Audit and Tax Updates for Nonprofits in 2022

January 25, 2022

WEALTH ADVISORY | OUTSOURCING | AUDIT, TAX, AND CONSULTING

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Today's Presenters

- Carianne Geerts, Manager
- Marcus Harwood, Principal
- Jackie Eckman, Principal
- Jason Neumann, Principal
- Sarah Hintz, Signing Director
- Tina Henton, Principal
- Laura Kenney, Director

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Learning Objectives

- Outline new tax and accounting guidance affecting nonprofits
- Discuss recent cases and IRS rulings of interest to exempt organizations
- Identify changes to audit reporting standards and what nonprofits can expect related to gifts in-kind, lease accounting, reference rate reform, and more

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Upcoming Standards and Other Current Accounting Topics

Carianne Geerts, Manager, CPA

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Prepare for Changes at 12/31/21

AUDITOR REPORTING STANDARDS: SAS 134-141

SSARS 25: REVIEWS, COMPILATIONS AND PREPARATIONS

SSAE NO. 19: AGREED UPON PROCEDURES

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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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Standards on the Horizon

- Implementation Costs Incurred in Cloud Computing (ASU 2018-15)
- Credit Losses (CECL) ASU 2016-13
- Intangibles – Goodwill and Other: Simplifying the Test for Goodwill Impairment (ASU 2017-04, 2021-03)
- ASU 2021-08: Business Combinatoins: Accounting for Contract Assets and Contract Liabilities

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Polling Question

- How many leases does your organization have?
  - None
  - 1-5
  - 6-10
  - More than 10

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Leases (Topic 842)

EFFECTIVE DATE: FISCAL YEARS BEGINNING AFTER 12/15/21; EXCEPT FOR PUBLIC NFP ENTITIES WHICH HAVE AN EFFECTIVE DATE OF YEARS BEGINNING AFTER 12/15/19

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

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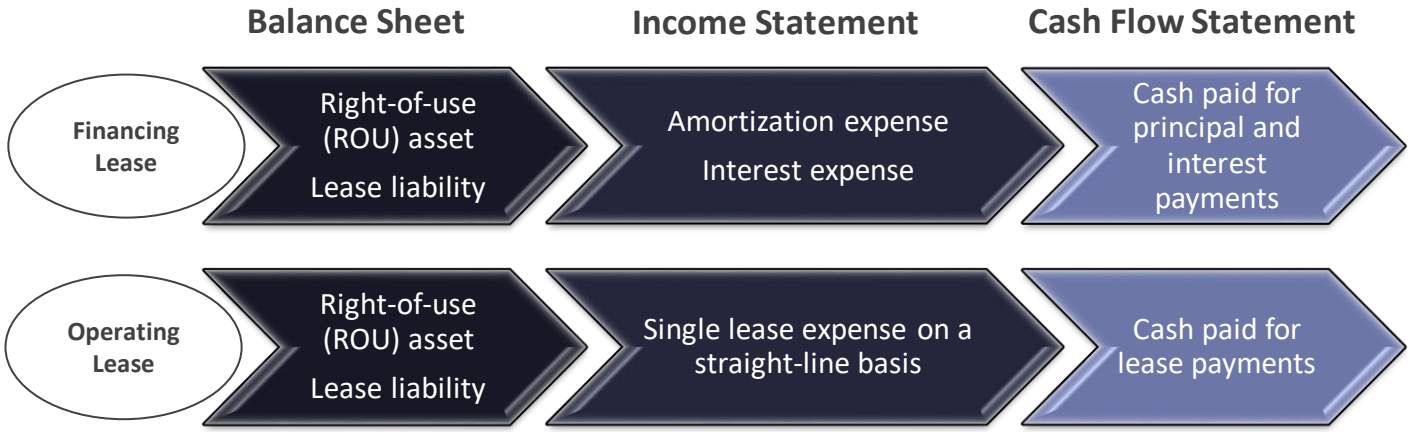
Leases (Topic 842; ASU 2016-02) – Lessee Accounting Overview



Classification is similar to that in Topic 840, *Lease*

Recognition and measurement exemption for short-term leases

Entities other than public business entities may use risk-free rates as practical expedient for measurement of all lease liabilities

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Leases – Getting Ready

Inventory of leases – *What's out there? Know your leases and service contracts. Where are your lease documents?*

Materiality – *How modern is your capitalization policy?*

Debt covenants – *To what extent will capitalizing your operating leases affect covenants based on leverage ratios?*

Complex Calculations - *How will you perform the calculations to record? Will this require a software solution? How much time will it take?*

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Inventory of Leases

- Review contracts – determine whether any part of the contract contains a lease
- Lease and non-lease considerations – allocation of costs
- Lease classification
- Detail of accounting for each lease
- Footnote disclosures

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Webinar: Nonprofit Lease Implementation Update and Common Practices

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February 23, 2022
11 a.m. – Noon Central Time

The new lease standard is here and effective now! Join us for a **complimentary** webinar that will discuss the basics of the new lease standard in addition to highlighting areas specific to nonprofit organizations. Learn what you need to be doing now as your organization prepares for implementation. CPE will be offered.

