



Nonprofit Accounting and Audit Update

Denver Government & Nonprofit Training Academy – 2023

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Learning Objectives

1

Outline new and current accounting guidance affecting nonprofits

2

Identify upcoming accounting standards and recognize important items to consider during implementation of the leasing standard





ASC 842 (Leases)

Leases (Topic 842)



EFFECTIVE DATE:

FISCAL YEARS BEGINNING AFTER 12/15/21

(12/31/22; 6/30/23);

EXCEPT FOR **PUBLIC NFP ENTITIES** WHICH HAVE AN
EFFECTIVE DATE OF YEARS BEGINNING AFTER 12/15/19

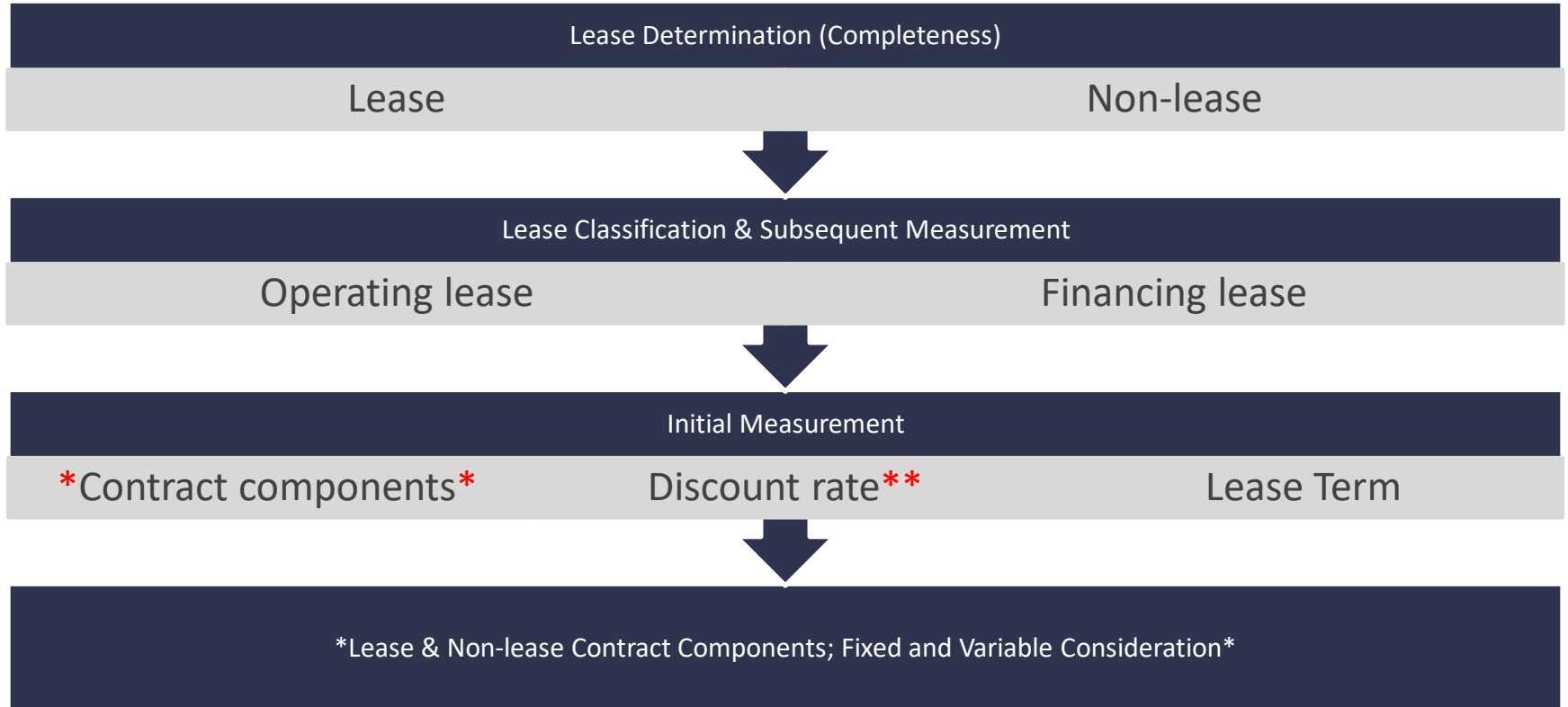
(12/31/20; 6/30/21)



PUBLIC NFP ENTITY = AN ENTITY THAT HAS ISSUED, OR IS
A CONDUIT BOND OBLIGOR FOR, SECURITIES THAT ARE
TRADED, LISTED, OR QUOTED ON AN EXCHANGE OR
OVER-THE-COUNTER MARKET



Steps: Lease Analysis and Accounting



Lease Determination



An identified asset

- Can be explicitly or implicitly specified
- Supplier has no practical ability to substitute
- Supplier receives no economic benefit from substituting



