NON-PROFIT ACCOUNTING & AUDITING UPDATE

ALLEN L. FETTERMAN, CPA, MBA

(845) 638-1460

allenfetterman@yahoo.com

ACE SEMINARS

cpe@aceseminars.com

718.544.1929 718.544.1540

137-34 71st Avenue, Flushing, NY 11367

ALLEN L. FETTERMAN, CPA, MBA
allenfetterman@yahoo.com (845) 548-0998

Allen L. Fetterman, CPA, MBA lectures extensively on not-for-profit accounting, auditing, federal single audits, tax-exempt issues and governance. He speaks at conferences, seminars and webcasts throughout the country. Allen was an assistant professor of accounting at a local college and a guest lecturer at Yale University and New York University. He was a member of the Faculty Bank of the Foundation for Accounting Education (FAE). He is a past recipient of both the AICPA's and the FAE's Outstanding Discussion Leader Award. He has written articles published in national accounting periodicals in the United States and Israel on accounting and taxes for not-for-profit entities.

Allen served on the American Institute of CPAs Not-for-Profit Organizations Committee, Not-for-Profit Audit and Accounting Guide Task Force and Joint Trial Board. He chaired the New York State Society of CPAs Not-for-Profit Organizations, Professional Ethics, Audit, and Quality Controls Committees and the AICPA Joint Trial Board. He also served as Vice-President of the New York State Society of CPAs and as a Trustee of the Foundation for Accounting Education.

Allen retired in 2003 from Loeb & Troper, where he spent thirty-six years serving not-for-profit entities as an auditor and consultant, the last twenty-five years as a partner. In addition to his client responsibilities, he was the partner in charge of the firm’s quality controls and technical resources.

Allen received his BBA in Accounting from The City College of New York in 1968 and his MBA in Accounting from the Bernard M. Baruch College in 1972. He was elected to Beta Gamma Sigma, the national honorary society in business. He received his CPA certificate in 1973 and is a member of the American Institute of Certified Public Accountants and the New York State Society of Certified Public Accountants.

Allen has served on the governing boards of not-for-profit organizations, including positions as President, Treasurer and Chair of the Audit Committee and the Finance Committee.

Allen and Mimi, his wife of 52 years, live in West Nyack, New York. They have two sons and four grandchildren.

Nonprofit Accounting and Auditing Update

Allen L. Fetterman, CPA, MBA

What We Will Cover

- FASB and AICPA guidance specific to NFPs
- Other FASB and AICPA guidance and projects which will impact NFPs and their auditors
- Audit and attestation update

AICPA Audit and Accounting Guide and Audit Risk Alert

- Audit and Accounting Guide, *Not-for-Profit Entities*
  - Published annually; latest is the 2021 edition
  - Although nonauthoritative, it contains recommendations from FinREC in areas not covered by the FASB ASC
  - Includes new ASUs and changes to the auditor's report on financial statements
- Audit Risk Alert, *Not-for-Profit Entities Industry Developments*
  - Published annually; latest is the 2021 edition
  - Focuses on emerging practice issues and current economic, legislative, regulatory, accounting and auditing developments
  - Includes accounting, auditing and operating issues related to COVID-19

FASB Effective Dates Philosophy Two-Bucket Approach for Major Standards

- Bucket 1 – SEC Filers, excluding smaller reporting companies as defined by the SEC
- Bucket 2 – all other entities, including all not-for-profit entities
- Effective dates for major standards for Bucket 2 entities will be at least two years after the effective dates for Bucket 1 entities
- Examples of major standards are revenue recognition and leases

Revenue Recognition

- ASU No. 2014-09, *Revenue from Contracts with Customers* (Topic 606)
- ASU No. 2015-14 deferred the effective date
  - Public entities – years beginning after December 15, 2017
    - Public NFPs are those with publicly-traded debt (conduit or direct)
  - Nonpublic entities – years beginning after December 15, 2018
- ASU No. 2020-05 provided an additional 1-year deferral
  - Nonpublic entities that have not yet issued 2019 financial statements (as of June 3, 2020) – years beginning after December 15, 2019
    - Early implementation permitted

Revenue Recognition

- Focuses on contracts with customers ("exchange transactions"), with certain exceptions, such as lease contracts
- Contributions are not in the scope
  - They are not contracts with customers as defined in ASC Topic 606
- Establishes a single, principle-based revenue standard
  - Eliminates industry-specific standards for revenue recognition

Revenue Recognition

- Recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services
- The standard sets forth a five-step approach for revenue recognition
  - Identify the contract(s) with customers
  - Identify the performance obligations
  - Determine the transaction price
  - Allocate the transaction price to the performance obligations
  - Recognize revenue when (or as) a performance obligation is satisfied

Revenue Recognition

- The five-step revenue model highlights the identification of the performance obligations of the seller in the contract, determining the price to be paid by the customer, and allocating that price to the performance obligations so that revenue is recognized as each performance obligation is satisfied
- Revenue may be recognized at a point in time or over time, depending on the facts and circumstances

Revenue Recognition

- For NFPs, contracts with customers commonly come from such sources as tuition, fees, sales of goods and services, conferences and special events, advertising, royalties, licensing of intellectual property
- Certain transactions will require bifurcation between an exchange transaction and a contribution, e.g., membership dues, special events
  - Generally, the organization will determine the exchange component of the transaction under the new revenue recognition standard and apply contribution accounting to the remainder

Revenue Recognition

- Transition
  - Full retrospective
    - Cumulative catch-up to beginning of earliest year presented
    - Current year and prior year – all contracts under new standard
  - Modified retrospective
    - Current year – existing and new contracts under new standard (disclose existing and new contracts under legacy standard)
    - Cumulative catch-up to beginning of current year
    - Prior year – contracts under legacy standard

Revenue Recognition

- Transition disclosures
  - The selected adoption method, either full retrospective or modified retrospective, as well as the quantitative impact of the adoption
- Annual disclosures for NFPs
  - Description of revenue disaggregated according to the timing of transfer of goods or services to customers, i.e., at a point in time or over time
    - Public NFPs must disclose quantitative disaggregation of revenue
  - Qualitative information about how economic factors affect the nature, amount, timing and uncertainty of revenue and cash flows
  - Opening and closing balances of contract assets, contract liabilities and receivables from contracts with customers
  - Entity's performance obligations, e.g., when performance obligations are typically satisfied, significant payment terms
  - Significant judgments, e.g., the methods used to recognize revenue

Revenue Recognition

- FASB published *Revenue Recognition Implementation Q&As*
- AICPA publishes an Audit and Accounting Guide, *Revenue Recognition*
  - 2021 is the latest edition
  - Separate chapter devoted to NFPs
    - Tuition and housing revenues
    - Subscriptions and membership dues
    - Bifurcation of transactions between contribution and exchange components

Revenue Recognition

- Planning for implementation
  - Inventory all revenue streams
  - Review all significant agreements
  - Document the existence of a contract – enforceable rights and obligations
  - Review your revenue recognition policies
  - Identify similar revenue streams, i.e., bundle similar contracts
  - Perform analysis, reach and document conclusions

Grants and Contracts

- Long-time debated question: Are government contracts exchange transactions, i.e., contracts with customers or are they contributions from the government sponsor?
- A *customer* is defined in Topic 606 as "a party that has contracted with an entity to obtain goods or services… in exchange for consideration"
- Is the government obtaining goods or services (reciprocal exchange transaction) or is it giving money (nonreciprocal contribution)?
  - Example

Grants and Contracts

- ASU No. 2018-08, *Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made* (Topic 958)
- Applies to both contributions received by a recipient and contributions made by a resource provider
- Provides guidance to help determine whether a transaction should be accounted for as a contribution or as an exchange transaction
- Clarifies the definition of a conditional contribution

Grants and Contracts

- Key clarifications
  - A resource provider, even a government entity, is not synonymous with the general public; if a resource provider receives value indirectly by providing a societal benefit, this would be considered a nonreciprocal transaction
  - If the primary beneficiary of a grant contract is a third party, an NFP should use judgment to determine if the transaction is reciprocal or nonreciprocal (Is it eligibility based or part of an existing exchange transaction?)
  - Furthering a resource provider's mission or "feel good" sentiment does not constitute commensurate value received
  - The type of resource provider should not override the substance of the transaction

Grants and Contracts

- If the resource provider is receiving commensurate value for the resources provided, the resource receiving entity should follow Topic 606 or other guidance, such as leases (or 605 if deferred (ASU No. 2020-05))
- If the resource provider is not receiving commensurate value for the resources provided, the resource receiving entity should determine whether the transfer of assets represents a payment from a third-party payer on behalf of an existing exchange transaction between the recipient and an identified customer, e.g., Medicare

Grants and Contracts

- If it is determined to be a third-party payment on an existing contract, the resource receiving entity should follow Topic 606 (or 605 if deferred (ASU 2020-05))
- If the resource provider is not receiving commensurate value for the resources provided and it is not a payment from a third-party payer on behalf of an existing exchange transaction, then the transfer of assets is a contribution from the resource provider and the resource receiving entity should follow the contribution model guidance in Topic 958-605

Grants and Contracts

- Does not need to be classified as a "contribution" on the statement of activities
- It may be described as "government grants" or "revenue from government contracts"
- The ASU updates the ASC Master Glossary definition of *contribution* and *exchange transaction*
  - In a contribution transaction, the resource provider often receives value indirectly by providing a societal benefit although that benefit is not considered to be of commensurate value. In an exchange transaction, the potential public benefits are secondary to the potential direct benefits to the resource provider.