Register at: https://www.claconnect.com/events/2022/nonprofit-lease-implementation-update-and-common-practices

Employee Retention Credits

Refundable payroll tax credit for compensation paid to employees

Processed through payroll taxes, 941s and form 7200

CARES Act and Consolidated Appropriations Act

- Provide guidance and access to ERCs

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ERC – Accounting Considerations

- No GAAP specifically addresses ERC or similar funding stream
- ASC 740 Income Taxes
  - Generally recognized through existence of income tax credit
  - Would NOT apply to ERC
- GAAP – government grants
  - ASC 958-605 for nonprofits
  - Analogize to government grants
  - ERC is not a change to payroll tax law but a method to provide funding to organizations

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ERC – Accounting Considerations

Nonprofits should evaluate the following:

- When is a grant in place
  - Cannot record revenue until there is a grant in place
- Exchange vs. Contribution – generally considered contribution
- Conditional vs. Unconditional – are there barriers?
  - Payment of qualified expenses
  - Limits on # of employees
  - Gross receipts reductions, required closures, etc.
  - **Recognize when barriers have been met**
- With or Without restriction

Present as grant revenue or other income

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ERC – Accounting Considerations

When do I record revenue?

What if I determine eligibility and request credits after my audit is completed?

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Shuttered Venue Operators Grant

- Accounting Considerations:
  - Account for government grants in accordance with contributions received
  - Conditional contribution
    - Barrier – incurrence of eligible expenses as barrier to entitlement
    - Right of Return
  - Recognize revenue to the extent of eligible expenses
  - Payment received in advance of expenses = Refundable Advance
  - With or Without restriction

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Shuttered Venue Operators Grant

When do I record revenue?

- Consider when a grant is in place
- Consider when conditions have been met

Am I subject to single audit requirements?

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Single Audit Considerations

- Compliance with the applicable federal statutes and regulations and the terms and conditions of the federal awards (compliance Supplement and grant agreements)
- Proper internal controls over compliance requirements
- Policies and procedures

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When is a Single Audit Required?

Single audit is required when a state or local government, Indian tribe, institution of higher education (IHE), or nonprofit organization is the recipient or subrecipient of a federal award and expends $750,000 or more of federal awards during their fiscal year. The $750,000 threshold includes assistance received in the form of loans.

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Presentation and Disclosures by Not-for-Profit Entities for Contributed Nonfinancial Assets
ASU 2020-07

Marcus Harwood, Principal, CPA

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Overview

- Why - increasing the transparency through enhancements to presentation and disclosures
- Who - applies to NFPs that receive contributed nonfinancial assets
- What - present contributed nonfinancial assets as a separate line item in the statement of activities and disclose disaggregated the amount of contributed nonfinancial assets recognized within the statement of activities by category in footnotes.
- When - the amendments in this Update should be applied on a retrospective basis and are effective for annual periods beginning after June 15, 2021, and interim periods within annual periods beginning after June 15, 2022. Early adoption is permitted.

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How Do the Main Provisions Differ from GAAP

- Subtopic 958-605 does not include specific presentation requirements for contributed nonfinancial assets or specific disclosure requirements for contributed nonfinancial assets other than contributed services.

- The amendments will not change the recognition and measurement requirements in Subtopic 958-605 for those assets.

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Key Terms

- **Most Advantageous Market -** The market that maximizes the amount that would be received to sell the asset or minimizes the amount that would be paid to transfer the liability, after taking into account transaction costs and transportation costs.

- **Principal Market -** The market with the greatest volume and level of activity for the asset or liability.

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Fair Value Measurement—Overall

- Paragraph 958-605-50-1A(d) requires that an NFP disclose a description of the valuation techniques and inputs used in fair value measurement of those assets in accordance with paragraph 820-10-50-2(bbb)(1) at initial recognition.