The right to control the use during the lease term

- Decision making authority over the use of the asset
- Ability to obtain substantially all economic benefits from the use of the asset



Lease Classification – Lessee

Financing lease if ANY of the following 5 conditions are met:

Transfer of ownership

Option to purchase is reasonably certain

Lease term is a major part of the economic life

Present value of lease payments is substantially all of the fair value of the underlying asset

The underlying asset is of a specialized nature

If none of the above are met, the lease is an operating lease



Leases Financial Statement Impact – Balance Sheet

Finance Lease

- Right-of-Use Asset
- Lease Liability

Operating Lease

- Right-of-Use Asset
- Lease Liability



Lease Liability – Initial Measurement



Lease Right of Use Asset – Initial Measurement

- ROU asset =
 - Initial measurement of lease liability
 - Plus: lease pre-payments
 - Plus: lessee initial direct costs
 - Minus: lease incentives received



Lease Financial Statement Impact - Income Statement

Finance Lease

- Amortization Expense
- Interest Expense

Operating Lease

- Lease Expense



Lease Financial Statement Impact - Cash Flow Statement

Finance Lease

- Operating:
 - Amortization of ROU Asset
 - Change in lease liability
- Financing:
 - Principal Payments

Operating Lease

- Operating:
 - Amortization of ROU Asset
 - Change in lease liability



Example – Operating Lease

3 year lease term

Annual rent of \$100, escalating \$3 annually

7% interest rate



Example – Operating Lease

- Initial Recognition:

Dr. ROU Asset	270	
Cr. Lease Liab		270

- Year 1 Entry:

Dr. Lease Exp	103 A	
Dr. Lease Liab	81 D	
Cr. Cash		100 B
Cr. Accum Amort		84 A-C

- NOTE: No amortization expense is recorded! It is a component of the lease expense!

	Expense	Liability			Asset
		Payment	Interest	Principal	Amortization
Year	A	B	C	D	A-C
1	103	100	19	81	84
2	103	103	13	90	90
3	103	106	7	99	96
	309	309	39	270	270



Example – Finance Lease

3 year lease term

Annual rent of \$100, escalating \$3 annually

7% interest rate



Example – Finance Lease

- Initial Recognition:

Dr. ROU Asset	270	
Cr. Lease Liab		270

- Year 1 Entry:

Dr. Interest Exp	19 C	
Dr. Amort Exp	90 A	
Dr. Lease Liab	81 D	
Cr. Cash		100 B
Cr. Accum Amort	90 A	

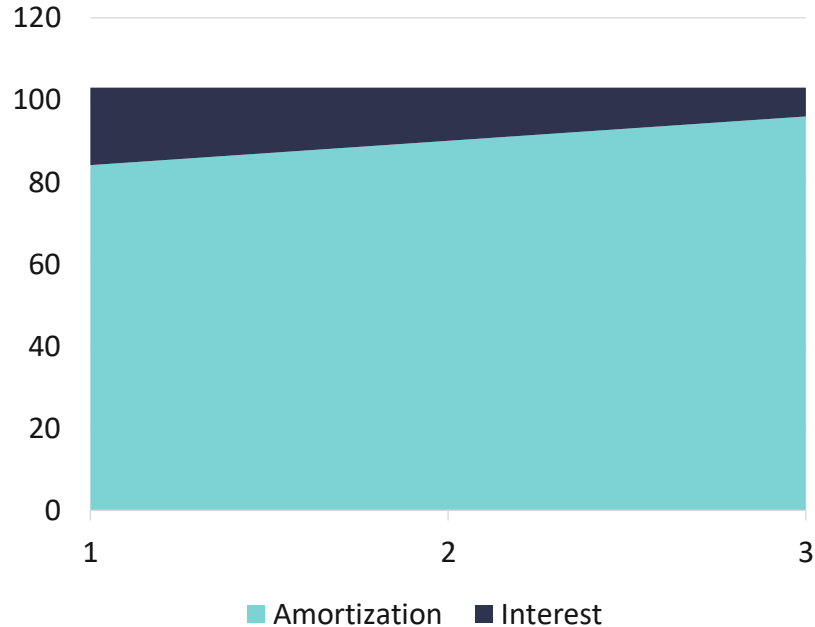
- NOTE: No lease expense is recorded. Each component is recorded.