Grants and Contracts

- Requires that an entity determine whether a contribution is conditional based on whether the agreement includes
  - A barrier that must be overcome and
  - Either a right of return of assets transferred or a right of release of a promisor's obligation to transfer assets (does not need to be explicitly stated in the agreement)
- A probability assessment about whether the recipient is likely to meet the stipulation is not a factor when determining whether an agreement contains a barrier

Grants and Contracts

- To assess whether an agreement contains a barrier, the entity would consider indicators such as
  - The inclusion of a measurable performance-related barrier or other measurable barrier, e.g., achieving a specified level of service, an identified number of units of output, a specified outcome, a matching requirement
  - The extent to which a stipulation limits discretion by the recipient on the conduct of an activity, e.g., a requirement to incur only qualifying expenses that are based on specific requirements
  - The extent to which a stipulation is related to the purpose of the agreement, e.g., a report conveying findings from a research grant; this would generally exclude administrative tasks and trivial requirements, e.g., a report indicating how grant moneys have been spent or a requirement for an audit in accordance with OMB guidelines

Grants and Contracts

- A contribution containing stipulations that are not clearly unconditional shall be presumed to be conditional
- After a contribution has been determined to be unconditional, an entity would consider whether the contribution is restricted on the basis of the current definition of a *donor-imposed restriction*

Grants and Contracts

- Modifies the simultaneous release option, which allows a NFP to recognize a restricted contribution directly in net assets without donor restrictions if the restriction is met in the same period that the revenue is recognized
- Creates two "buckets" for restricted contributions: (1) those that were initially conditional and (2) other
- The ASU allows this option to be elected for bucket 1 and not for bucket 2

Grants and Contracts

- No additional recurring disclosures
- For conditional promises to give, recipients are required to disclose
  - The total of the amounts promised
  - A description and amount for each group of promises having similar characteristics
- Consider key attributes of the barriers such as
  - Subject to matching
  - Incurring qualifying expenses
  - Measurable performance-related barrier

Grants and Contracts

- Effective dates for recipients
  - NFP that has issued, or is a conduit bond obligor for, publicly traded securities – annual periods beginning after June 15, 2018
  - Other NFPs – annual periods beginning after December 15, 2018
- Effective dates for resource providers
  - NFP that has issued, or is a conduit bond obligor for, publicly traded securities – annual periods beginning after December 15, 2018
  - Other NFPs – annual periods beginning after December 15, 2019

Grants and Contracts

- The ASU may be applied on a modified prospective basis in the first financial statements following the effective date to agreements that are either
  - Existing at the effective date (apply only to the portion not previously recognized)
  - Entered into after the effective date
- Modified prospective basis
  - No cumulative effect adjustment to opening net assets
  - No restatement of prior period results
- Retrospective application to each period presented in the financial statements is also permitted

Leases

- ASU No. 2016-02, *Leases* (Topic 842)
- Effective dates
  - Public entities – years beginning after December 15, 2018
    - Public NFPs are those with publicly-traded debt (direct or conduit)
  - Nonpublic entities – years beginning after December 15, 2020 (ASU No. 2019-10)
- ASU No. 2020-05 provided a one-year deferral
  - Public NFPs that have not yet issued financial statements (as of June 3, 2020) - years beginning after December 15, 2019
  - All nonpublic NFPs, i.e., years beginning after December 15, 2021
  - Early adoption permitted

Leases

- Standard does not include leases of
  - Inventory (Topic 330)
  - Intangible assets (Topic 350)
  - Assets under construction (Topic 360)

Leases

- A lease is a contract that conveys the right to use an asset for a period of time in exchange for consideration
  - Must be an identified asset
    - Explicitly stated or implicitly specified
    - Supplier has no practical ability to substitute, and would not economically benefit from substituting, the asset
  - Lessee must have the right to control the use of the asset during the lease term
    - Has decision-making authority over the use of the asset
    - The ability to obtain substantially all the economic benefits from the use of the asset

Leases

- Requires entities that lease assets ("lessee"), with lease terms of more than 12 months, to recognize a right-of-use asset and a lease liability measured at the present value of the lease payments
- Capitalize initial direct costs, i.e., incremental costs that an entity would not have incurred if the lease had not been executed, e.g., broker's commission
- Costs to negotiate a lease are expensed as incurred, e.g., legal fees

Leases

- What discount rate to use
  - Standard requires the rate implicit in the lease, but only if readily determinable
  - When not determinable, use the lessee's incremental borrowing rate
  - Other than PBEs, including all NFPs, may elect to use a risk-free rate to measure lease liabilities

Leases

- Initial measurement
  - Lease liability = present value of lease payments
  - Right of use asset = lease liability + prepaid lease payments + initial direct costs - lease incentives

Leases
Example – Initial Recognition

- Facts
  - Five-year lease
  - Payments
    - Year 1 – $5,000
    - Year 2 – $5,100
    - Year 3 – $5,300
    - Year 4 – $5,600
    - Year 5 – $6,000
  - Total lease payments - $27,000
  - No renewal option
  - Initial direct costs - $500
  - Cash incentive received - $2,000

Leases
Example – Initial Recognition

- Total lease payments - $27,000
- Lease liability = present value of lease payments - $24,900
- Adjustments: plus initial direct costs ($500); less lease incentive ($2,000)
- Journal entry to record lease

Right of use asset	23,400	
Cash	2,000	
Lease payable		24,900
Cash		500

Leases

- Expense recognition depends on the type of lease
  - Finance lease
  - Operating lease

Leases

- A finance lease includes
  - A lease that is effectively an installment purchase, i.e., transfer of ownership at the end of the lease term
  - Lease grants an option to purchase the asset, which is reasonably certain to be exercised
  - Lease term is for a major part of remaining economic life of the asset
  - Present value of lease payments and residual value equals or exceeds substantially all of the asset's fair value
  - Underlying asset is specialized asset with no alternative use to lessor after the lease term
- A lease that does not meet the requirements for a finance lease is classified as an operating lease

Leases

- Operating lease
  - Statement of activities - recognize a single total lease (rent) expense, calculated so that the cost of the lease is allocated over the lease term generally on a straight-line basis
  - Statement of cash flows – cash paid for leases (operating)
- Finance lease
  - Statement of activities - recognize amortization of the right-of-use asset separately from interest expense on the lease liability
    - Front-loading of interest expense
  - Statement of cash flows – cash paid for principal (financing) and cash paid for interest (operating)

Leases

- Subsequent accounting – operating lease
  - Unwind the liability using the effective interest method
  - Straight-line expense over the term
  - Reduce the right-of-use asset by the difference between the annual straight-line lease expense and the annual interest on the lease liability
- Subsequent accounting – finance lease
  - Unwind the liability using the effective interest method
  - Interest determined on the lease liability in each period during the lease term using a constant discount rate
  - Right-of-use asset amortized on the straight-line basis

Leases
Example – Subsequent Accounting

- Facts
  - Ten-year lease with payments of $50,000 per year
  - Considered to be an operating lease
  - Risk-free rate (10-year U.S. Treasury rate) = 3%
  - Present value of $500,000 = $426,500
  - Fiscal year end June 30
  - Lease commencement date – July 1, 2021

Leases
Example – Subsequent Accounting

- Adjustment to statement of financial position on July 1, 2021
  - Debit right of use asset 426,500
  - Credit lease liability 426,500
- Future periods (as rent is paid)
  - Debit lease expense 50,000
  - Credit cash 50,000
- On June 30, 2022 (end of fiscal year 1)
  - Debit lease liability (use same discount rate) 37,205*
  - Credit right of use asset (accumulated amortization) 37,205

*50,000 - (426,500 x. 03)

This amount will increase each year from years 2 to 10

Leases

- Provides guidance as to the lease term
  - Renewal options included only if the lessee is reasonably certain to exercise the option based on relevant economic factors, considering renewal terms and the degree of asset customization
- Short-term leases with a term of twelve months or less, without renewal options that are reasonably certain of exercise, are not required to be recognized on the balance sheet
- Standard requires several new qualitative and quantitative disclosures

Leases

- Apply standard on a modified retrospective approach
  - At the beginning of the earliest year presented
  - Comparative periods required to be in accordance

OR

- Cumulative effect adjustment to net assets at the beginning of the year of adoption
  - Comparative periods not required to be in accordance
- At adoption, need not reassess lease classification
  - Capital = Finance
  - Operating = Operating

Leases

- Preparing for implementation
  - Inventory leases
  - Review capitalization policy
  - Determine effect on debt covenants
- At the time of adoption, when discounting the remaining lease payments, does an entity use the historical rate in effect at the commencement of each lease?
- No...practical expedient to use the discount rate in effect at the beginning of the year of implementation, including comparative years

Leases

- The accounting by entities that own the assets leased by the lessee (“lessor”) remains largely unchanged
- AICPA published, “Navigating the New Lease Accounting Standards – An Overview for Not-for-Profits”
- What about donated space or below-market leases?
  - Not within the scope of the standard
  - Use the contribution model in ASC 958-605
    - If specified period of time greater than one year – restricted contribution
    - Asset could be described as pledge receivable, building or leasehold
    - If indefinite period, recognize revenue and expense when received and used

Leases
Discount Rate for Lessees

- Proposed ASU, *Discount Rate for Lessees That Are Not Public Business Entities*
- Reconsider the risk-free discount rate accounting policy election available to lessees that are not public business entities, which includes all NFPs
- Retain a risk-free rate for the discount rate policy decision rather than another specified rate, e.g., corporate bond rate, prime rate
- Risk-free rate election may be made by class of underlying asset

Leases
Discount Rate for Lessees

- Require the lessee to disclose the election, including the asset class to which it has made the election
- Require the lessee to use the rate implicit in the lease when it is readily determinable instead of the risk-free rate or an incremental borrowing rate
- Effective date and transition depends on whether a lessee has adopted Topic 842 as of the issuance of a final ASU, but no later than when Topic 842 is adopted

Lease Concessions

- Due to the COVID-19 pandemic, many lessors are providing lease concessions to lessees, e.g., payment forgiveness, deferral of payments
- Subsequent changes to lease payments that are not stipulated in the original lease contract are generally accounted for as lease modifications under Topic 842 or 840
- FASB issued a Staff Q&A to address these COVID-19-related lease concessions

Lease Concessions

- FASB Staff Q&A
  - Entities may elect to account for lease concessions related to COVID-19 as if enforceable rights and obligations for those concessions existed in the original contract
  - Entities do not have to review contracts to see if rights and obligations for lease concessions exist
  - Entities do not have to, but may, apply the lease modification accounting requirements in Topics 842 and 840 as a result of COVID-19
  - Entities should provide disclosures about material concessions granted (lessors) or received (lessees)

Credit Losses

- ASU No. 2016-13, *Measurement of Credit Losses on Financial Instruments*
- Effective for NFPs for years beginning after December 15, 2022 (ASU No. 2019-10)
- Early adoption permitted for years beginning after December 15, 2018
- Changes the financial accounting model applicable to all financial instruments other than those measured at fair value

Credit Losses

- Included are student loans receivable, programmatic loans receivable and trade receivables
  - Contributions receivable and most grants receivable (if following the contribution model) are scoped out
- Impairment model is changing from an incurred loss model to an expected loss model (accelerated recognition)
- Requires an entity to measure all current expected credit losses (CECL) over the contractual life of a financial asset

Credit Losses

- Current conditions and a broader range of reasonable and supportable information to be used to make credit loss estimates
- Record the difference between the amortized cost and the amount to be collected as an allowance for credit losses
  - Valuation account
  - Deducted from the cost basis of the receivable
  - Used to present "net amount expected to be collected"
  - Changes flow through net income or change in net assets