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Implementation Guidance and Illustrations

This format reports information in a single column and most easily accommodates presentation of multiyear comparative information

REVENUE	
Contributions and Grants	$ 890,283
Contributed Nonfinancial Assets	272,602
Special Event	29,000
Other Income	3,100
Total Revenue	$ 1,194,985

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Implementation Guidance and Illustrations

This format reports information in a multicolumn with donor restricted amounts presented

	Without Donor Restriction	With Donor Restriction	Total
REVENUE			
Contributions and Grants	$ 645,283	$ 245,000	$ 890,283
Contributed Nonfinancial Assets	241,602	31,000	272,602
Special Event	29,000	-	29,000
Other Income	3,100	-	3,100
Net Assets Released from Restrictions	197,430	(197,430)	-
Total Revenue	$ 1,116,415	$ 78,570	$ 1,194,985

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Implementation Guidance and Illustrations

This format reports information related to donor restricted amounts presented in “stacked” presentation

Without Donor Restictions:	
REVENUE	
Contributions and Grants	$ 645,283
Contributed Nonfinancial Assets	241,602
Special Event	29,000
Other Income	3,100
Net assets released from restrictions	197,430
Total Revenue without donor restiction	1,116,415
Expenses (detailed not useful in example)	
With Donor Restrctions:	
REVENUE	
Contributions and Grants	$ 245,000
Contributed Nonfinancial Assets	31,000
Special Event	-
Other Income	-
Net assets released from restrictions	(197,430)
Total Revenue with donor restiction	78,570

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Notes to Financial Statements

958-605-50-1A - A **not-for-profit entity** (NFP) shall disclose in the notes to financial statements a disaggregation of the amount of contributed **nonfinancial assets** recognized within the statement of activities by category that depicts the type of contributed nonfinancial assets. For each category of contributed nonfinancial assets, an NFP also shall disclose the following:

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Qualitative Information for Disclosure

Monetized -	The NFP's policy (if any) about monetizing rather than utilizing contributed nonfinancial assets.
Utilized -	Disclose a description of the programs or other activities in which those assets were used.
Restrictions -	A description of any donor-imposed restrictions.

Valuation -	A description of the valuation techniques and inputs used to arrive at a fair value measure, in accordance with the requirements in Topic 820, Fair Value Measurement.
Principal Market -	The principal market (or most advantageous market) used to arrive at a fair value measure if it is a market in which the recipient NFP is prohibited by a donor-imposed restriction from selling or using the contributed nonfinancial assets.

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Contributed Service

An entity (NFPs and business entities) that receives contributed services shall describe the programs or activities for which those services were used, including the nature and extent of contributed services received for the period and the amount recognized as revenues for the period.

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Disclosure Example of Disaggregation, Contributed Nonfinancial Assets

A disaggregation of the amount of contributed nonfinancial assets

recognized within the statement of activities by category that depicts

the type of contributed nonfinancial assets.

Note X - Contributed Nonfinancial Assets		
The Organization received the following contributions of nonfinancial assets for the year ending December 31,		
	20X1	20X0
Office Equipment and Supplies	$ 148,752	$ 262,387
Silent Auction items	19,000	28,000
Rent	95,000	95,000
Legal Services	9,850	6,980
	$ 272,602	$ 392,367

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Disclosure Example Cont'd

- The Organization recognized contributed nonfinancial assets within revenue, including an office equipment and supplies, silent auction items, rent and legal services. Contributed items as noted in the statement of activities were restricted by donors for use at the special event.
- In valuing office equipment and supplies, and silent auction items the Organization estimated the fair value on the basis of estimates of wholesale values that would be received for selling similar products in the United States.
- Contributed rent is for the office space which is used for general and administrative activities. In valuing the contributed office space, which is located in Somewhere USA, the Organization estimated the fair value on the basis of recent comparable sales prices in Somewhere, USA's real estate market.
- Contributed services recognized comprise professional services from attorneys advising the Organization on various administrative legal matters. Contributed services are valued and are reported at the estimated fair value in the financial statements based on current rates for similar legal services.

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Auditor Reporting Standards

Jacqueline Eckman, Principal, CPA
Jason Neumann, Principal, CPA

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Auditor Reporting Standards

Effective for 12/31/21 audits

Revised form and content of the auditor's report

Extensive changes to other performance standards

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SAS 134-141 – Auditor Reporting Standards

SAS No.	Description
134	Auditor Reporting and Amendments
135	Omnibus Statement on Auditing Standards
136	Reporting on Employee Benefit Plans - ERISA
137	Other Information Included in Annual Reports
138	Description of the Concept of Materiality
139	Add'l reporting changes from SAS No. 134
140	Add'l reporting changes from SAS Nos. 134/137
141	Amendment to Effective Dates - SAS (134-140)

