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Audit & Tax Update

January 18, 2024



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Session CPE Requirements

- You need to attend 50 minutes to receive the full 1 CPE credit.
- 4 Attendance Markers that read: “I’m Here,” will be launched during this session. You must respond to a minimum of 3 to receive the full 1 CPE credit.

****Both of these requirements must be met to receive CPE credit****



With you today



Melanie Ballestas

Marcus Harwood

Robbie Williams

Mackenzie McNaughton

Kathleen Thies





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Audit Update

Marcus Harwood, CPA

Melanie Ballestas, CPA

Learning Objectives

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

- Describe new accounting guidance affecting nonprofits and how it could impact your organization
- Identify upcoming accounting standards and recognize the important items to consider when implementing the standards
- Recall current tax developments
- Recognize how various state and local taxes could impact your organization
- Identify tax opportunities and risks that may affect your organization



ASU 2016-13 Financial Instruments – Credit Losses



The ASU is relevant for all organizations.



Objective is to provide more decision-useful information about expected credit losses by replacing the incurred loss methodology with a methodology that incorporates a broader range of supportable information to inform credit loss estimates.

ASU 2016-13 Financial Instruments Credit Losses

Why did the FASB issue this update?

- In the wake of the 2008/2009 financial crisis the Financial Crisis Advisory Group was formed
- Mission to advise FASB and IASB on improvements to financial reporting



ASU 2016-13 Financial Instruments Credit Losses

- Many users of financial statements understood heightened credit risk before the financial statements reflected those risks
- Restrictions under existing GAAP
 - Organizations are unable to record credit losses until it is probable that a loss has been incurred
 - Organizations are unable to recognize expected losses
 - Users are utilizing forward looking financial models and assessing credit losses for their own purposes before issuers were recognizing losses



ASU 2016-13 Financial Instruments – Credit Losses

- Financial Instruments include:
 - Trade receivables
 - Financing receivables
 - Held to maturity debt securities
 - Available for sale debt securities
 - Loans
 - Net investment in leases
 - Any right to receive settlement in the form of cash
 - Contract Assets



ASU 2016-13 Financial Instruments – Credit Losses

- What is excluded?
 - Pledges receivable
 - Operating lease receivables
 - Loans and A/R between entities under common control
 - Financial assets measured at fair value
 - Available for sale debt securities
 - Loans to participants of DC benefit plans
 - Insurance entity policy loans receivable



ASU 2016-13 Financial Instruments Credit Losses

- Assets measured at amortized cost
 - Present net of a valuation allowance at net amount expected to be collected.
 - Allowance should incorporate relevant information about past events, historical experience, current conditions and reasonable and supportable forecasts that affect the collectability of the reported amount.
 - The standard does not specify a method for measuring expected credit losses and allows an entity to apply methods that reasonably reflect its expectations



ASU 2016-13 Financial Instruments Credit Losses

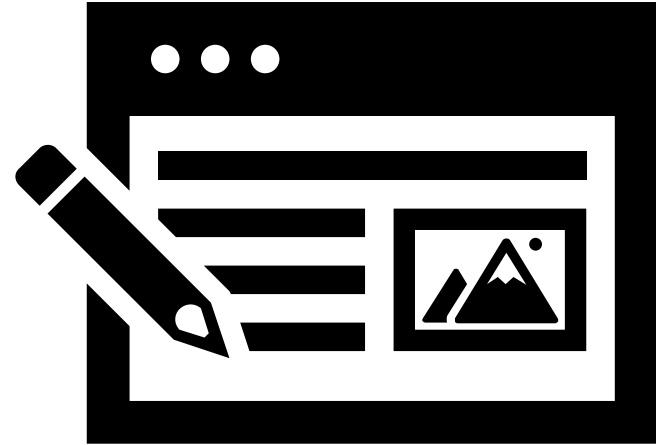
Potential Impacts

- It depends on current reserving methodologies
 - There is diversity in practice in application of “incurred loss” models
- The more that reasonably supportable future expectations may have been incorporated, the less impact there will be
- The more that the reserve methodology was based on backward looking data and excluded future expectations, the more impact there may be
- Understand rationale for changes – beware unsupported changes in methodologies that may indicate bias...