Goodwill and Intangible Assets

- ASU 2019-06, *Extending the Private Company Accounting Alternatives on Goodwill and Certain Identifiable Intangible Assets to Not-for-Profit Entities*
- Extends options from ASU No. 2014-02 for private companies to NFPs
- Effective upon issuance
  - Open-ended effective date and a one-time ability to elect without having to demonstrate preferability

Goodwill and Intangible Assets

- An NFP that elects these accounting alternatives would
  - Amortize goodwill over 10 years, or less if appropriate, on a straight-line basis
    - If an entity believes that their goodwill has real value in perpetuity, it would not adopt this option
  - Test for impairment when a triggering event occurs that indicates that the fair value of the entity may be below its carrying amount
  - Have the option to test for impairment at the entity level or the reporting unit level
  - Have the option to subsume into goodwill certain customer-related intangible assets and all noncompete agreements

Goodwill and Intangible Assets

- ASU No. 2021-03, *Accounting Alternatives for Evaluating Triggering Events*
- Provides private companies and NFPs with an accounting alternative to perform the goodwill impairment triggering event evaluation, and any resulting test for goodwill impairment, as of the end of the reporting period
  - Reporting period could be an interim or annual period

Goodwill and Intangible Assets

- An entity that elects this alternative is not required to monitor for goodwill impairment triggering events during the reporting period
- Effective on a prospective basis for fiscal years beginning after December 15, 2019
- Early adoption permitted for financial statements that have not been issued or made available for issuance as of March 30, 2021
- Unconditional one-time option to adopt after the effective date without assessing preferability

Goodwill and Intangible Assets

- FASB has a current project to revise the subsequent accounting for goodwill and identifiable intangible assets for all entities
- Objectives are to improve decision-usefulness and to rebalance the cost/benefit

Collections

- ASU No. 2019-03, *Updating the Definition of Collections*
- Applies to all entities that maintain collections (works of art, historical treasures or similar assets), including business entities
- Effective for financial statements issued for fiscal years beginning after December 15, 2019
- Early adoption permitted
- Should be applied on a prospective basis

Collections

- Modifies the definition of *collections* in the *ASC Master Glossary* to align it with the definition used in the American Alliance of Museums' *Code of Ethics for Museums*
  - Allows the proceeds from sales of collection items to be used to acquire new collection items or to support the direct care of existing collections

Collections

- Requires an entity to disclose its policy for the use of proceeds from the sale of collection items
- If an entity has a policy that allows proceeds from the sale of collection items to be used for direct care, it should disclose its definition of *direct care*
- *Direct care* is not defined in the ASC
- The AICPA issued Technical Q&A (6140.27) to provide nonauthoritative guidance related to direct care of collection items

59

Collections

- The Technical Q&A states that when an entity determines which costs are considered direct care, important characteristics to consider include, but are not limited to, whether those costs
  - Enhance the life, usefulness or quality of an entity's collection
  - Provide a benefit to the collections (not the entity as a whole or other areas of the entity beyond the collections)
  - Exclude expenditures that are regular and ongoing in nature (such as expenditures for routine maintenance of the collection)

60

Gifts-in-Kind

- ASU No. 2020-07*, Presentation and Disclosures by Not-for-Profit Entities for Contributed Nonfinancial Assets*
- Effective for fiscal years beginning after June 15, 2021
- Early adoption is permitted
- Retrospective application required to all periods presented
- Improves transparency in the reporting by NFPs of contributed nonfinancial assets, aka gifts-in-kind (GIK), through enhancements to presentation and disclosure

Gifts-in-Kind

- GIK include fixed assets (land, buildings, equipment), the use of fixed assets or utilities, materials or supplies (food, clothing, pharmaceuticals), intangible assets, services and unconditional promises of those assets
- Does not change existing recognition and measurement requirements, i.e., does not address valuation
- Requires NFPs to present contributed nonfinancial assets as a separate line item in the statement of activities, apart from contributions of cash or other financial assets

Gifts-in-Kind

Statement of Activities

	Without Donor Restrictions	With Donor Restrictions	Total
Revenues			
Contributions			
Cash and other financial assets	98,400	30,200	128,600
In-kind or **nonfinancial assets***	37,300	10,800	48,100
Government grants	267,900		267,900
Other	8,200		8,200
Total revenues	411,800	41,000	452,800

*In-kind could be presented as a separate column on the line, "contributions"

No requirement to separately report the related expenses

Gifts-in-Kind

- Required quantitative disclosure
  - Contributed nonfinancial assets recognized on the statement of activities disaggregated by category that depicts the type of contributed nonfinancial assets
- Required qualitative disclosures
  - For each category, information about whether contributed nonfinancial assets were either monetized or utilized during the reporting period and, if utilized, a description of the programs or other activities in which those assets were used

Gifts-in-Kind

- Required qualitative disclosures (cont.)
  - The NFP's policy (if any) about monetizing rather than utilizing contributed nonfinancial assets
  - A description of any donor-imposed restrictions associated with the contributed nonfinancial assets
  - The valuation techniques and inputs used to arrive at a fair value measure at initial recognition
  - 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

Reporting Donated Services Received From an Affiliate

- The following guidance related to equity transfers became applicable to all NFPs with the issuance of ASU 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities*
  - Previously it applied only to not-for-profit business-oriented health care entities
- The increase in net assets associated with services received from personnel of an affiliate for which the affiliate does not charge the recipient NFP should be reported as an equity transfer

Reporting Donated Services Received From an Affiliate

- Before the change in ASU No. 2014-16, an NFP that received donated services from an affiliate was recording the credit as contribution revenue
- Now, the credit should be recorded as an equity transfer
- Equity transfers should be reported separately as a change in net assets after a subtotal such as "change in net assets before equity transfer"
- The debit would continue to be reported as an expense, such as salaries, which would be functionalized, or as an asset

Other FASB Actions

- Consolidation of a NFP by a for-profit sponsor project removed from the agenda
  - No significant diversity in practice
- Feedback received by the NAC from NFP stakeholders
  - Define intermediate operating measures for NFPs
  - Improve the NFP consolidations model
  - Make targeted improvements to accounting for government grants
  - Provide additional guidance on the valuation of nonfinancial assets
  - Provide additional guidance on MD&A for NFPs

Revenue Recognition
Paycheck Protection Program (PPP) Loans

- AICPA issued a Technical Q&A 3200.18, *Borrower Accounting for a Forgivable Loan Received Under the Small Business Administration Paycheck Protection Program*
  - Two approaches: Loan model vs. conditional contribution model
- Whether the NFP expects to repay the loan or expects it to be forgiven, the NFP may account for the loan as a financial liability, in accordance with ASC 470, *Debt*, and accrue interest on the liability
- If and when forgiven, the NFP would record a gain on extinguishment

Revenue Recognition
Paycheck Protection Program (PPP) Loans

- If the NFP chooses not to follow ASC 470 and expects to meet the PPP's eligibility criteria for loan forgiveness and concludes that the loan represents, in substance, a grant, it should account for the loan under ASC 958-605 as a conditional contribution
- The cash inflow would be treated as a refundable advance
- A contribution would be recognized once the conditions of release have been substantially met or explicitly waived

Revenue Recognition
Paycheck Protection Program (PPP) Loans

- Question: What are the barrier(s) that need to be overcome…meeting the conditions for forgiveness or receiving the actual forgiveness
  - There is no definitive answer
  - Judgment of each PPP loan recipient
- Barriers
  - Incurring qualifying expenses, e.g., payroll, rent, mortgage interest, utilities
  - Maintaining or restoring headcount and salary levels

Revenue Recognition
Paycheck Protection Program (PPP) Loans

- Is the review/forgiveness process a separate barrier to entitlement?
  - Does the entity believe that the act of forgiveness is administrative in nature or in furtherance of the program, i.e., keeping the entity in business
- Entities with material PPP loans should disclose their accounting policy for such loans and the impact on the financial statements

Revenue Recognition
Employee Retention Credit (ERC)

- Credits are obtained as reductions of payroll tax
- These should be treated as grants and be recorded as grant revenue and a reduction of payroll tax liability (not as a reduction of payroll tax expense)
- May not be claimed for wages paid with the proceeds of a PPP loan that has been forgiven

Changes to the Auditor's Report on Financial Statements

- Statement on Auditing Standards No. 134, *Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements*
- Original effective date was for audits of financial statements for periods ending on or after December 15, 2020, with early implementation not permitted

Changes to the Auditor's Report on Financial Statements

- Due to the effect of the coronavirus pandemic, SAS No. 141, *Amendment to the Effective Dates of SAS Nos. 134-140,* was issued, delaying the effective date by one year, to periods ending on or after December 15, 2021
- Early implementation is no longer precluded (SASs 134, 136-137, 139-140)
  - ASB recommends that SASs 134-140 be implemented concurrently
- AICPA issued two versions of *Professional Standards*, one for auditors that early implement and one for auditors that do not early implement

2019 Omnibus SAS

- Statement on Auditing Standards No. 135, *Omnibus Statement on Auditing Standards – 2019*
- Intended to more closely align ASB standards with PCAOB standards
- Amends, among other AU-C sections
  - Section 240, *Consideration of Fraud in a Financial Statement Audit*
  - Section 260, *The Auditor's Communication With Those Charged With Governance*
  - Section 550*, Related Parties*

Changes to the Auditor's Report Employee Benefit Plans Subject to ERISA

- Statement on Auditing Standards No. 136, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*
- Creates a new AU-C Section 703
- Creates new reporting requirements and performance requirements for audits of ERISA financial statements
- Changes the the term, "ERISA limited-scope audits" to "ERISA Section 103(a)(3)(C) audits"

Changes to the Auditor's Report Employee Benefit Plans Subject to ERISA

- Form and content of auditor's report on employee benefit plans consistent with SAS No. 134
- Changes to the ERISA Section 103(a)(3)(C) report
  - New section, "Nature of ERISA Section 103(a)(3)(C) audit"
- Includes new requirements for
  - Performance of an ERISA Section 103(a)(3)(C) audit
  - Communications with those charged with governance
  - Considerations relating to Form 5500
    - Management to provide the auditor with a draft Form 5500 that is substantially complete prior to dating of the auditor's report

Other Information in Annual Reports

- Statement on Auditing Standards No. 137, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*
- Clarifies the auditor's responsibilities relating to financial and nonfinancial information in documents containing audited financial statements and the auditor's report
- The auditor's opinion on the financial statements does not cover the other information