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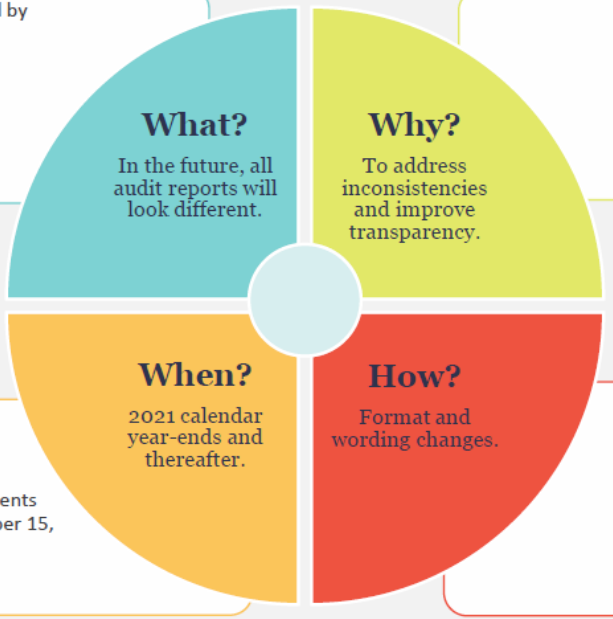
Eight new standards will affect audits of financial statements for periods ending on or after December 15, 2021. These standards are frequently referred to as the auditor reporting standards, but they affect a variety of auditing matters unrelated to the new auditors' report. Our CLA audit methodology has been updated to incorporate the new requirements. This resource is intended to provide a high-level overview of reporting changes and provide an example of the new unmodified opinion.



- Present opinion section first, followed by the basis for the auditors' opinion.
- Enhance reporting related to going concern.
- Expand description of the auditors' responsibilities.

- Improve transparency and visibility of the roles and responsibilities of the auditor and the entity's management.
- Align more closely with international reporting.
- Increase consistency of reporting with listed entities.

- The auditor reporting standards are effective for audits of financial statements for periods ending on or after December 15, 2021.

- Change required format and wording.
- Introduce optional Key Audit Matters (KAM) reporting.

How will this change affect my audit?

- Reporting and communication with governance will change significantly.
- Additional procedures may be performed for related-party transactions.
- The phrase "significant unusual transactions" was introduced to audit literature which may require further consideration.

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Auditor's Report Structure

Report Structure - Current	Report Structure – SAS 134
1. Introduction	1. Opinion
2. Management's Responsibilities for the Financial Statements	2. Basis for Opinion (New)
3. Auditor's Responsibility	3. Key Audit Matters (New) – **if engaged to communicate**
4. Opinion	4. Responsibilities of Management for the Financial Statements
5. Report on Other Legal and Regulatory Requirements	5. Auditor's Responsibilities for the Audit of the Financial Statements
	6. Report on Other Legal and Regulatory Requirements

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Performance Standards Changes – SAS 135

- Significant risks communicated to governance during planning
- Increased focus on disclosures
  - Assessing risk of material misstatement
  - Brainstorm where disclosures are susceptible to fraud
  - Required to be audited – responsible for information within and outside the general ledger
  - Explicit disclosure misstatement aggregation requirement
    - Ex: omission of reasons for impairment loss, incorrect accounting policy (even if immaterial), inadequate description of sensitivity of rates, omission of capitalization policy, etc.
  - Give same care to presentation as measurement

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Performance Standards Changes – SAS 135

- Significant unusual transactions
  - “transactions outside normal course of business, appear unusual due to size, timing, nature”
- Governance communication of significant unusual transactions and potential effects of passed audit adjustments on future financial statements
- Related parties
  - Enhanced requirements to identify related parties and transactions (new inquiries of others within the entity, and governance)

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Performance Standards Changes – SAS 137

- Other Information – Annual Report
  - “contains, accompanies, or incorporates by references the FS and auditor’s report thereon….”
- Obtain written acknowledgement from management about what documents comprise annual report and their timing of issuing the document