ASU 2016-13 Financial Instruments Credit Losses

- Effective date:
 - Fiscal years beginning after December 15, 2022
 - Record a cumulative effect adjustment as of the beginning of the first reporting period in which the guidance is effective



ASU 2023-08 Intangibles – Goodwill and other-Crypto Assets

- Accounting for crypto assets – what are they?
- Crypto Assets must meet all of the following:
 - Meet the definition of *intangible asset* as defined in the Accounting Standards Codification Master Glossary
 - Do not provide the asset holder with enforceable rights to, or claims on, underlying goods, services, or other assets
 - Are created or reside on a distributed ledger based on blockchain or similar technology
 - Are secured through cryptography
 - Are fungible
 - Are not created or issued by the reporting entity or its related parties



ASU 2023-08 Intangibles – Goodwill and other-Crypto Assets



Current guidance – crypto assets are intangible assets

Account for as cost less impairment
Recognize impairment for declines in value
Do not recognize subsequent recoveries in value



This ASU requires measurement at fair value

Consider volatility and impact on earnings



ASU 2023-08 Intangibles – Goodwill and other-Crypto Assets

Statement of Financial Position

- Crypto assets separate from other intangible assets measured using other measurement bases

Statement of Activities

- Gains and losses in net income separate from amortization and impairment of other intangible assets

Cash Flow

- Classify cash flows from crypto assets received in ordinary course of business or as a contribution and converted nearly immediately into cash as operating activities
- If received with **donor-imposed restrictions for long-term or capital use**, required to classify the activity as cash flows from **financing activities**



ASU 2023-08 Intangibles – Goodwill and other-Crypto Assets

- Disclosure requirements
 - A roll forward, in the aggregate, of activity in the reporting period for crypto asset holdings, including additions (with a description of the activities that resulted in the additions), dispositions, gains, and losses
 - For dispositions, the difference between disposal price and cost basis and a description of activities leading to the disposal
 - If gains and losses are not separately presented, the line item in which they are presented
 - Method for determining the cost basis of Crypto assets



ASU 2023-01 Leases

Emphasis of new standard is on legally enforceable rights rather than economic substance – challenging in common control situations

- Practical expedient – may rely on written terms if they exist, if not stick with legally enforceable rights

Amortization of leasehold improvements in common control leases

- Amortize by lessee over economic life of LHI (regardless of lease term) provided that life does not exceed term of lease with third party (if relevant)



ASU 2023-01 Leases

- If lessee no longer controls the use of the underlying asset, account for as transfer of equity



Going Concern Considerations

- We are seeing changes throughout the industry including:
 - Increased demand for services, but reduced funding available
 - Inflationary pressures, including staff salaries
 - Cost of financing
 - Declining federal and state COVID-19 financial assistance
- Uptick in “Going Concern” discussions

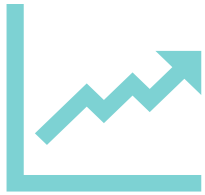


Going Concern Considerations

- Is liquidation imminent?
- Do conditions exist that in the aggregate give rise to substantial doubt about ability to continue as a going concern within **1 year after** financial statement issuance?
 - Consider management's plans to mitigate adverse conditions
 - Is it probable that plans will be implemented?
 - Is it probable that plans will mitigate relevant conditions?
- If conditions exist, expanded disclosures required
 - EOM paragraph in opinion

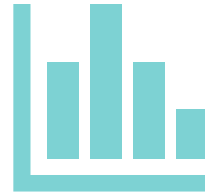


Changes to Audits in 2023 – SAS 143 & 145



What changed

Standards have been modernized for the evolving business environment



New Requirements

Enhanced risk assessments and understanding of accounting estimates

Deeper understanding of IT

- More inquiries of IT group
- Additional request for data



SAS 143 – Auditing Estimates and Related Disclosures



Definition of an estimate

A monetary amount where management is putting forth an approximate calculation or judgement of the value, number or quantity in accordance with the applicable financial reporting framework.