	Asset	Liability			Expense
	Amortization	Payment	Interest	Principal	
Year	A	B	C	D	A+C
1	90	100	19	81	109
2	90	103	13	90	103
3	90	106	7	99	97
	270	309	39	270	309

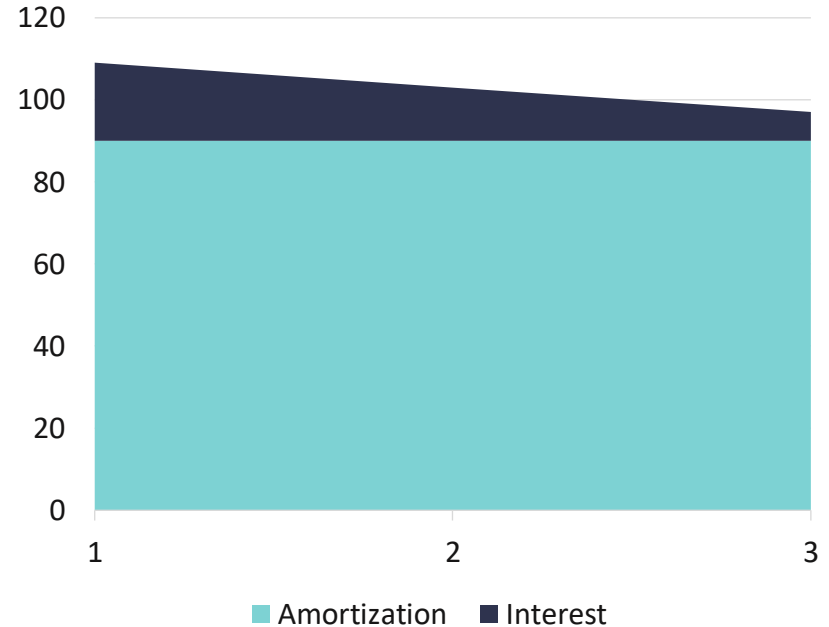


Total Expense – Operating Lease vs Finance Lease

Operating

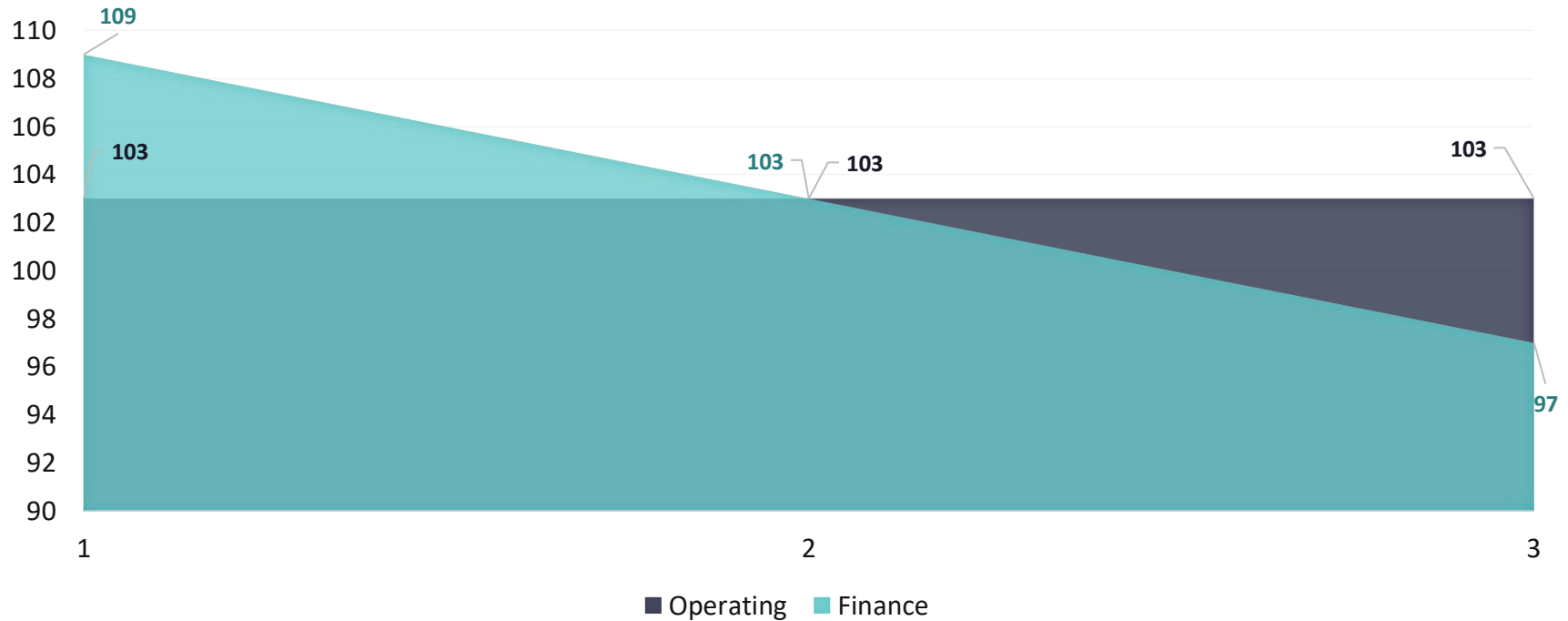


Finance

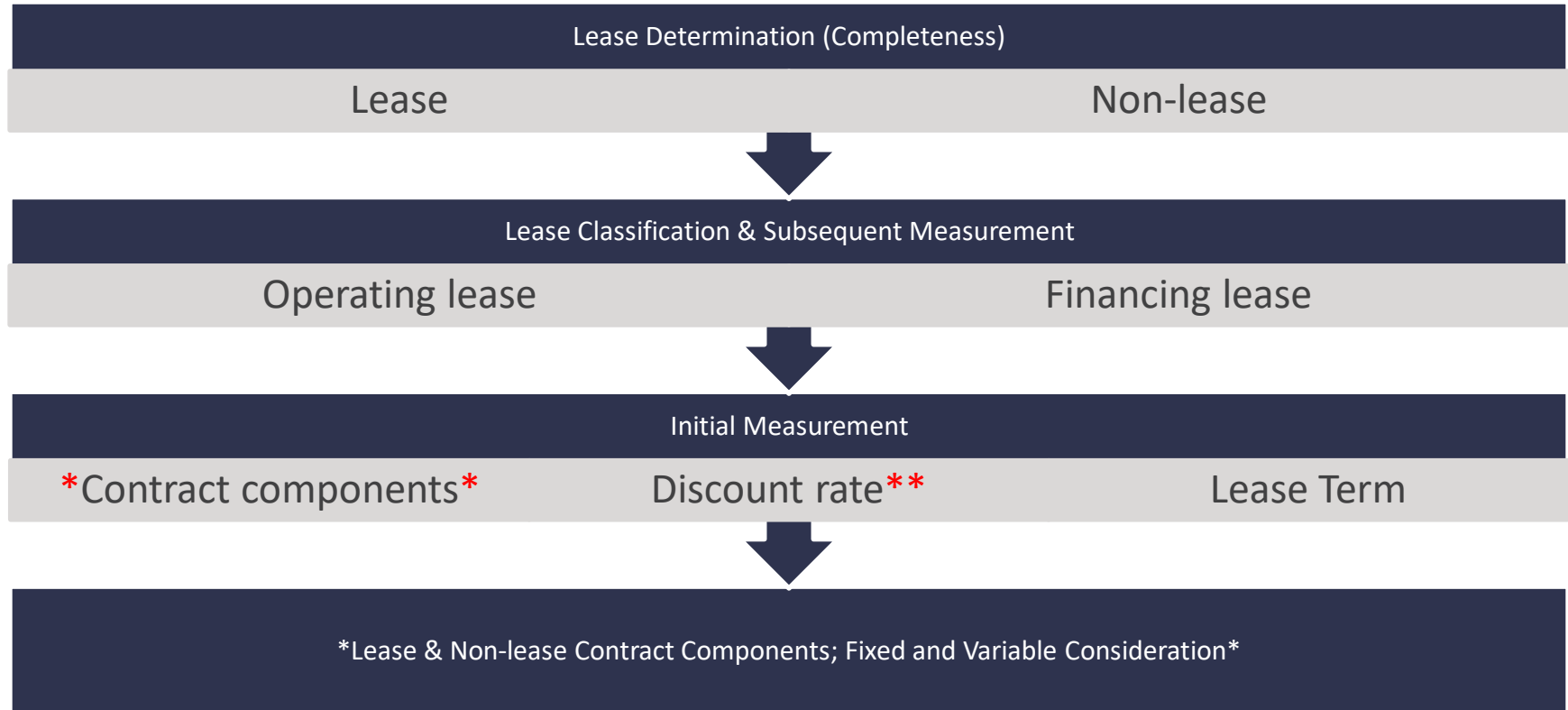


Total Expense – Operating Lease vs Finance Lease

TOTAL EXPENSE



Steps: Lease Analysis and Accounting



Contract Components

- Separate lease components from non-lease components
- Allocate the consideration on a relative standalone basis
 - Use observable standalone prices wherever available
- May elect practical expedient to not separate the non-lease component
 - Accounting policy



Contract Components – Example 1

- Payments for taxes and insurance are included in a contract
- Annual lease payments are fixed at \$10,000 per year
- Real estate taxes and insurance payments are variable and will be billed to the lessee each year



Contract Components – Example 1

- Are the real estate taxes and insurance components of the contract?
- Contract contains a single lease component
 - The right to use the building
- Lessee payments are a reimbursement of the lessor's costs
 - Not a payment for goods or services in addition to the right to use the building



Contract Components – Example 2

- Payments for taxes and insurance are included in a contract
- Annual lease payments are fixed at \$13,000 per year
- Contract components are itemized
 - \$10,000 for rent
 - \$2,000 for real estate taxes
 - \$1,000 for insurance



Contract Components – Example 2

- Are the real estate taxes and insurance components of the contract?
- Contract contains a single lease component
 - The right to use the building

Contract Components – Example 3

- Payments for taxes, insurance, and common area maintenance are included in a contract
- Annual lease payments are fixed at \$17,000 per year and include rent, taxes, insurance, and building maintenance