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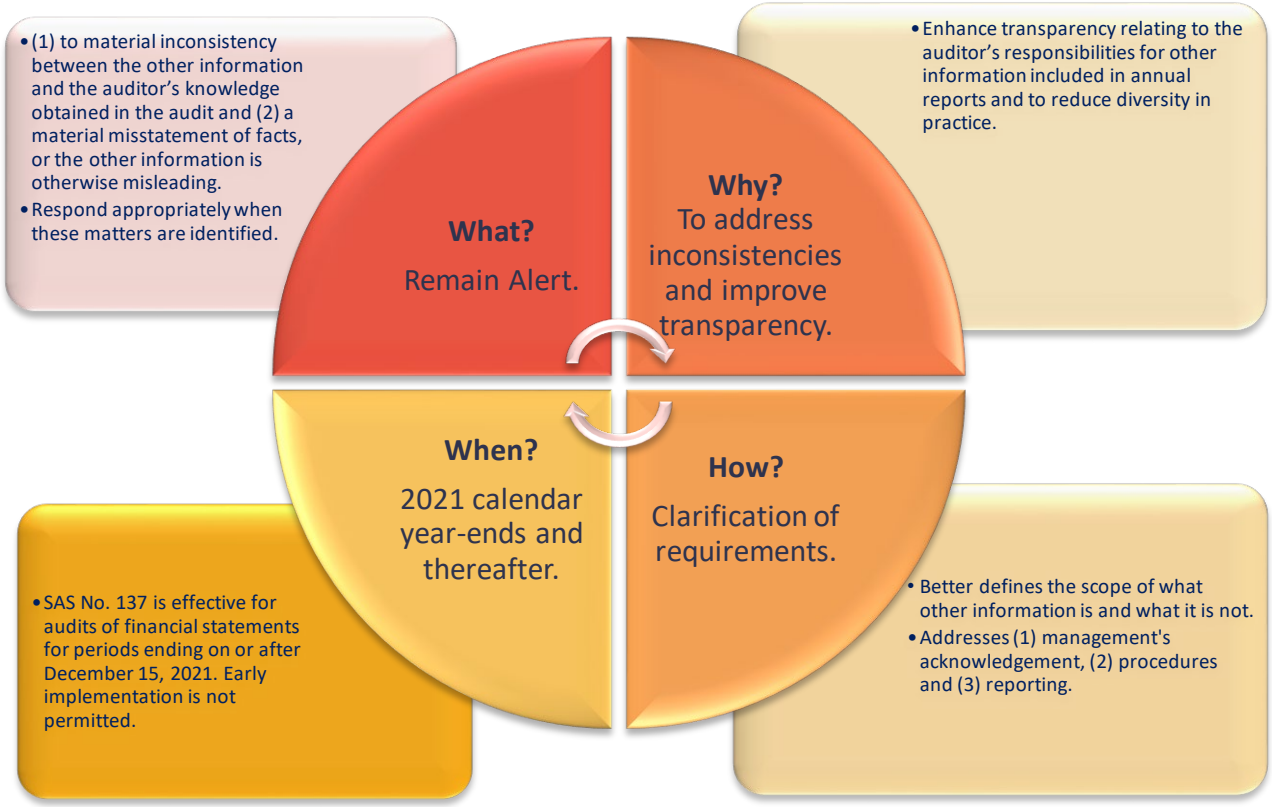
Statement on Auditing Standards (SAS) No. 137, The Auditor's Responsibilities Relating to Other Information Included in Annual Reports



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SAS No. 137 Annual Reports

What is an Annual Report?

1. A document, or combination of documents, typically prepared on an annual basis by management or those charged with governance in accordance with law, regulation, or custom, the purpose of which is to provide owners (or similar stakeholders) with information on the entity's operations and entity's financial results and financial position as set out in the financial statements.

2. An annual report contains, accompanies, or incorporates by reference the financial statements and the auditor's report thereon and usually includes information about the entity's developments, its outlook and risks and uncertainties, a statement by the entity's governing body, and reports covering governance matter.

3. Annual reports include annual reports of governments (CAFR) and organizations for charitable or philanthropic purposes that are available to the public.

What is NOT an annual report?

1. IRS Form 990
2. IRS Form 5500
3. Exempt offering documents
   (e.g., Franchise Disclosure Documents [FDDs])
4. Corporate social responsibility reports
5. Sustainability reports
6. Annual statement filed with National Association of Insurance Commissioners
7. Separate industry or regulatory reports, such as used by banking, insurance, or pension industries
8. Diversity and equal opportunity reports
9. Product responsibility reports
10. Labor practices and working conditions reports
11. Human rights reports

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SAS No. 137 Annual Reports – Other Information

What could be "Other Information" included in an annual report?

1. Employment data
2. Planned capital expenditures
3. Financial Ratios
4. Names of officers and directors
5. Selected quarterly data
6. Chairman's statement
7. Corporate governance statement
8. Management's internal control and risk assessment reports
9. Financial summaries or highlights