Other Information in Annual Reports

- Clarifies that the auditor is required to read and consider other information in an annual report which may indicate material inconsistencies with the financial statements
- The auditor should remain alert for indications of
  - A material misstatement of facts
  - A material inconsistency with the auditor's knowledge from the audit
  - Information that is otherwise misleading

Other Information in Annual Reports

- Clarifies the scope of documents that the auditor is required to subject to the procedures, i.e., what constitutes an "annual report"
- Requires the auditor, through discussion with management, to determine and obtain management's written acknowledgement regarding which document(s) comprise the annual report
- Requires the auditor to include a separate section in the auditor's report with the heading "Other Information"
  - Includes examples of an "other information" paragraph

AICPA Changes the Definition of Materiality

- SAS No. 138 and SSAE No. 20, both titled *Amendments to the Description of the Concept of Materiality*
- Aligns ASB's definition of materiality for audits and attestation engagements with the FASB, the PCAOB, the SEC and the U.S. judicial system, instead of the international standard setters, as in the past

Misstatements, including omissions, are considered to be material if ~~they~~ **there is substantial likelihood that,** individually or in the aggregate ~~could reasonably be expected to~~ **they would** influence the ~~economic decisions of users~~ **judgment of a reasonable user** made **based** on ~~the basis of~~ the financial statements

Changes to Compliance Audits

- Statement on Auditing Standards No. 140, *Amendments to AU-C Sections 725, 730, 930, 935, and 940 to Incorporate Auditor Reporting Changes From SAS Nos. 134 and 137*
- SAS No. 140 conforms AU-C Section 935, *Compliance Audits,* to SAS No. 134 and provides an illustrative combined report on compliance and internal control over compliance
- Original and delayed effective dates and early implementation the same as for SAS No. 134

Changes to Compliance Audits

- In addition, SAS No. 140
  - Revises the definition of *material noncompliance* to align with the description of *materiality* in SAS No. 138
  - Presents requirements for a combined report on compliance and internal control over compliance as the default form of report, followed by requirements addressing when the auditor chooses to issue separate reports on compliance and internal control over compliance
  - Updates references to *OMB Circular A-133* to refer instead to the *Uniform Guidance* and addresses changes in the OMB Compliance Supplement and the most recently issued Yellow Book
  - Updates the appendix, “AU-C Sections That Are Not Applicable to Compliance Audits”

Audit Evidence

- SAS No. 142, *Audit Evidence*
- Effective for periods ending on or after December 15, 2022
- Addresses evolving nature of audit services
  - Accuracy, completeness, relevance and reliability of audit evidence
  - The expanding sources of information to be used as audit evidence
  - Innovative ways of gathering audit evidence, including when the auditor is working remotely
  - Whether the information corroborates or contradicts management's assertions
  - The application of professional skepticism

Auditing Estimates

- SAS No. 143, *Auditing Accounting Estimates and Related Disclosures*
- Effective for periods ending on or after December 15, 2023
- Addresses the auditor's responsibilities relating to accounting estimates, including fair value
- Enhances the auditor's focus on factors driving estimation uncertainty and potential management bias
- Encourages auditors to exercise professional skepticism

Attestation Engagements

- Statement on Standards for Attestation Engagements No. 19*, Agreed-Upon Procedures Engagements*
- Effective for reports dated on or after July 15, 2021
- Early implementation permitted

Attestation Engagements

- Provides practitioners with flexibility
  - Removes the requirement that the practitioner request an assertion from the responsible party
  - Allows procedures to be developed over the course of the engagement
  - Allows the practitioner to develop or assist in developing the procedures
  - Requires the engaging party to acknowledge the appropriateness of the procedures before the issuance of the practitioner's report
  - Permits the practitioner to issue a general-use report

Attestation Engagements

- Statement on Standards for Attestation Engagements No. 21, *Direct Examination Engagements*
- Effective for reports dated on or after June 15, 2022
- Adds a new AT-C Section 206, *Direct Examination Engagements*
- Enables entities that do not provide an assertion about whether the underlying subject matter is in accordance with the criteria to undergo an examination engagement
- Establishes performance requirements for a direct examination

Attestation Engagements

- Changes the title of AT-C Section 205 from *Examination Engagements* to *Assertion-Based Examination Engagements*
  - Differentiates Section 205 from Section 206
- Substantially retains the traditional examination engagement, including the requirement for the practitioner to request a written assertion from the responsible party

Attestation Engagements

- Statement on Standards for Attestation Engagements No. 22, *Review Engagements*
- Effective for reports dated on or after June 15, 2022
- Early implementation permitted

Attestation Engagements

- Describes the types of procedures a practitioner may perform in a review engagement
- Clarifies that the objective of a review engagement is to obtain limited assurance instead of being an exercise in performing analytical procedures and inquiries
- Requires the practitioner to disclose in the review report the procedures performed to obtain limited assurance
- Allows the practitioner to issue a report containing an adverse review conclusion when the subject matter is materially and pervasively misstated

Single Audit Update

Allen L. Fetterman, CPA, MBA

What We Will Cover

- The 2020 Compliance Supplement
- Revisions to the Uniform Guidance
- Other activities related to the COVID-19 Pandemic
  - Federal
  - AICPA
- Other AICPA guidance impacting single audits
- The 2018 Yellow Book

2020 OMB Compliance Supplement

- The final Supplement was released in August 2020
- Supersedes the 2019 Supplement and is effective for audits of fiscal years beginning after June 30, 2019, e.g., fye June 30, 2020, December 31, 2020
- Does not address COVID-19 implications other than in Appendix VII, Other Audit Advisories
- An addendum was released in December 2020, which addresses certain of the new federal programs established by the Coronavirus Aid, Relief, and Economic Security (CARES) Act

2020 OMB Compliance Supplement

- Provides routine updates unrelated to COVID-19
  - Adds new programs and deletes some programs
  - Changes to existing programs, including significant changes to student financial assistance programs
    - Approximately 60 programs in the Supplement had some changes from the prior year (there are approximately 200 programs in the Supplement)

2020 OMB Compliance Supplement

- Maintains the six-requirement mandate
  - Exception: Research & Development may be identified as a 7th requirement
  - Activities allowed and unallowed and allowable costs/cost principles are treated as one compliance requirement
  - Some programs have changes regarding the six requirements
  - Does not apply to programs not included in the Supplement

2020 OMB Compliance Supplement

- Reminder regarding the six-requirement mandate
  - For Part 2, Matrix “Y” entries, auditors must still determine whether those requirements could have a direct and material (D&M) effect on their particular client’s program
  - If an auditor determines that a “Y” requirement will not be tested as part of the compliance audit because it does not have a D&M effect, the auditor must document the rationale for not testing
    - “N/A” is not an appropriate way to document why a requirement subject to audit is not being tested

2020 OMB Compliance Supplement

- Changes Part 2, Matrix of Compliance Requirements (changes are shown in yellow highlights; corrections are shown in blue highlights)
- Removes Part 3-1, used previously for federal awards made prior to December 26, 2014
  - Now only one Part 3, Compliance Requirements
  - If the auditee is still expending federal funds from awards received prior to December 26, 2014, use Part 3-1 from the 2019 Supplement

2020 OMB Compliance Supplement

- Updates Part 5, Clusters of Programs
  - Appendix VII provides that, although the addendum will include new COVID-19 related programs and changes to existing programs due to COVID-19 funding, the addendum will not add new clusters of programs nor will it revise existing clusters

2020 OMB Compliance Supplement

- No changes to Part 6, Internal Control
  - Refreshed in 2019 Compliance Supplement
- Minor changes to Part 7, Guidance for Auditing Programs Not Included in This Compliance Supplement
- Changes from the previous Compliance Supplement in Appendix V
- Provides information on COVID-19 in Appendix VII, Other Audit Advisories

2020 OMB Compliance Supplement

- With respect to COVID-19, Appendix VII covers
  - Identification of COVID-19 related awards and single audit applicability
  - Clusters of programs
  - Identification of COVID-19 related awards on the SEFA and SF-SAC
  - Identification of compliance requirements for COVID-19 related awards
  - Changes to compliance requirements for existing awards due to additional COVID-19 funding
  - COVID-19 related OMB memoranda
  - Responsibilities for informing subrecipients
  - Identification of COVID-19 related awards in audit findings
  - Single audit due dates

2020 OMB Compliance Supplement

- Requirement to identify COVID-19 expenditures on the SEFA and the Data Collection Form
- SEFA example

COVID-19 Temporary Assistance for Needy Families	93.558	1,000,000
Temporary Assistance for Needy Families	93.558	3,000,000
Total Temporary Assistance for Needy Families		4,000,000

- Requirement to add "COVID-19" in the additional award column on the Data Collection Form for existing programs with incremental COVID-19 funding

2020 OMB Compliance Supplement

- Issue regarding adding a new program to an existing cluster
  - Question: When a new program is added to an existing cluster, can that cluster still meet the two-year look-back if the cluster was audited in the past two years?
  - Answer: The cluster may still be considered low risk if the added program's expenditures are less than or equal to 25% of the Type A threshold (subject to risk assessment)

2020 OMB Compliance Supplement Addendum

- The effective date of the addendum is the same as for the August 2020 Supplement, i.e., for audits of fiscal years beginning after June 30, 2019
- The addendum must be used in conjunction with the August 2020 Supplement in determining the appropriate audit procedures to support the compliance opinion
- Part 1 provides a description of which parts of the August 2020 Supplement are being modified, as well as which sections are new

2020 OMB Compliance Supplement Addendum

- Part 2, Matrix of Compliance Requirements, identifies the requirements subject to audit for all new programs (noted with “new” after the title and bolded), as well as existing programs that are included in the addendum
- Part 4, Agency Program Requirements, contains both new COVID-19 programs and existing programs which have changed due to CARES Act funding added to the program
  - There are other programs impacted by COVID-19 that are not included in the addendum

2020 OMB Compliance Supplement Addendum

- The Federal Funding and Accountability Transparency Act (FFATA) requires direct recipients who make first-tier subawards of $25,000 or more to report subaward data through the FFATA Subaward Reporting System
- Part 3 requires the auditor to test FFATA reporting for all COVID-19 programs included in the Addendum (except for the Coronavirus Relief Fund) for fiscal years ending after September 30, 2020 regardless of whether COVID-19 funding is involved, if the compliance requirement is marked as a “Y” in the Part 2 Matrix

2020 OMB Compliance Supplement Addendum

- Part 5, Clusters of Programs, informs auditors that there may be requirements in the August 2020 Supplement concerning the student financial assistance cluster that may have been waived or changed due to the pandemic
  - It refers to a website of SFA-related COVID-19 issues developed by DOE