Contract Components – Example 3

- Real estate taxes and insurance are still not components of the contract
- What about the common area maintenance?
- Lessee receives a service from the lessor
 - A second component of the contract (non-lease component)
 - Consideration is allocated among the two components
 - CAM payments are not included in lease liability
 - Unless the practical expedient is selected



Disclosures

Objective

- Enable users of financial statements to assess the amount, timing and uncertainty of cash flows arising from leases

Requirement

- Enhanced qualitative and quantitative disclosures



Example Disclosures – Quantitative

	2019
Lease cost:	
Finance lease cost:	
Amortization of right-of-use assets	\$ -
Interest on lease liabilities	
Operating lease cost	
Short-term lease cost	
Variable lease cost	
Sublease income	
Total lease cost	<u>\$ -</u>
Other information:	
(Gains) and losses on sale leaseback transactions, net	\$ -
Cash paid for amounts included in the measurement of lease liabilities	
Operating cash flows from financing leases	
Operating cash flows from operating leases	
Financing cash flows from financing leases	
Right-of-use assets obtained in exchange for new financing lease liabilities	
Right-of-use assets obtained in exchange for new operating lease liabilities	
Weighted-average remaining lease term - financing leases	x years
Weighted-average remaining lease term - operating leases	x years
Weighted-average discount rate - financing leases	
Weighted-average discount rate - operating leases	



Example Disclosures – Maturity Table

A maturity analysis of annual undiscounted cash flows for lease liabilities as of December 31, 2019, is as follows:

<u>Year</u>	<u>Financing Leases</u>	<u>Operating Leases</u>
2020	\$ -	\$ -
2021		
2022		
2023		
2024		
Thereafter		
Total	<u>\$ -</u>	<u>\$ -</u>

As of December 31, 2019, the Company has additional operating and finance leases, primarily copiers and facility rental, that have not yet commenced of \$XXX and \$XXX, respectively. The operating and finance leases will commence between fiscal year 2020 and fiscal year 2021 with lease terms of 1 year to 20 years.





Presentation and Disclosures by Not-for-Profit Entities for Contributed Nonfinancial Assets (Gifts in Kind) ASU 2020-07

Gifts in Kind (ASU 2020-07)



Effective Date:

Annual reporting periods
beginning after June 15, 2021

(6/30/22; 12/31/22)



Objective:

Clarifies the presentation and
disclosure of contributed
nonfinancial assets; recognition
and measurement requirements
remain unchanged



How to prepare for implementation:

- Track amounts separately
- Prepare for additional disclosures - see examples included in the ASU
- Review related accounting policies



Gifts in Kind (ASU 2020-07) Specified Changes

Financial Statement Presentation:

- Contributed nonfinancial assets as a separate line in the statement of activities

Disclose:

- Disaggregation of the amount of contributed nonfinancial assets by category
- For each category disclose:
 - Qualitative info about monetized vs utilized
 - Policy about monetizing rather than utilizing
 - Description of donor-imposed restrictions
 - Description of valuation techniques and inputs to determine FMV
 - Principal market used to arrive at FMV in NFP is prohibited from participating in that market

Gifts in Kind (ASU 2020-07) Income Statement Presentation

Not-for-Profit Entity A
Statement of Activities
Year Ended June 30, 20X1
(in thousands)

	<u>Without Donor Restrictions</u>	<u>With Donor Restrictions</u>	<u>Total</u>
Revenues, gains, and other support:			
Contributions	\$ 8,640	\$ 8,390	\$ 17,030
<u>Contributions of cash and other financial assets</u>	<u>\$ 6,790</u>	<u>\$ 7,430</u>	<u>\$ 14,220</u>
<u>Contributions of nonfinancial assets</u>	<u>1,850</u>	<u>960</u>	<u>2,810</u>
Fees	5,200		5,200
Investment return, net	6,650	18,300	24,950
Gain on sale of equipment	200		200
Other	150		150
Net assets released from restrictions (Note D):			



Gifts in Kind Disclosure - Example 1

Contributed Nonfinancial Assets

For the years ended December 31, contributed nonfinancial assets recognized within the statement of activities included:

	20X9	20X8
Building	\$ 550,000	\$ -
Household goods	95,556	100,486
Food	85,407	86,633
Medical Supplies	90,389	115,173
Pharmaceuticals	111,876	113,982
Clothing	85,765	83,890
Vehicles	127,900	-
Services	73,890	65,392
	<u>\$ 1,220,783</u>	<u>\$ 565,556</u>

NFP K recognized contributed nonfinancial assets within revenue, including a contributed building, vehicles, household goods, food, medical supplies, pharmaceuticals, clothing, and services. Unless otherwise noted, contributed nonfinancial assets did not have donor-imposed restrictions.