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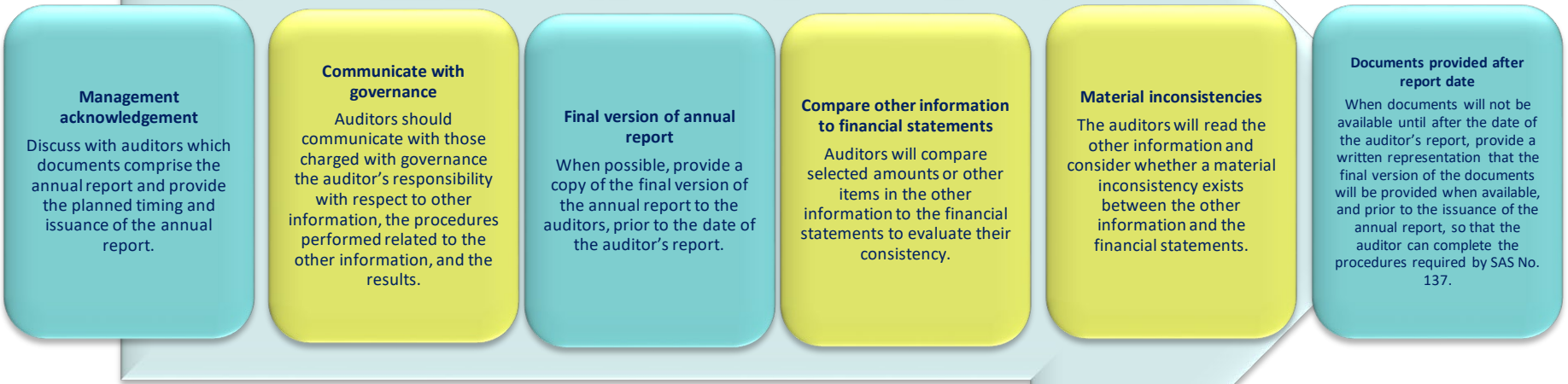
Steps



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Tax Update

Unrelated Business Income Tax and Tax Reform

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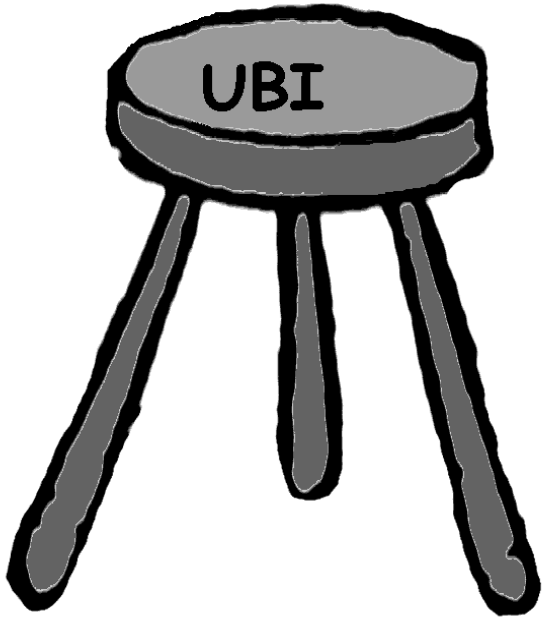
UBI Defined – IRC § 512(a)(1)

Trade or Business



Not Substantially Related To Exempt Purpose

Regularly Carried On

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Potential Sources of Unrelated Business Income

Alternative investments (Partnerships and S-Corp interests)	Advertising (qualified sponsorship payments are not UBI)	Rental income from personal property or mixed leases
Inventory Sales	Debt financed income	Exploitation of exempt functions
Public use of facilities - Fitness centers, ice rinks, swimming pools, golf courses, cafeteria, childcare, etc.	Royalties	Unrelated laboratory or pharmaceutical testing

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Polling Question

- Which of these common UBI activities is the most significant to your organization?
  - Advertising
  - Alternative investments (Partnerships and S-Corp interests)
  - Public usage of facilities
  - UBI is not a risk
  - Not sure

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UBI: “Siloing Rules”

- Prior to January 1, 2018, Exempt Organizations were able to aggregate their UBI activity (whether profitable or not) in the determination of their Unrelated Business Income (UBI).
  - Final Regulations issued November 19, 2020.
  - Effective for tax years beginning after December 31, 2017: losses of one unrelated activity cannot offset gains of another.
- Organizations with more than one unrelated trade or business may generally rely on a "reasonable, good-faith interpretation of IRC Sections 511 – 514" when identifying different trades or businesses for purposes of the silo rules under IRC Sec 512(a)(6).
  - IRS has identified North American Industry Classification System (NAICS) as a "reasonable, good-faith interpretation“:
    - **NAICS – Initially six-digit NAICS codes, final regulations updated to two-digit NAICS codes**

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UBI: “Siloing Rules” – Partnership Activity

- Exempt organizations are permitted to aggregate into a single silo all partnership investment activities that meet the definition of a “Qualified Partnership Interests (QPI):
  - Includes debt-financed property as an investment
  - QPI rule is intended as an administrative convenience
  - If not a QPI then each partnership interest is treated as a single trade or business or “silo”
  - "Qualified partnership interests“ – If partnership meets either the de minimis or participation tests, activity can be aggregated.
    - De minimis: own (average beginning/ending) no more than 2% of profits interest and capital interest
    - Participation (previously control): directly holds no more than 20% of the capital interest and does not have control or influence over the partnership