2020 OMB Compliance Supplement Addendum

- Appendix VII, Other Audit Advisories, provides for a three-month audit submission extension for single audits of 2020 year-ends through September 30, 2020 year-ends only if the recipient expended COVID-19 funding reported on the SEFA, e.g., the single audit deadline for June 30, 2020 year-ends is extended from March 31, 2021 to June 30, 2021
  - Auditees do not need to obtain approval for this extension
  - Must document the reason for the delayed filing
  - Auditee that files within the extension period qualifies as low-risk auditee if it meets all the other requirements

2020 OMB Compliance Supplement Addendum

- Appendix VII states that nonfederal entities that received donated personal protective equipment (PPE) should include the fair value of the PPE in a stand alone note to the SEFA that is marked “unaudited”
- The donated PPE should not be counted for purposes of determining the single audit threshold or determining the Type A/B program threshold and is not required to be audited as a major program

How to Use the 2020 OMB Compliance Supplement

- Start with Part 2
- If a federal program is included in the Supplement, go to Part 4 for the specific requirements and Part 3 for the generic requirements and suggested audit procedures
- If a federal program is **not** included in the Supplement, follow the guidance in Part 7 and determine which of the 12 compliance requirements are applicable and then use Part 3 for the generic requirements and suggested audit procedures

2021 OMB Compliance Supplement

- First release expected in summer 2021
- Addendum likely to be used again for new ARP programs
- Updates to part 3 for UG changes
  - OMB will not take a 3.1 and 3.2 approach as in the past
- Appendix VII will provide guidance for COVID-19 implications, e.g., year 2 audit considerations, higher risk programs, SEFA presentation

Revisions to the Uniform Guidance

- OMB issued revisions to the Uniform Guidance (2 CFR Part 200)
- Effective for new federal awards and modification of existing federal awards on or after November 12, 2020
- The revisions include
  - Changes to the procurement standards
  - Expansion of the use of the de minimis indirect cost rate
  - Timing of the single audit quality project
  - Definition and terminology changes
  - Alignment with statutory and other requirements

Revisions to the Uniform Guidance

- Micro-purchase threshold changed from $3,500
  - Up to $10,000 (no action needed)
  - $10,001-$50,000 (qualify and self-certify)
  - Greater than $50,000 (cognizant agency approval)
- Threshold based on internal controls, evaluation of risk and documented procedures
- Explanation needed for determining price
- Noncompetitive method does not apply to micro-purchases

Revisions to the Uniform Guidance

- Simplified acquisition threshold increased from $150,000 to $250,000
- Threshold based on internal controls, evaluation of risk and documented procedures

Revisions to the Uniform Guidance

- Expands the use of the 10% de minimis indirect cost rate to all nonfederal entities that do not have a **current** negotiated (including provisional) indirect cost rate, except for state, local and tribal governments
  - UG originally provided that the 10% de minimis indirect cost rate could be used only by nonfederal entities that **never** received a negotiated indirect cost rate
- Clarifies that when a nonfederal entity uses the de minimis rate for its federal awards, it is not required to provide proof of costs covered under that rate
  - From previous COFAR FAQ

Revisions to the Uniform Guidance

- Changes the date for the requirement for a government-wide audit quality project that must be performed once every six years to years beginning with audits submitted in 2021
  - UG originally provided for the study of single audit quality to begin with audits submitted in 2018
- Clarifies that, for purposes of the project, the federal government may rely on current and ongoing quality control review work performed by federal agencies, state auditors and professional audit associations

Revisions to the Uniform Guidance

- On February 22, 2021, OMB issued a Federal Register notice, ”Guidance for Grants and Agreements”
  - Contains several technical corrections to the previous UG revisions
  - Fixes citations and references and clarifies language
  - Does not appear to have any substantive changes

OMB Memorandum M-20-26

- Recipients must maintain appropriate records and cost documentation to substantiate charging salaries and other costs related to interruption of operations or services
- Clarifies that payroll and other costs paid with Paycheck Protection Program (PPP) loans or any other federal CARES Act programs must not be also charged to current federal awards as it would result in the federal government paying for the same expenditures twice ("double dipping")

OMB Memorandum M-20-26

- In order to provide adequate oversight of the COVID-19 Emergency Acts funding and programs, recipients must separately identify COVID-19 on the SEFA and the Data Collection Form, even if additional funding to an existing CFDA number
- Provided single audit due date extensions to recipients and subrecipients affected by the loss of operational capacity due to the COVID-19 pandemic through December 31, 2019 year-ends

OMB Memorandum M-21-20

- Provides single audit due date extensions to recipients and subrecipients that have not yet filed their single audits with the FAC as of the date of the the issuance of this memo (March 19, 2021), that have fiscal year-ends through June 30, 2021, to six months beyond the normal due date
- Applies to all entities who are required to undergo a single audit, regardless of whether they have COVID-19 funding

OMB Memorandum M-21-20

Fiscal Year-End	Original Due Date	Extended Due Date
June 30, 2020	March 31, 2021	September 30, 2021
December 31, 2020	September 30, 2021	March 31, 2022
June 30, 2021	March 31, 2022	September 30, 2022

OMB Memorandum M-21-20

- Does not require recipients and subrecipients to seek approval for the extension
- Recipients and subrecipients should maintain documentation of the reason for the delayed filing
- Recipients and subrecipients taking advantage of this extension would still qualify as a “low-risk auditee”, assuming all other requirements are met

Other Federal COVID-19 Activities

- Congress made appropriations under several acts to address the COVID-19 pandemic
- Coronavirus Aid, Relief, and Economic Security (CARES) Act includes
  - Paycheck Protection Program (SBA) – loans to businesses and NFPs
  - Provider Relief Fund (DHHS) – payments to hospitals, nursing homes and other health care providers
  - Educational Stabilization Fund (DOE) – grants to states, local school districts and institutions of higher education
  - Coronavirus Relief Fund (U.S. Treasury) – payments to state, local and tribal governments

Other Federal COVID-19 Activities

- As the pandemic continues, auditors should be alert to additional actions by Congress after the release date of the 2020 Compliance Supplement
- Federal agencies may have incorporated COVID-19 funding into an existing program and CFDA number or set up a separate COVID-19 program with a unique CFDA number
- Federal agencies are required to specifically identify COVID-19 awards, regardless of whether the funding is provided under a new or existing CFDA number

Other Federal COVID-19 Activities

- When COVID-19 funds are subawarded from an existing program, the information furnished to subrecipients should distinguish the subawards of incremental COVID-19 funds from non-COVID-19 subawards under the existing program

New COVID-19 Programs

- The Coronavirus Aid, Relief, and Economic Security (CARES) Act and other legislation provided funding for new programs and additional funding for existing programs
- The Paycheck Protection Program (PPP) is the only program not subject to single audit
- Although PPP may be issued a CFDA #, it is not included on the SEFA

New COVID-19 Programs

- In order to assist recipients and auditors in the identification of all the COVID-19 funds and their related program CFDA numbers, OMB published a listing of the COVID-19 programs along with their CFDA numbers in the following link under "Guidance, Policies and Resources"
  - https://www.cfo.gov/financial-assistance
- An asterisk (*) by the CFDA number denotes a new CFDA number

Provider Relief Fund

- Provider Relief Fund (PRF) expenditures and lost revenue were not to be reported on the SEFA until December 31, 2020 year-ends and later (before 6/30/21)
- The PRF Reporting Portal is not yet open to accept submissions
- Thus, December 31, 2020 and later (before 6/30/21) year-end single audits which include PRF cannot yet be completed
- Anticipating guidance for June 30, 2021 and thereafter in the 2021 Compliance Supplement

COVID-19 Vaccines

- DHHS determined that COVID-19 vaccines provided by the federal government to nonfederal entities, including NFPs, are not considered federal financial assistance
  - Should not be reported on the SEFA nor included in the scope of a single audit

American Rescue Plan Act

- Funding for both new and existing federal programs
- Potential implications to single audits not yet known
- Federal agencies currently establishing program policies, including subjectivity to a single audit
- NFPs that receive Shuttered Venue Operators Grant will be subject to single audit

AICPA GAQC Nonauthoritative Guidance

- There has been much confusion as to when to report costs incurred (or lost revenue, if applicable) on the SEFA
- Due in part to the short time between the passage of the CARES Act and the receipt of funding by NFPs, sometimes before award terms and conditions were established
- Also because some programs allow costs to be charged both before and after the award was made

AICPA GAQC Nonauthoritative Guidance

- In February 2021, GAQC issued ”GAQC Nonauthoritative Guidance on the Reporting of Certain COVID-19 Awards on an Accrual Basis SEFA”
  - Available on the GAQC website
- Provides illustrative scenarios to assist in determining which fiscal year to report costs incurred on an accrual-basis SEFA

AICPA GAQC Nonauthoritative Guidance

- GAQC updated its “GAQC Summary of Uniform Guidance (UG) Applicability for New COVID-19-Related Federal Programs” as of February 16, 2021
  - Available on the GAQC website
- Provides guidance regarding the applicability of the UG to specific federal programs
- Does not apply to single audits of the Provider Relief Fund

2020 Single Audit Challenges

- Since COVID-19 funds were released very quickly, many federal agencies have developed new audit requirements
  - Has led to numerous questions and uncertainty
  - The result will be significant challenges for the 2020 single audits
  - Documentation of key decisions by both auditees and auditors is more critical than ever

2020 Single Audit Challenges

- Many more single audits than in previous years
  - Many states and large local governments received significant amounts of Coronavirus Relief Funds directly from the federal government
  - These recipients may have passed these funds down to smaller entities that may not have had single audits in prior years
  - Other funding through the CARES Act to existing CFDA numbers may take recipients over the $750,000 threshold

2020 Single Audit
Planning and Performance Considerations

- Clients may receive funding for new programs under the CARES Act
  - These programs may have new compliance requirements
- Understand how the client is addressing the challenge of new CARES Act money covering expenses already incurred
- Consider whether audit work will need to be performed remotely due to COVID-19 restrictions

2020 Single Audit
Planning and Performance Considerations

- Determining whether a nonfederal entity has funding under new COVID-19 programs that are subject to single audit is important
  - Critical to major program determination
  - May affect Type A/B program determination
  - New COVID-19 programs may be high-risk Type A programs because they have not been audited before
  - New COVID-19 programs could also be Type B
    - In evaluating risk, need to consider the newness of the programs
    - Currently, no requirement to select these Type B programs for audit nor to consider them high risk

2020 Single Audit
Planning and Performance Considerations

- Type A programs that might have been low risk would be impacted by changes in personnel and systems due to COVID-19 funding or moving to a remote environment
- Remember that inherent risk may not be considered in type A risk assessment
  - Inherent risk may be considered in type B risk assessment