It is NFP K's policy to sell all contributed vehicles immediately upon receipt at auction or for salvage unless the vehicle is restricted for use in a specific program



Gifts in Kind Disclosure - Example 2

Contributed Nonfinancial Assets

	<u>Revenue Recognized</u>	<u>Utilization in Programs/Activities</u>	<u>Donor Restrictions</u>	<u>Valuation Techniques and Inputs</u>
Building	\$550,000	General and Administrative	No associated donor restrictions	In valuing the contributed building, which is located in Metropolitan Area B, NFP K estimated the fair value on the basis of recent comparable sales prices in Metropolitan Area B's real estate market.
Household goods	\$95,556	Domestic Community Development; Community Shelters	No associated donor restrictions	NFP K estimated the fair value on the basis of estimates of wholesale values that would be received for selling similar products in the United States.
Food	\$85,407	Natural Disaster Services; Domestic Community Development; Community Shelters	No associated donor restrictions	NFP K estimated the fair value on the basis of estimates of wholesale values that would be received for selling similar products in the United States.



Gifts in Kind Disclosure - Example 3

CONTRIBUTED NONFINANCIAL ASSETS

For the year ended December 31, 20XX, contributed nonfinancial assets recognized within the statement of activities:

<u>Nonfinancial Asset</u>	<u>Revenue Recognized</u>	<u>How Utilized</u>	<u>Donor Restrictions</u>	<u>Valuation Technique</u>
Clothing	\$3,500	Community Shelter	No associated restrictions	Thrift store price guides
Children's books	\$2,200	Afterschool program	No associated restrictions	Used bookstore pricing





Other Current Accounting Topics, Upcoming Standards, and Operational Considerations

Other Current Accounting Topic Upcoming Standards

ASU 2016-13 Current Expected Credit Losses (CECL)

- Effective for years beginning after 12/15/22
 - (12/31/23; 6/30/24)

Reference Rate Reform



ASU 2016-13 Current Expected Credit Losses (CECL)

A credit loss
is recognized
when:

Current US GAAP:

- It is probable a credit loss has occurred

ASU 2016-13:

- Based on a Current Expected Credit Loss (CECL) model

ASU 2016-13 CECL

Trade receivables,
such as:

membership
dues

tuition

Notes receivable

Capital or
financing leases
held by the lessor

ASU 2016-13 CECL

Assets reported at the net amount expected to be collected

Requires entities to use an allowance for credit losses (contra-asset account) that serves as a valuation account



(CECL) Estimate Expected Credit Losses Using:

Information from:

- Past events and historical experience
- Current conditions
- Supportable forecasts

Methods including:

- Discount cash flow methods
- Loss rate methods
- Roll rate methods
- Probability of default methods
- Aging schedule methods



Reference Rate Reform



ASU 2020-04: Effective Date: may be applied any time after 3/12/20 but no later than 12/31/22

ASU 2021-01: Effective immediately



Objective: Provides relief in accounting for contract modifications related to transitioning from LIBOR and other reference rates for a limited period of time



How to prepare for implementation: Inventory all contracts (receivables, debt, leases, derivatives) that reference discontinued rates; understand and apply the optional expedients relative to each type



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Questions?



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Nonprofit Tax Update: What's New for 2023?



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Today's Speakers



Michael De Prima

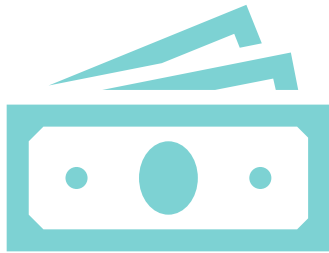
Michael.deprima@CLAconnect.com



Sarah Hintz

Sarah.hintz@CLAconnect.com

At the end of the session, you will be able to:



Recall current tax developments



Identify tax opportunities and risks that may affect your organization



We'll get you there.

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Priority Guidance Plan & Compliance Initiatives




Donor advised funds (DAFs)

Regulations under section 4966 – excise taxes on donor advised funds



Regulations under section 4967 – prohibited benefits and related excise taxes



Regulations under section 4958 – donor advised funds and supporting orgs



Impact of donor advised funds on the public support test



Donor Advised Funds – Proposed ACE Act

Guidance regarding the public-support computation with respect to distributions from donor advised funds

- Accelerating Charitable Efforts (ACE) Act
 - Introduced to Senate on June 9, 2021
 - Introduced to House & referred to the House Committee on Ways and Means on February 3, 2022
- Designed to encourage DAFs and private foundations to distribute funds more rapidly
- Discouraging the shifting charitable funds between DAFs & private foundations
- Could have a negative affect on public charities
- Pending – we will be tracking



Charitable guidance for cryptocurrency

IRS Legal Memorandum
(ILM) 202302012
released January 13

To qualify for a charitable contribution deduction, taxpayer must submit a qualified appraisal over \$5,000

Can't rely on value listed on a cryptocurrency exchange

Cryptocurrency doesn't fit statutory exceptions on appraisal requirements under section 170