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IRS Section 4960: Excess Compensation Excise Tax

and

IRC Section 4968: Colleges/Universities Net Investment Excise Tax

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Excise Tax on Compensation

- Final regulations issued January 11, 2021.
- An “Applicable Tax-Exempt Organization” (ATEO) is subject to a 21% excise tax on
  - Remuneration over $1 million paid to a covered employee
    - Generally Federal taxable wages (box 1) of calendar year within fiscal year if fiscal year filer.
    - Includes 457(f)
    - Does not include amounts paid to licensed medical professionals
  - Excess parachute payments paid to a covered employee
- ATEO = your related 501(c)(3) organizations
  - Excludes governmental unit (including a state college or university) without an IRS determination letter

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Excess Parachute Payments

- Compensatory payment to a covered employee if:
  - The payment is contingent on an employee separation from employment with the employer and
  - Aggregate present value of the payment exceeds three times the base amount, which is the average annual compensation over the preceding 5-years
- Notice 2019-9
  - Payment is deemed to be a parachute payment only if the payment is contingent on involuntary separation from service

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IRC Section 4968: College Endowment Excise Tax

- Final regulations issued September 18th, 2020
- Applies to private colleges and universities
- At least 500 tuition-paying students
- Aggregate FMV assets of at least $500k per student
  - Excludes assets used directly in exempt purpose
- Includes assets and NII of certain related organizations

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IRC Section 4968: College Endowment Excise Tax

1.4% excise tax on net investment income:

- Gross interest, dividends, rents, royalty income
  - excludes student loan interest
  - excludes rental income from student housing
  - excludes rental for faculty/staff required housing
  - excludes royalty from assets resulted from work of students or faculty, but not from other intangibles
- Capital gains

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IRC Section 4968: College Endowment Excise Tax

Allowable expenses to arrive at net investment income:

- Deduct ordinary and necessary investment expenses
- Can allocate internal operating expenses
- Depreciation, straight-line method, is allowed
- Do not deduct charitable contributions, NOLs, etc.
- Do not deduct the net investment excise tax

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Reporting the Excise Taxes

- Additional filing (Form 4720) is required
- Same due date as Form 990
- **Separate extension is required**
- Potential tax liability must be paid with extension

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2021-22 Priority Guidance Plan

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2021-22 Priority Guidance Plan

Group Exemptions	• Guidance revising Rev. Proc. 80-27 regarding group exemption letters. Notice 2020-36 was published on May 18, 2020.
LLC	• Guidance on circumstances under which an LLC can qualify for recognition under §501(c)(3).
Supporting Organizations	• Final regulations on §509(a)(3) supporting organizations. Proposed regulations were published on February 19, 2016.
UBI	• Regulations under §512 regarding the allocation of expenses in computing unrelated business taxable income and addressing how changes made to §172 net operating losses by section 2303(b) of the CARES Act apply for purposes of §512(a)(6).

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Net Operating Losses

- Tax Cuts and Jobs Act Changes to Net Operating Loss (NOL) rules
- Effective for losses with tax years beginning **after December 31, 2017**
  - Indefinite carryforward but no carryback
  - NOL offset allowed up to **80%** of taxable income
  - NOLs follow the revenue stream from which they are created
- Pre-2018 NOLs can be used to offset income from all silos and at **100% until exhausted**
- **CARES Act Net Operating Loss Provisions**
  - NOLs generated in 2018-2020 can be carried back 5 years & offset **100%** of taxable income in years beginning before 1/1/18
    - Can't apply silo'd NOL to a different silo after 1/1/18 as siloing rules applied after 1/1/18 per IRS FAQ on 5/25/21
  - NOL Carryforward through 2020

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2021-22 Priority Guidance Plan

Private Foundations	• Guidance under §4941 regarding a private foundation's investment in a partnership in which disqualified persons are also partners.
Donor Advised Funds	• Regulations regarding the excise taxes on donor advised funds and fund management.
Other Final Regulations	• Regulations under §6104(c). Proposed regulations were published on March 15, 2011. • Regulations designating an appropriate high-level Treasury official under §7611. Proposed regulations were published on August 5, 2009

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State & Foreign Compliance Considerations

Payroll

Sales and use tax

Business registration

Charitable solicitation registration

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Recent tax guidance, cases and IRS rulings of interest to exempt organizations