2020 Single Audit
Planning and Performance Considerations

- Auditors will need to identify whether the client's existing programs have compliance requirements subject to audit that have been revised
  - Discuss with clients about how they are identifying changed requirements

2020 Single Audit
Planning and Performance Considerations

- Testing completeness of the SEFA will be especially important this year
  - Recipients should separately present COVID-19 relief funds on the SEFA
  - Programs and amounts may be harder to identify
- Issues may arise relating to client documentation evidencing compliance due to COVID-19 shutdowns or operating changes

2020 Single Audit
Planning and Performance Considerations

- Pay special attention to internal controls over compliance
  - New awards, as well as a switch to a more work-from-home environment, may have introduced changes to clients’ internal controls over their federal awards

2020 Single Audit
Planning and Performance Considerations

- Making certain that findings include all required elements is more important this year
  - Potentially more findings this year due to COVID-19 funding
  - Likely focus by federal agencies on COVID-19 findings follow-up
- Testing for “double dipping”, i.e., costs paid with federal CARES Act programs must not also be charged to current federal awards

Changes to the Auditor’s Report on Financial Statements

- Statement on Auditing Standards No. 134, *Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements*
- Original effective date was for audits of financial statements for periods ending on or after December 15, 2020, with early implementation not permitted

Changes to the Auditor's Report on Financial Statements

- Due to the effect of the coronavirus pandemic, SAS No. 141, *Amendment to the Effective Dates of SAS Nos. 134-140,* was issued, delaying the effective date by one year, to periods ending on or after December 15, 2021
- Early implementation is no longer precluded (SASs 134, 136-137, 139-140)
  - ASB recommends that SASs 134-140 be implemented concurrently
- AICPA issued two versions of *Professional Standards*, one for auditors that early implement and one for auditors that do not early implement

Changes to Compliance Audits

- Statement on Auditing Standards No. 140, *Amendments to AU-C Sections 725, 730, 930, 935, and 940 to Incorporate Auditor Reporting Changes From SAS Nos. 134 and 137*
- SAS No. 140 conforms AU-C Section 935, *Compliance Audits,* to SAS No. 134 and provides an illustrative combined report on compliance and internal control over compliance
- Original and delayed effective dates and early implementation the same as for SAS No. 134

Changes to Compliance Audits

- In addition, SAS No. 140
  - Revises the definition of *material noncompliance* to align with the description of *materiality* in SAS No. 138
  - Presents requirements for a combined report on compliance and internal control over compliance as the default form of report, followed by requirements addressing when the auditor chooses to issue separate reports on compliance and internal control over compliance
  - Updates references to *OMB Circular A-133* to refer instead to the *Uniform Guidance* and addresses changes in the OMB Compliance Supplement and the most recently issued Yellow Book
  - Updates the appendix, "AU-C Sections That Are Not Applicable to Compliance Audits"

AICPA Audit Guide

- AICPA Audit Guide, *Government Auditing Standards and Single Audits*
- Published annually; 2020 is the latest edition
  - 2021 edition expected during the summer
- Incorporates
  - 2018 revision of *Government Auditing Standards*
  - Concepts introduced in the 2019 *Compliance Supplement*
    - Six-requirement mandate
    - Internal control
- Does not include any COVID-19 considerations

AICPA Audit Guide

- Report illustrations
  - Slight updates to the Yellow Book report illustrations to reflect changes needed for the 2018 Yellow Book
  - No changes to the text of the single audit report illustrations; updates to certain report footnotes
- Includes an appendix with summary information on SAS Nos. 134-141

AICPA Audit Guide

- Updated report illustrations for financial statement reports, Yellow Book reports and single audit reports are being developed, to reflect the new AICPA reporting requirements
  - Will be incorporated into the 2021 Audit Guide

Revision to Government Auditing Standards ("Yellow Book")

- The 2018 revision of *Government Auditing Standards* is effective for financial audits, attestation engagements and reviews of financial statements for periods ending on or after June 30, 2020

Revision to Government Auditing Standards ("Yellow Book")

- Areas with significant changes or clarifications
  - New format and organization
  - Nonaudit independence requirements
  - CPE
  - Peer review
  - Internal control
  - Waste and abuse
  - Reviews of financial statements

Revision to Government Auditing Standards ("Yellow Book")

- Subsequent technical update to the 2018 Yellow Book
  - Changes reference in 3.83 from "skills, knowledge, <u>and</u> experience" to "skills, knowledge, <u>or</u> experience"

New Audit Report Standards – SAS No. 134

Allen L. Fetterman, CPA, MBA

Introduction

- SAS No. 134, *Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements*
- Original effective date was for audits of financial statements for periods ending on or after December 15, 2020, with early implementation not permitted
- In light of the effect of the coronavirus pandemic, SAS No. 141, *Amendment to the Effective Dates of SAS Nos. 134-140*, was issued, delaying the effective date by one year, to periods ending on or after December 15, 2021
- Early implementation is no longer precluded
  - ASB recommends that SASs 134-140 be implemented concurrently

Overview of Changed AU-C Sections

- Supersedes the following sections of SAS No. 122
  - Section 700, *Forming an Opinion and Reporting on Financial Statements*
  - Section 705, *Modifications to the Opinion in the Independent Auditor's Report*
  - Section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*
- Adds a new Section 701, *Communicating Key Audit Matters in the Independent Auditor's Report*

Overview of Changed AU-C Sections

- Amends the following sections of SAS No. 122
  - Section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*
  - Section 210, *Terms of Engagement*
  - Section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*
  - Section 230, *Audit Documentation*
  - Section 240, *Consideration of Fraud in a Financial Statement Audit*
  - Section 260, *The Auditor's Communication With Those Charged With Governance*

Overview of Changed AU-C Sections

- Section 300, *Planning an Audit*
- Section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*
- Section 320, *Materiality in Planning and Performing an Audit*
- Section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*
- Section 450, *Evaluation of Misstatements Identified During the Audit*
- Section 510, *Opening Balances – Initial Audit Engagements, Including Reaudit Engagements*
- Section 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*

Overview of Changed AU-C Sections

- Section 600, *Special Considerations – Audits of Group Financial Statements*
- Section 910, *Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country*

- Amends SAS No. 132, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*
  - Particular attention should be paid to amendments to AU-C Section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*

Communications Impacted

- SAS No. 134 will impact the following communications
  - Auditor's report on the financial statements
  - Engagement letter
  - Management representation letter
  - Auditor's communication with those charged with governance

Changes to the Auditor's Report on Financial Statements

- The "Opinion" section will be presented first, followed by the "Basis for Opinion" section
- The "Basis for Opinion" section will include a statement that the auditor is required to be independent of the entity and to meet other ethical responsibilities
- Provides a framework for auditors of nonissuers to communicate key audit matters (KAM). Although communication of KAM is not required for audits of nonissuers, if the terms of the engagement include reporting KAM, the auditor would be required to follow the new AU-C Section 701
  - Communicate in a separate "Key Audit Matters" section

Changes to the Auditor's Report on Financial Statements

- Expands the description of the responsibilities of management for the financial statements to include management's responsibility to evaluate whether there are conditions or events that raise substantial doubt about the entity's ability to continue as a going concern
- Expands the description of the responsibilities of the auditor and key features of the audit, including references to the auditor's responsibility to conclude on an entity's ability to continue as a going concern and the auditor's responsibility to communicate with those charged with governance

Illustration of the Auditor's Report For-Profit Entity (Comparative)

An auditor's report on comparative financial statements prepared in accordance with GAAP

Circumstances include the following:

- Audit of a complete set of general-purpose financial statements (comparative) and the audit is not a group audit
- Management is responsible for the preparation of the financial statements in accordance with GAAP
- The terms of the engagement reflect the description of management's responsibility for the financial statements
- The auditor has concluded that an unmodified opinion is appropriate
- Based on the audit evidence obtained, the auditor has concluded that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern
- The auditor has not been engaged to communicate key audit matters

Illustration of the Auditor’s Report For-Profit Entity (Comparative)

Independent Auditor’s Report

Report on the Audit of the Financial Statements [1]

Opinion

We have audited the financial statements of ABC Company, which comprise the balance sheets as of December 31, 2021 and 2020, and the related statements of income, changes in stockholders’ equity, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of ABC Company as of December 31, 2021 and 2020, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Illustration of the Auditor’s Report For-Profit Entity (Comparative)

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor’s Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Illustration of the Auditor's Report For-Profit Entity (Comparative)

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for [*insert the time period set by the applicable financial reporting framework].*

Illustration of the Auditor's Report For-Profit Entity (Comparative)

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users made on the basis of these financial statements.

Illustration of the Auditor's Report For-Profit Entity (Comparative)

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed. **[2]**
- Evaluate the appropriateness of accounting principles used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC Company's ability to continue as a going concern for a reasonable period of time.

Illustration of the Auditor's Report For-Profit Entity (Comparative)

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

Report on Other Legal and Regulatory Requirements

[*The form and content of this section of the auditor's report would vary depending on the nature of the auditor's other reporting responsibilities.* **[3]**

[*Signature of the auditor's firm*]
[*City and state where the auditor's report is issued*]
[*Date of the auditor's report*]

Illustration of the Auditor's Report For-Profit Entity (Comparative)

[1] The subtitle, "Report on the Audit of the Financial Statements" is unnecessary in circumstances in which the second subtitle, "Report on Other Legal and Regulatory Requirements" is not applicable.

[2] In circumstances in which the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the financial statements, omit the following: "but not for the purpose of expressing an opinion on the effectiveness of ABC Company's internal control. Accordingly, no such opinion is expressed."

[3] An example would be "Other Reporting Required by *Government Auditing Standards*", i.e. the GAS report on internal control over financial reporting and compliance.

Illustration of the Auditor's Report Not-for-Profit Entity (Single Year)

An auditor's report on financial statements for a single year prepared in accordance with GAAP when summarized comparative financial information derived from audited financial statements for the prior year is presented

Circumstances are the same as in the first illustration, except

- Audit of a complete set of general purpose financial statements (single year)
- Prior year summarized comparative information derived from audited financial statements is presented

All references to "ABC Company", from the first illustration, should, in this illustration, refer to "XYZ Nonprofit Organization"

Illustration of the Auditor's Report
Not-for-Profit Entity (Single Year)

Opinion

We have audited the financial statements of XYZ Nonprofit Organization, which comprise the statement of financial position as of December 31, 2020, and the related statements of activities and cash flows for the year then ended, and the related notes to the financial statements.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of XYZ Nonprofit Organization as of December 31, 2020, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audit...