Form 8283 is required for donations over \$500



Other Priority Guidance Plan Topics

Allocation of indirect expenses in computing unrelated business income

- IRC Section 512

509(a)(3) Supporting Organizations

- Pending final regulations
- Proposed regulations issued in February of 2016

Group exemptions

- Initial guidance released in 1980 in Rev. Proc. 80-27
 - Notice 2020-36 suggested proposed updates
 - No group exemption applications being accepted



Compliance Initiatives



Worker misclassification and W-2/1099 matches



Retirement plans of small exempt organizations



Retirement plans and worker misclassification



990-N filings



Excess compensation excise tax



Tax exempt bonds





IRS Audit Trends

Recent IRS audit activity

Audits are back

Auditors are
coming in person

Increased IRS
funding =
more audits

Exemption issues

In determining whether you comply as an organization described in Section 501(c)(3), it is necessary to review your internal controls. Therefore, please provide responses to the following questionnaire and mail them by the stated due date in an electronic format.

1. Describe your internal control structure.

Does your organization:

2. Use an annual budget or financial plan?
3. Analyze budget variances and report to the Board?
4. Provide monthly income statements to the Board?
5. Provide monthly balance sheets to the Board?
6. Require Board approval of non-budgeted expenses?
7. Require Board approval of checking account signatory's?
8. Use accounting procedure and policy manuals?
9. Require internal audits or performance reviews?
10. Use computer access passwords or security checks?
11. Require multiple signatures and dollar limits for checks?
12. Require independent (external) financial audits?
13. Provide cash payments for expenses or disbursements?
14. Reconcile all bank accounts on a monthly basis?
15. Deposit all receipts in a financial institution?
16. Provide lock and key security for unused checks and drafts?
17. Perform periodic checks for compliance with Federal, State, and local laws, regulations and legal requirements?
18. Restrict access to accounting files and records?
19. Follow record retention and file purge procedures?



Revenue and Expense Deep Dive

We have completed our review of the financial data you submitted. We sampled the revenue and expense items for further review as noted below.

A. Revenue Accounts:

Attached is a sample of the revenue accounts that were reviewed. Please provide the following information for greater clarity.

1. Source documents.
2. A detailed explanation for the source of revenue.
3. Explain what "BFET" and "Muckleshoot" means.
4. Provide any contracts that were entered for the sources of revenue identified, i.e. "Van Rental."

B. Expense Accounts:

Attached is a sample of the expense accounts that were sampled. Please provide the following information for greater clarity.

1. An explanation describing the business nature of the expense.
2. Source documents supporting the expense: i.e. invoices, receipts, contracts, cancelled checks.
3. Explain what "NICMERE," "NARCH-AIWRE" and "NACTEP" mean.
4. It was observed that there were expenses related to a "boat." Please fully explain your ownership in a boat and its purpose.



Employee / Independent Contractor

F. Information Returns:

During our review, we identified several individuals who were issued both Forms W-2 and 1099. See attachment. To clarify the nature and proper worker classification, please provide the following:

1. A detailed explanation why both information returns were issued.
2. Detailed job description(s) for classification as an employee and an independent contractor.

B. Invalid TIN:

In our review of the Form 1099 information, our records indicate that two individuals were identified as having invalid taxpayer identification numbers, social security numbers (“SSN”) in these instances. They are as follows:

- George Janice Marie
- Kelly Norton

To clarify the correct SSN, please provide the following:

1. Forms W-9 for each individual.

- C. State if you were contacted by the IRS with respect to this discrepancy and if so, what actions did you take to remedy the issue?



Employee / Independent Contractor

A. Worker Clarification:

In our review of the Forms 1099, we sampled 25 workers for the 2018 and 2019 years, which are listed in the schedule below. To clarify the accuracy of the worker classification as independent contractors, please provide the following:

1. Detailed description of the duties performed.
2. State if there are other workers who conduct similar duties but who are issued a Form W-2.
3. Describe how it was determined that the workers were properly classified as independent contractors.



Political activities

In determining whether you comply as an organization described in Section 501(c)(3), it is necessary to review and clarify your activities with respect to legislative and political activities. Therefore, please provide responses to the following questionnaire and mail them by the stated due date in an electronic format.

LEGISLATIVE:

1. Do you urge either the public or your members to contact lawmakers regarding proposing, supporting or opposing specific legislation?
2. Do you make direct appeals to lawmakers concerning specific legislation, either in person or by letter?
3. Do you donate to or support other organizations, groups, or committees whose primary purpose is to engage in legislative or lobbying activities?
4. Do you provide information to the public or to your members concerning legislative issues?
5. Do you employ/contract with a professional lobbyist?