What is considered an estimate:

Monetary amounts that can not be directly observed

Amounts that have uncertainty about their measurement

Amounts that have subjectivity involved in valuation



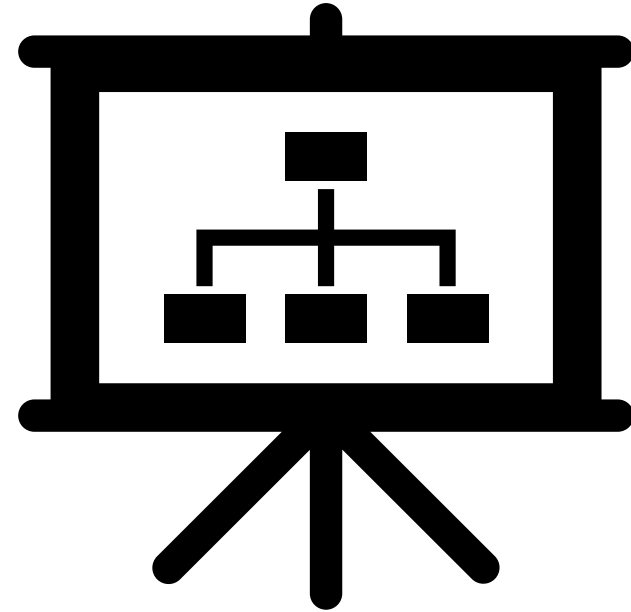
SAS 143 – Auditing Estimates and Related Disclosures

- Clarifies the auditor’s responsibilities for evaluating accounting estimates, including fair value accounting estimates and their related disclosures
- How do we do this:
 - Gain an understanding of the entity and internal controls
 - Review internal controls specific to estimates
 - Review the areas driving estimates
 - Transactions / Events / Conditions that trigger the estimate
 - Determine how management identifies such item
 - Under the internal controls over this process



SAS 143 – Auditing Estimates and Related Disclosures

- There is an emphasis on performing additional audit procedures that are responsive to identified risks
- We must design audit procedures based upon our risk assessment
 - If estimates are straightforward with minimal risk, not a significant impact on audit procedures
 - If estimates are more complex, increase in audit procedures
 - Conduct inquiries with management on procedures followed and inputs utilized
 - Independently calculate the estimate and compare to managements estimate



SAS 145 Risk Assessment

- *SAS 145 – Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*
 - Updates and enhances guidance regarding risk assessment procedures to be performed
 - Requires consideration of economic, regulatory and technological aspects in which an entity operates
 - Deeper understanding of IT and corresponding controls
 - More in depth inquiries
 - Increased data requests to evaluate risks related to IT

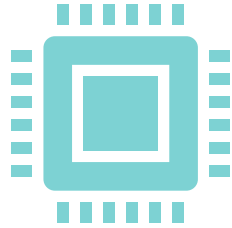


SAS 145 Risk Assessment

- The need to obtain a deeper understanding of IT will have the most significant impact on the audit
 - Program change management
 - Network security and user access
 - Application security and user access
 - Infrastructure security
 - Backup and recovery
 - Cybersecurity



SAS 145 Risk Assessment



Activities that can significantly impact an audit:

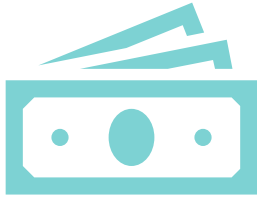
- Cyber breaches on financial reporting element
- Employee ability to access source code and modify source code
- New or complex systems implemented



Potential audit impact

- Additional time spent by audit team on internal control evaluations
- Increased use of IT specialists for analysis of complex areas
- Increased chance of management comments

SAS 145 Risk Assessment



Lower IT Risks

Stand alone application use

Low volume of transactions

Transactions supported by hard copy documents



Higher IT Risks

Implementation of new financial system

Interfaced applications

High volume of transactions

Applications that automatically initiate transactions

Cybersecurity incident affecting the financial system

SAS 145 Risk Assessment

- What can you do - be pro-active!
 - Determine early on what they will need from you:
 - Is your financial system a custom solution and/or do you have access to change source code?
 - Do you have financial systems other than the GL that you rely on?
 - Have you implemented a new financial system or new software modules within the past year?
 - Do you prepare financial statements outside of the General Ledger/Financial system?
 - Do you formally review user access and segregation of duties within the financial system?
 - Have you had a cybersecurity breach or incident within the past year?
 - Do you have written policies over your information technology internal controls?





