-functional solution. The team consisted of members from the Treasury, Accounting, and Tax areas. It also included outside advisors, such as the University's financial advisor, bond counsel, and arbitrage calculation agent. This group of stakeholders worked together to gather relevant information, assess current compliance practices, understand new compliance requirements and design a project plan to make the necessary enhancements to meet the increased standards.

Step 3 – Data Gathering

The University gathered data to educate itself on the latest IRS compliance requirements. The data reviewed included:

- IRS Form 13907 – Tax-Exempt Bond Financings Compliance Check Questionnaire sent to public schools
- IRS Form 14002 - Governmental Bond Financings Compliance Check Questionnaire
- The National Association of Bond Lawyers/Government Financial Officers Association's Post Issuance Compliance Questionnaire
- A publication by the IRS Advisory Committee on Tax Exempt and Governmental Entities titled "After the Bonds are Issued: Then What?", and
- Various presentations, best practices, and policies of other schools.

This data was used to help determine the requirements of a comprehensive TEBC solution.

Step 4 – Setting Scope and Objectives

After reviewing the data gathered, the team identified two requirements to enhance TEBC practices. First, was the need for a formal policy. Second was the need for a better way to manage, research, and report TEBC data. The TEBC team determined the objectives of the policy to be to following:

- Define compliance practices
- Identify responsible parties
- Address records retention, data management, and filing requirements
- Establish guidelines for compliance continuity

Additionally, the team began assessing the current process for managing records and determined that a dashboard would be useful to provide a single point of reference with regard to TEBC data.

The solution was not expected to result in any external costs. To create the dashboard, the University planned to use QlikView software, a complete business intelligence solution that consists of a data source integration module, analytics engine, and user interface.

Implementation

Over a 3-month period, the TEBC team drafted and edited a policy to achieve its TEBC objectives. The draft policy was then reviewed by external advisors including the University's bond counsel, financial advisor and rebate/arbitrage agent, and comments were incorporated into the draft policy. After making final revisions, the TEBC team forwarded the policy to the Vice

President & Chief Financial Officer for final review and approval. The result was a comprehensive policy that the team felt adequately addressed requirements identified by the IRS.

The objectives of the dashboard were (1) to make all TEBC data accessible through one interface and (2) to link the data so that searches would return all related information. Data was gathered from multiple sources, including the Oracle accounting system, a treasury management system, multiple spreadsheets, and an online project management system hosted by our financial advisor. An accounting information technology analyst then created the user interface and developed customized reports for users. Additionally, the IT analyst is working on an enhancement that would prompt stakeholders regarding compliance requirement due dates and allow them to “check-off” when compliance items have been completed.

Benefits

The benefits from this solution include (1) a comprehensive TEBC policy that complies with newly-developed IRS guidelines and (2) a flexible, powerful, TEBC dashboard that consolidates all TEBC-related data and has given stakeholders an easily accessible tool to gather data and report on TEBC activities. For example, a search on a single field, such as “Series 2009 Bonds,” would return the bond’s terms, projects financed by that bond, compliance requirements, location of documentation, and responsible parties. Historically, such a query would have required multiple parties searching both electronic and paper records in various locations to find all the related data.

Aside from the commitment of human capital, the cost to implement this solution was minimal, whereas the avoided cost associated with non-compliance has the potential to be great.

Additionally, the mitigation of risk and the time and energy saved by having TEBC data readily accessible, searchable, and reportable has proven to be a valuable benefit for the University.