POLITICAL:

1. Do you make donations to political campaigns or endorse political candidates?
 2. Do you have a political action committee (PAC)?
 3. Do you donate to any PAC funds?
 4. Do you collect political campaign donations from your members or the public and remit them to a PAC?
 5. Do you permit candidates to use your facilities, computers, employees, mailing or membership lists?
 6. Do you provide non-partisan information about candidates to any persons or groups?
 7. Do you conduct voter registration drives or promote voter participation in elections?
 8. Do you allow political intervention, in that do you permit employees to disseminate information using company computers to email staff members and students encouraging or discouraging them to vote for particular candidates running for public office?
-



Unrelated Business Income

During our on-site visit to [REDACTED], it was observed that you maintained a small store, referred to as the [REDACTED], that sold primarily clothing and snack items. [REDACTED] stated that the [REDACTED] was at one time a bookstore but because students now typically purchase books on-line, there was no need for the College to sell books.

[REDACTED] Manager of the [REDACTED] stated that the items sold in the [REDACTED] are marketed through Facebook and the [REDACTED] [REDACTED] indicated that most of the sales were made to the public.

What are the issues here?

Recap



Compliance Initiatives & Priority Guidance Plan in audits



What puts you on the radar?



Importance of having a pulse on overall compliance



Regardless of where the audit starts....it will likely hit all of these topics





Additional Insights

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Employee Retention Credit Overview

	2020	2021
Covered Dates (payroll paid during period)	3/13/20 – 12/31/20	1/1/21 – 9/30/21
Employer size-based restrictions*	Over 100 fulltime employees can only include paid but not working	Over 500 fulltime employees can only include paid but not working
Quarterly Revenue Decline vs. same quarter 2019 OR	>50%	>20%
Partial or full government shut-down	Actual dates organization was shut-down by government order	
Maximum eligible wages + healthcare cost per employee	\$10,000/year	\$10,000/quarter
% wages + healthcare eligible for credit	50%	70%
Maximum annual credit/employee	\$5,000	\$21,000

*Fulltime employee measured by Calendar 2019 according to ACA definition of fulltime employee (130 hrs+/mo = 1.0; < = 0.0)



Employee Retention Credit Opportunity

- Still a great opportunity if you have not yet looked into it!
- Reconciliation of ERC revenue to Form 990 revenue
- Reduce compensation tax deductions for UBI on Form 990-T
- American Rescue Plan Act of 2021 - expanded statute of limitations
- IRS Information Release IR-2022-183



Inflation Reduction Act



Alternative minimum tax
(AMT)

\$79.6 billion IRS improvements
and enforcement

Clean Energy Tax Credits





Refundable Tax Credit Opportunities for Tax-Exempts

Inflation Reduction Act Credit Opportunities

- IRA of 2022 created and modified several green energy credits
- IRC Section 6417 provides a “direct pay” option for tax-exempts and certain governmental entities
- Many credits have prevailing wage requirements that increase credit, in most cases from 6% to 30%
- Applies to tax years beginning after Dec. 31, 2022
- Unique opportunity for NFPs to get cash refunds from the federal government for green energy investments



Section 6417 Overview

- **Sec. 6417(a):** “In the case of an applicable entity making an election...with respect to any applicable credit determined with respect to such entity, such entity shall be treated as making a payment against the tax imposed by subtitle A (for the taxable year with respect to which such credit was determined) equal to the amount of such credit.”
- **Applicable Entity:**
 - **Any organization exempt from the tax imposed by subtitle A,**
 - Any state or political subdivision thereof,
 - The Tennessee Valley Authority,
 - An Indian tribal government,
 - Any Alaska Native Corporation, or
 - Any corporation operating on a cooperative basis which is engaged in furnishing electric energy to persons in rural areas



Section 6417 Overview (Continued)

- **Election Timing**
 - In the case of any government, or political subdivision for which no return is required under section 6011 or 6033(a), such date as is determined appropriate by the Secretary, or
 - In any other case, the due date (including extensions of time) for the return of tax for the taxable year for which the election is made, but in no event earlier than 180 days after the date of the enactment of this section



Section 6417 Direct Pay Credits

§30C Alternative fuel vehicle refueling property credit

§45 Electricity produced from certain renewable resources, etc.

§45Q Credit for carbon oxide sequestration

§45U Zero-emission nuclear power production credit

§45V Credit for production of clean hydrogen

§45W Credit for qualified commercial clean vehicles

§45X Advanced manufacturing production credit

§45Y Clean electricity production credit

§45Z Clean fuel production credit

§48 Energy credit

§48C Advanced energy project credit

§48E Clean electricity investment credit



Guidance Still Needed...

How will credits be refunded?

- “The Secretary may require such information or registration as the Secretary deems necessary for purposes of preventing duplication, fraud, improper payments, or excessive payments under this section”
- Excessive payment penalty of 20%

What support will be required?

- Will the projects/costs/credits have to be certified by a third party?
- What forms or applications will need to be submitted?
- Will there be a “monitoring” period?





THANK YOU!