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Tax Update

Robbie Williams

Mackenzie McNaughton

Kathleen Thies



IRS Audits



Recent IRS Audit Activity

Audits are
back

Auditors are
coming in
person

Increased IRS
Funding =
more audits



Are you prepared for an IRS audit?



Review internal controls and governance policies and procedures



Contemporaneous documentation

New activities/programs/transactions



Not just IRS audit risk – reputational risk too

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 & 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:

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.



Employee / Independent Contractor

The following documents are requested for the examination of your organization's Forms 941 for tax periods ended March 31, 2021 through December 31, 2022. The following documents are being requested to verify correctness of Forms 941 filed and to determine if the following worker class: Officer-Treasurer was classified correctly. Please refer to the enclosed Publication 1976 *Do You Qualify for Relief Under Section 530?* Documents can be mailed or faxed. Mailed documents can be provided on a flash drive.

Information is being requested for the following worker class:

1.) Officer- Treasurer

- a.) Provide detailed written description of job duties and responsibilities.
- b.) Approximate hours worked per week. If there is documentation of hours worked such as a schedule or calendar, provide copies.
- c.) Location of where the work is conducted.
- d.) Is the position year-round or seasonal? If seasonal, please specify what months.
- e.) What is the method of payment? (salary, hourly wage, commission, amount per event, stipend, percent of profit, etc.)
- f.) Is the worker eligible for benefits? If so, list the benefits such as health insurance, paid leave, pension plan, etc.



Employee / Independent Contractor

- g.) How often are they paid? (weekly, bi-weekly, monthly, etc.)
- h.) To whom do they report?
- i.) Are they required to keep time sheets or other methods to report their time?
- j.) Are they reimbursed for expenses? What expenses are reimbursed and how is it documented?
- k.) What job training is provided to the worker?
- l.) What instructions are provided concerning the work to be done?
- m.) Do they submit written reports?
- n.) Who sets or determines their job schedule and assigns their work duties?
- o.) What supplies and equipment does the organization provide to the worker?
- p.) Is the worker required to bring their own supplies?
- q.) How long has the compensated person worked with your organization? (Months, years, etc.)
- r.) Provide copy of written job contract or agreement if applicable.
- s.) Does the worker make their services available to the public?



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.





IRS Statistics



IRS EO Rulings & Agreements Determinations Results

- Received 128,087 applications for tax-exempt status; closed 119,491
- Average age of open inventory - 80 days
 - Average age of Form 1023-EZ - 34 days
 - Average age of Form 1023 - 94 days
 - Average age of Form 1024 - 106 days
 - Average age of Form 1024-A - 106 days
 - Average age of Form 8940 - 113 days
- Average processing time for all closed case inventory - 48 days
 - Average processing time for closed Forms 1023-EZ - 20 days
 - Average processing time for closed Forms 1023 - 100 days
 - Average processing time for closed Forms 1024 - 158 days
 - Average processing time for closed Forms 1024-A - 175 days
 - Average processing time for closed Forms 8940 - 164 days



IRS EO Examination Results

- Started 2,528 total exams; closed 2,444; 75.6% overall change rate
- 232 compliance strategy exams (9% of exam starts), closed 221
 - 84.2% change rate on closed compliance strategy exams
- 789 data driven exams (31% of exam starts), closed 738
 - 61.7% change rate on closed data driven exams
- 1,507 referrals, claims and other casework exams (60% of exam starts), closed 1,48
 - 81.3% change rate on closed referrals, claims and other casework exams





The Inflation Reduction Act



Introduction and background

- Inflation Reduction Act – passed August 2022
 - Landmark climate legislation
 - Clean energy economy
 - Create new good paying jobs
 - 6% to 30% to 70% credits depending on various factors
- Tax credits for investments – now available to exempt organizations!!!