Illustration of the Auditor's Report
Not-for-Profit Entity (Single Year)

Responsibilities of Management for the Financial Statements

Auditor's Responsibilities for the Audit of the Financial Statements

Report on Summarized Comparative Information

We have previously audited XYZ Nonprofit Organization's 2019 financial statements, and we expressed an unmodified opinion on those audited financial statements in our report dated May 15, 2020. In our opinion, the summarized comparative information presented herein as of and for the year ended December 31, 2019, is consistent, in all material respects, with the audited financial statements from which it has been derived.

Communicating Key Audit Matters

- AU-C Section 701 provides guidance on the auditor's responsibility to communicate key audit matters in the auditor's report when the auditor is engaged to do so
- It addresses
  - The auditor's judgment about what to communicate
  - The form and content of the communication
- *Key audit matters* are defined as
  - Those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance

Illustration of the Auditor's Report
Key Audit Matters

An auditor's report on comparative financial statements prepared in accordance with GAAP, including communication of key audit matters

Circumstances are the same as in the first illustration, except the auditor has been engaged to communicate key audit matters

Illustration of the Auditor's Report
Key Audit Matters

Opinion

Basis for Opinion

Key Audit Matters

Key audit matters are those matters that were communicated with those charged with governance and, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

[*Description of each key audit matter in accordance with SAS No. 134, Section 701,* Communicating Key Audit Matters in the Independent Auditor's Report]

Communicating Key Audit Matters

- In determining which matters communicated with those charged with governance are key audit matters, the auditor should take into account
  - Areas of higher assessed risk of material misstatement or significant risks identified
  - Areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty
  - The effect on the audit of significant events or transactions that occurred during the period

Communicating Key Audit Matters

- The auditor should describe each key audit matter, using an appropriate subheading, in a separate section of the auditor's report under the heading "Key Audit Matters", unless
  - Law or regulation precludes disclosure about the matter
  - The auditor determines that the matter should not be communicated because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits

Communicating Key Audit Matters

- The description of each key audit matter should include a reference to the related disclosures, if any, in the financial statements and should describe
  - Why the matter was considered to be one of most significance in the audit
  - How the matter was addressed in the audit
- The auditor should not communicate a matter in the "Key Audit Matters" section of the auditor's report when the auditor would be required to modify the opinion as a result of the matter

Communicating Key Audit Matters

- Matters giving rise to a qualified opinion or when substantial doubt exists about an entity's ability to continue as a going concern for a reasonable period of time are, by their nature, key audit matters
- However, these matters should not be described in the "Key Audit Matters" section of the auditor's report
- In these situations, the auditor should
  - Report on these matters in accordance with the applicable AU-C sections
  - Include a reference to the "Basis for Qualified Opinion" or "Going Concern" section in the "Key Audit Matters" section

Communicating Key Audit Matters

- AU-C Section 705 provides that when the auditor expresses an adverse opinion or disclaims an opinion on the financial statements, the auditor's report should not include a "Key Audit Matters" section
- If the auditor determines that there are no (other) key audit matters to communicate, the auditor should include a statement to this effect in the "Key Audit Matters" section of the auditor's report
  - We have determined that there are no key audit matters to communicate
  - Except for the matter described in the Basis for Qualified Opinion section, we have determined that there are no other key audit matters to communicate

Communicating Key Audit Matters

- AICPA SAS No. 140, which updates AU-C Section 935, *Compliance Auditing,* to conform to the changes in SAS No. 134
- Will OMB in the future require the communication of key audit matters
  - In the auditor's report on the financial statements?
  - In the auditor's report on compliance?

Consideration of Going Concern

- If, after considering conditions and management's plans, the auditor concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains, the auditor should include a separate section in the auditor's report, with the heading "Substantial Doubt About the Entity's Ability to Continue as a Going Concern" that
  - Draws attention to the note to the financial statements that discloses
    - The conditions or events identified and management's plans
    - That substantial doubt exists about the entity's ability to continue as a going concern
  - States that the auditor's opinion is not modified with respect to the matter

Illustration of the Auditor's Report Going Concern

Basis for Opinion

***Substantial Doubt About the Entity's Ability to Continue as a Going Concern* [1]**

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations, has a net capital deficiency, and has stated that substantial doubt exists about the Company's ability to continue as a going concern. Management's evaluation of the events and conditions and management's plans regarding these matters are also described in Note X. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

[1] In SAS No. 134, presented immediately after the "Basis for Opinion" section for illustrative purposes.

Consideration of Going Concern

- If adequate disclosure about an entity's ability to continue as a going concern is not made in the financial statements, the auditor should
  - Express a qualified opinion or adverse opinion, as appropriate
  - In the *"B*asis for Qualified" (Adverse) Opinion" section of the auditor's repo*rt,* state
    - *Substantial doubt exists about the entity's ability to continue as a going concern and the financial statements do not adequately disclose this matter.* *or*
    - *Substantial doubt about the entity's ability to continue as a going concern has been alleviated by management's plans but the financial statements do not adequately disclose this matter.*

Consideration of Going Concern

- If management concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time has been alleviated, and the auditor agrees with that conclusion and concludes that management's disclosures are adequate, the auditor should include an "Emphasis of Matter" paragraph in the auditor's report, stating

  As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency. Management's evaluation of the events and conditions and management's plans to mitigate these matters are also described in Note X. Our opinion is not modified with respect to this matter.

Modifications to the Auditor's Report

- When the auditor modifies the opinion on the financial statements, the auditor should
  - Amend the heading "Basis for Opinion" to "Basis for Qualified Opinion", "Basis for Adverse Opinion", or "Basis for Disclaimer of Opinion", as appropriate
- When the auditor expresses a qualified or adverse opinion, the auditor should amend the statement in the "Basis for Opinion" section about whether the audit evidence obtained is sufficient and appropriate to provide a basis for the auditor's opinion, to include the word "qualified" or "adverse", as appropriate

Modifications to the Auditor's Report

- When the auditor disclaims an opinion on the financial statements, the auditor's report should not include
  - A reference to the section of the auditor's report where the auditor's responsibilities are described and
  - A statement about whether the audit evidence is sufficient and appropriate to provide a basis for the auditor's opinion
- Even if the auditor has expressed an adverse opinion or disclaimed an opinion on the financial statements, the auditor should describe the reasons for any other matters of which the auditor is aware that would have required a modification to the opinion, and the effects thereof in the "Basis for Opinion" section

Modifications to the Auditor's Report

- When the auditor disclaims an opinion on the financial statements due to an inability to obtain sufficient appropriate audit evidence, the auditor should include in the "Auditor's Responsibilities for the Audit of the Financial Statements" section of the auditor's report only the following
  - A statement that the auditor's responsibility is to conduct an audit of the entity's financial statements in accordance with auditing standards generally accepted in the United States of America and to issue an auditor's report

Modifications to the Auditor's Report

- A statement that, however, because of the matters described in the "Basis for Disclaimer of Opinion" section of the auditor's report, the auditor was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements
- A statement that the auditor is required to be independent and to meet other ethical responsibilities, in accordance with the relevant ethical requirements relating to the audit

Emphasis-of-Matter and Other-Matter Paragraphs

- An emphasis-of-matter paragraph is required by GAAS or is included at the auditor's discretion, that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's professional judgment, is of such importance that it is fundamental to users' understanding of the financial statements
- An other-matter paragraph is required by GAAS or is included at the auditor's discretion, that refers to a matter other than those presented or disclosed in the financial statements that, in the auditor's professional judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report

The Auditor's Communication With Those Charged With Governance (AU-C 260)

- Requirements for communicating with those charged with governance were modified by adding
  - Significant risks identified in the audit
  - Circumstances that affect the form and content of the auditor's report

Question Regarding Implementation of SAS No. 134

- In October 2019, the AICPA issued Q&A Section 8100.04, *Reporting Guidance Upon Initial Implementation of Statement on Auditing Standards No. 134, as Amended*
  - Q: If a continuing auditor is engaged to perform an audit of comparative financial statements in the first year of implementation of SAS No. 134, is the auditor permitted to express an opinion on all periods presented in one report in accordance with SAS No. 134?
  - A: Yes. The auditor may issue one report that refers to each period, e.g., for the years ended December 31, 2020 and 2019. Alternatively, the auditor may issue two separate reports: one in accordance with SAS No. 134 for the current year (year ended December 31, 2020) and one in accordance with extant AU-C Section 700A for the prior year (December 31, 2019).

Nonprofit Common Financial Reporting Deficiencies

Allen L. Fetterman, CPA, MBA

Statement of Financial Position Required Totals

- Common deficiency: One of the five required totals (assets, liabilities, net assets by class and in total) is missing
  - Most common error - net assets without donor restrictions when category has been subdivided

Board designated	xxx
Net investment in plant	xxx
Operating fund	xxx
Total net assets without donor restrictions	xxx

2

Statement of Financial Position
Assets with Long-Term Restrictions

- Common deficiency: Reporting cash, contributions receivable and other assets restricted for long-term purposes as available for current use
  - Assets received with long-term donor restrictions should be reported separate from assets available for current use

3

Statement of Financial Position
Dues Receivable

- Common deficiency: Reporting dues receivable as an asset
  - Unless an obligation exists – goods or services received by members
- Common deficiency: Reporting dues receivable and deferred revenue
  - Not a receivable under GAAP - unearned

4

Statement of Financial Position
Pledges Receivable

- Common deficiency: Initial recognition of unconditional promises to give is reported net of an allowance for estimated uncollectible amounts
  - Initial promises should be reported at fair value
    - Due in less than 1 year = net realizable value
    - Due in 1 year or longer = net realizable value discounted to present value using a risk-adjusted rate (present value of expected cash flows)

5

Statement of Financial Position
Pledges Receivable

- Example
  - Group of donors promise to give $100,000 all due within 1 year
  - Based on past experience with similar campaigns, entity expects to collect $90,000
  - Amount that should be reported as revenue and receivable is $90,000
  - Allowance is reported only if there are subsequent decreases in the expected collectible amount

6

Statement of Financial Position
Pledges Receivable

- Common deficiency: Reporting conditional pledges as receivables
  - Pledges should not be recognized until the condition has been met

7

Statement of Financial Position
Accounts Receivable

- Common deficiency: Reporting accounts receivable under cost-reimbursement contracts as restricted
  - May be legally limited as to use, but costs have been incurred which were charged to net assets without donor restrictions

8

Statement of Financial Position
Investments

- Common deficiency: Not appropriately measuring investments with no readily determinable fair value
  - Should use the same method for all “other investments”
  - Usually cost