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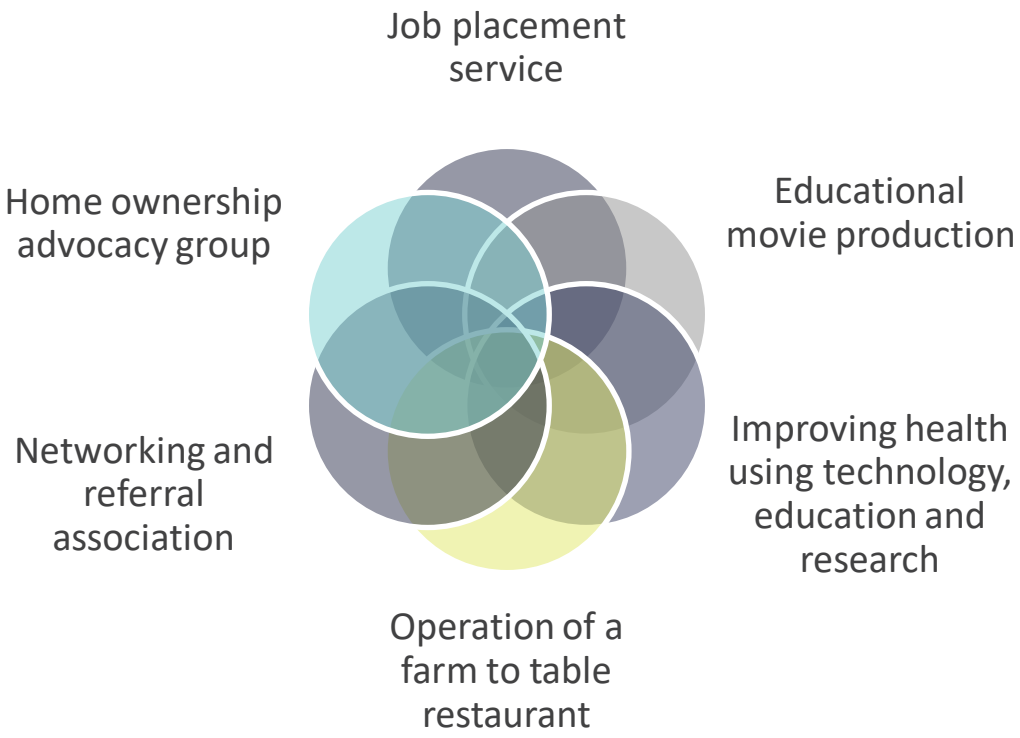
Recent Tax Cases and Rulings



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Educational Movie Production

- *Aegis for Dreams Foundation v. Commissioner of IRS*
- Purpose: to produce historically accurate film
- Revolutionary War story of George Washington's leadership
- Donor/founder donate exclusive license to his screenplay
- Film to be financed by $30m donations
- Primary purpose …

  commercial or educational?

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Improving Health, Using Technology, Education and Research

- Purpose: to improve health outcomes in all countries
- Research activities and educational website
- Software facilitates research studies
- Anyone, anywhere can use for free
- Clinically testing drugs for pharmaceutical companies

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Operation of a Farm to Table Restaurant

- Purpose: to supply food to the poor
- Future plans to own a farm
- Certain % of tables reserved for non-paying families
- Only wait staff know who are non-paying customers
- Training for underserved youth to feed homeless in city parks

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Networking and Referral Association

- Purpose: promote business opportunities for members
- Association allows only one member from each field
- Members are business owners and various types of professionals
- Monthly, annual meetings and publish newsletters
- Referral services for members

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Home Ownership Advocacy Group

- Purpose: end homelessness
- Free society of individuals to promote community living
- Help each other with science, technology, agriculture & arts
- Create a community-outreach and learning metropolis
- Fund developers of crypto, technicians and engineers
- Source of funds provided through community residents crypto mining for President's for-profit company

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Job Placement Service

- Membership organization
- Association of academicians, grad students and practitioners
- Advertisements in journals are only activity reported as UBI
- Outsourced online job placement service to a vendor
- Royalty license (excluded from tax) or unrelated business taxable income?

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Tax Positions

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Analysis of Tax Position

Facts

Issue

Law and tax guidance

Discussion

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Upfront Planning and Documenting is Beneficial

- Protect your organization from an IRS audit
- Planning may provide opportunities
- Board members have fiduciary responsibility
- Document tax positions
- Leave a roadmap for your successors
- Improve disclosures that tell the charitable story
- Your particular facts and circumstances are important
- The IRS, courts and knowledgeable tax professionals can arrive at different conclusions
- Compliance with tax filings and financial statement requirements
- Protect exempt status
- Identify and mitigate tax exposure
- Protect your reputation

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Thank you!

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