JCT estimates tax credits will be \$663 billion (original estimate \$369b)



Situations that may apply

Organizations who are building or renovating facilities

Schools electrifying their bus fleets

Conservation organizations with land who could build solar/wind

Nonprofits installing charging stations

Low-income housing developers

Any nonprofit with a facility needing upgrades

- (i.e. roof, solar panels, windows, HVAC)



Proposed tax regulations

Exempt organizations under
§501(a)

Direct pay election

Placed in service after
12/31/22

Must be the owner of the
property

- Disregarded LLC
- Taxable subsidiary
- Partnership
 - Even if all partners are exempt



Proposed tax regulations

- How to get credit? File Form 990-T, Form 3800 and other ITC form
- Direct payment election - treated as if making a tax payment
- Tax is deemed paid on later of original due date or date filed
- Don't need to have taxable unrelated business income
- Must be filed on an original timely return
- Due 15th date of 5th month after year end
- Extended but not amended!



Registration now open

- Pre-filing registration tool launched in Late December 2023
- Will be first step for tax-exempts to claim cash in lieu of credits
- Effective for tax years beginning on or after January 1, 2023.
- Registration isn't required until a qualified project is placed in service.
- Registration should not be done earlier than the beginning of the tax period in which the credit will be claimed.
- IRS recommends registering projects at least 120 days before the due date of the Form 990-T on which the applicable credit will be claimed.

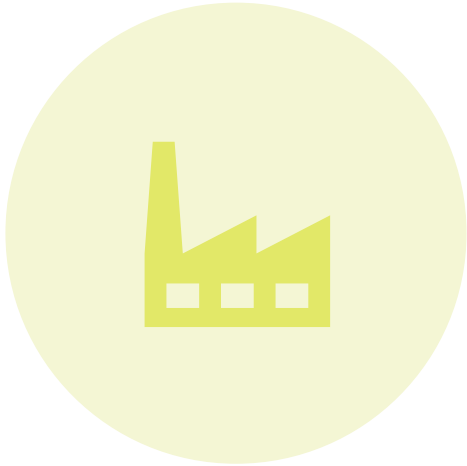




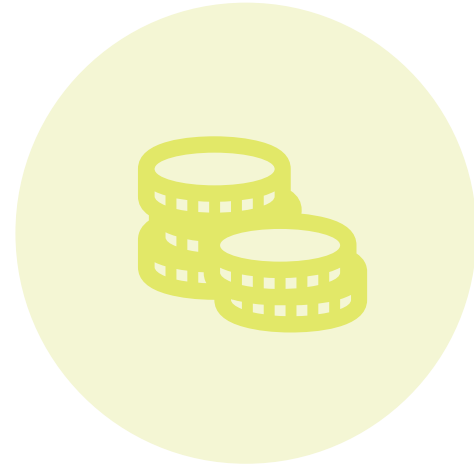
State and Local Considerations



SALT – What Are the Issues?



STATE TAX NEXUS – IMPACT
OF THE REMOTE WORKFORCE



SALES AND USE – IMPACT OF
ECONOMIC NEXUS

SALT Considerations – Why Now?



Remote work force – Increased detection risk if registered for any other tax type (i.e. payroll withholding).



Nexus inquiries often are prompted based on information gathered in another taxpayer's state audit.



States are addressing their taxation of intangibles, product downloads, and other digital products.



States are aggressively monitoring and legislating activities and products sold online.

Impact of the Remote Workforce



Pre and post pandemic workforce considerations



States may assume for profit status if no state exemption is filed.



Other considerations

Payroll registrations?

Charitable solicitation?

UBI filing?



Taxation of Nonprofit Organizations

Income/Franchise/Gross Receipts Tax

- Most states provide an exemption from income tax for nonprofit organizations.
- The exemption does not generally extend to “non-income based” taxes.
 - Washington B&O Tax
 - New Mexico Gross Receipts

Sales and Use Tax

- Many states provide an exemption from sales and use taxes for purchases by nonprofit organizations.
- The exemption does not extend to sales by the organization to an ultimate purchaser.



Sales To the Ultimate Purchaser

Services

- Most states do not tax sales of services.
- Information services
- Certain states do tax services very broadly.
 - HI - NM
 - SD - WV

Products

- Most states do tax sales of TPP.
 - Online sales may trigger sales tax obligations
- Digital products
 - Many states tax online tools & digital products



SALT – Best Practices for Nonprofits

Know your nexus footprint

Understand the taxes your organization may be subject to because of nexus with a state

Apply for any available exemptions

Ongoing compliance





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Thank you.

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