9

Statement of Financial Position
Fund-Raising Costs

- Common deficiency: Fund-raising costs reported as assets or otherwise deferred
  - Fund-raising costs should be expensed as incurred
  - FinREC recommendation with respect to tangible fund-raising assets, e.g., brochures

10

Statement of Financial Position
Board Designated Funds

- Common deficiency: Unrestricted board-designated amounts reported as restricted
  - Board designated amounts should be segregated and displayed within net assets without donor restrictions

11

Statement of Financial Position
Restricted Net Assets

- Common deficiency: Reporting a negative amount in either the total or any sub-part (individual fund or other component disclosed in a note) of restricted net assets
  - Not possible to release more restricted net assets than you started with
  - Overspending of restricted net assets should be charged to net assets without donor restrictions

12

Statement of Financial Position
Classified Balance Sheet

- Common deficiency: Assets are classified (current/noncurrent) but liabilities are not (or vice versa)
  - In a classified balance sheet, both assets and liabilities should be classified between current and noncurrent

Statement of Financial Position
Disaggregated

- Common deficiency: If the statement of financial position is disaggregated by class, reporting an interclass receivable/payable
  - One class of net assets cannot owe money to another class of net assets
  - Interfund receivables/payables are permitted

Statement of Financial Position
Other Issues

- Common deficiency: Displaying deferred revenue as restricted
- Common deficiency: Displaying prepaid expenses or accrued expenses payable as restricted (except for certain investment expenses)

15

Statement of Activities
Required Totals

- Common deficiency: One of the three required totals (change in net assets by class and in total) is missing
  - Be careful with comparative totals for the prior year
  - May not contain sufficient information to be in conformity with GAAP

16

Statement of Activities
Contributions

- Common deficiency: Reporting contribution revenues related to pledges receivable due in future periods as unrestricted
  - Revenue related to pledges due in future periods should be reported as restricted unless the donor stipulates (or circumstances indicate) that the contribution is intended to support the activities of the current period, in which case it would be reported within net assets without donor restrictions

17

Statement of Activities
Restricted Contributions

- Common deficiency: Not properly releasing net assets from restrictions
  - Net assets restricted for specific purposes should be released from restrictions before spending net assets without donor restrictions on the same purpose
  - Exception for cost-reimbursement contracts where following the above would result in a loss of revenue

18

Statement of Activities
Net Assets Released From Restrictions

- Common deficiency: Releasing net assets that are subject to both a time and a purpose restriction when one, but not the other, restriction is met
  - Net assets should not be released from restriction until all restrictions are met

19

Statement of Activities
Gifts-In-Kind

- Common deficiency: Not reporting in-kind contributions
  - Revenues from in-kind gifts should be reported
  - Includes free or below market rent, services, supplies, etc.

20

Statement of Activities
Contributed Services

- Common deficiency: Reporting contributed services that do not meet GAAP criteria for recognition or not recording contributed services that do meet the criteria
  - If services meet the criteria, they should be recorded at fair value
  - Simply choosing not to report contributed services is not in conformity with GAAP
  - Different recognition and measurement criteria for donated services received from an affiliate

21

Statement of Activities
Revenues from Cost-Reimbursement Contracts

- Common deficiency: Recognizing revenues and receivables from cost reimbursement contracts for which costs have not yet been incurred
  - Generally, revenues are conditional upon incurring related costs
  - Revenues are recognized as costs are incurred

22

Statement of Activities
Exchange Transactions

- Common deficiency: Reporting revenues from exchange transactions as increases in net assets with donor restrictions
  - Only contributions may be restricted (by donors)
  - Exchange transactions are not contributions
  - Revenues from exchange transactions with a legal or contractual restriction should be reported as an increase in net assets without donor restrictions
    - Restriction should be disclosed in the notes

23

Statement of Activities
Exchange Transactions

- Common deficiency: Reporting revenues and related expenses from fund-raising events, gift shop sales, etc. as a single net amount
  - Amounts need to be reported gross except for
    - Investment revenues and related expenses
    - Peripheral activities
  - Flexibility in presentation permitted

24

Statement of Activities
Investment Return

- Common deficiency: Reporting investment return (income and gains) from perpetual endowments as a change in the perpetual endowment and then transferring the return to some other line within net assets with donor restrictions or to net assets without donor restrictions
  - All investment return should be reported directly in the net asset class stipulated by the donor or law

25

Statement of Activities
Expenses

- Common deficiency: Aggregating functional expenses that should be reported separately
  - Most entities should have at least one program and management and general
  - Many will have fund raising

26

Statement of Activities
Expenses

- Common deficiency: Reporting depreciation, interest and occupancy as functional expenses rather than as natural expenses
  - These items should be allocated to functions
  - Occupying and maintaining a building is not a separate supporting service

27

Statement of Activities
Expenses

- Common deficiency: Reporting advertising for program services for which fees are charged as a program expense
  - The costs of soliciting funds other than contributions are management and general
    - Including the costs of soliciting government contracts, the revenues from which are treated as exchange transactions
  - The costs of soliciting contributions, including costs of soliciting contributed services that do not meet the recognition criteria, are fund-raising expenses

28

Statement of Activities
Expenses

- Common deficiency: Reporting expenses within net assets with donor restrictions
  - All expenses should be reported as decreases in net assets without donor restrictions
    - Exception for netted investment expenses
  - Losses may be reported in any class (investment loss, bad debt loss)

29

Statement of Activities
Reclassifications

- Common deficiency: Reclassifying amounts into restricted net assets
  - Exceptions
    - Donor imposes a restriction on otherwise unrestricted net assets
    - Donor changes the nature of a restriction in a year subsequent to the gift
    - Correction of an error

30

Statement of Activities
Change in Net Assets

- Common deficiency: Reporting an amount below "change in net assets" other than beginning and ending net asset balances
  - Change in net assets is the "bottom line"

31

Analysis of Expenses

- Common deficiency: Not including the required analysis of expenses by nature and by function in one place
  - All NFPs are required to present this analysis

32

Analysis of Expenses

- Common deficiency: Not including all expenses in the analysis of expenses
  - Expenses on the statement of activities netted against revenues or included in cost of goods sold or direct cost of donor benefits
  - The only exception is for investment expenses, which are netted against investment revenues

33

Analysis of Expenses

- Common deficiency: Not allocating expenses to management and general
  - General management, record keeping, finance and other administrative activities should be management and general
  - The following are almost always M&G: accounting, audit, bookkeeping
  - Direct program oversight should be program

34

Analysis of Expenses

- Common deficiency: Over-allocating to management and general
  - It is inappropriate to automatically include all occupancy, depreciation, insurance, etc. in management and general
  - If salaries are reported in a specific function, then it is improbable that no employee benefits or occupancy expense is allocated to that function

35

Analysis of Expenses

- Common deficiency: Not presenting the same expense breakdown on the analysis of expenses as on the statement of activities
  - The analysis of expenses should present each functional or natural expense category shown on the statement of activities

36

Statement of Cash Flows

- Common deficiency: Reporting long-term contributions, i.e., gifts restricted to perpetual endowment or the acquisition of plant, as operating activities
  - Contributions restricted to perpetual endowment and acquisition of plant are financing activities

37

Statement of Cash Flows

- Common deficiency: Reporting purchases and sales of investments as a net amount
  - Proceeds from sales of investments and costs of purchases of investments should be reported gross
- Common deficiency: Reporting borrowings and repayments of long-term debt as a net amount
  - Proceeds from borrowings and repayments should be reported gross

38

Statement of Cash Flows

- Common deficiency: Reporting bank overdrafts as operating activities
  - Bank overdrafts are financing activities, similar to proceeds from loans from banks

39

Statement of Cash Flows

- Common deficiency: Not disclosing noncash financing and investing transactions, e.g., receipt of donated fixed assets, acquisition of real property where the seller takes back a mortgage, acquisition of equipment through a capital lease, forgiveness of debt
  - Should be disclosed on the face of the statement of cash flows

40

Statement of Cash Flows

- Common deficiency: Reporting noncash items, e.g., gain or loss on sale of assets, increase in the cash surrender value of life insurance, as investing activities
  - Only the underlying cash transactions should be reported as investing activities

41

Statement of Cash Flows

- Common deficiency: Reporting board-designated amounts as cash flows
  - Board designations of net assets without donor restrictions do not result in cash flows

42

Statement of Cash Flows

- Common deficiency: If the indirect method is used, not disclosing interest paid and taxes paid as supplemental information
  - Interest paid might not be the same amount as interest expense

43

Notes to Financial Statements

- Common deficiency: Failure to disclose an adequate description of the entity's activities, including each major class of program
- Common deficiency: The accounting policy note describes a policy being followed which is not in conformity with GAAP and the note does not indicate that the departure does not have a material effect on the financial statements

44

Notes to Financial Statements

- Common deficiency: Failure to include the required disclosure for summarized financial information
- Common deficiency: Failure to disclose the capitalization policy for property, plant and equipment
- Common deficiency: Failure to disclose information about the nature of restrictions on net assets and the nature of board-designated net assets
- Common deficiency: Failure to disclose total fund-raising expenses

45

Notes to Financial Statements

- Common deficiency: Failure to disclose a description of the methods used to allocate costs among program and support functions
- Common deficiency: Failure to disclose whether investment income and related gains are classified as without donor restrictions if the restrictions are met within the same year if a similar policy exists for contributions
- Common deficiency: Failure to disclose concentrations of risk, such as geographic area, funding source, market segment, investments

46

Notes to Financial Statements

- Common deficiency: Failure to disclose information about significant accounting policies from exchange transactions including the credit quality of financing receivables and the allowance for credit losses
- Common deficiency: Failure to disclose material subsequent events
- Common deficiency: Failure to disclose material related party transactions, including with officers, board members, substantial donors and their immediate family members

47

Notes to Financial Statements

- Common deficiency: Failure to include all required disclosures about
  - Unconditional promises to give (pledges) receivable: present value discount, discount rate used, allowance for uncollectible, maturity by years, information about conditional pledges
  - Joint costs of multipurpose activities: types of activities involved, statement that such costs have been allocated, total amount allocated and the portion allocated to each function (encouraged but not required: amount of joint costs for each kind of joint activity)

48

Notes to Financial Statements

- Common deficiency: Failure to include all required disclosures about
  - Donated services of volunteers: nature and extent of contributed services received, description of the activity(ies) involved, amount recognized (encouraged but not required: information about contributed services received but not recognized). For services that are not recognized, the reason should be stated, e.g., does not meet recognition criteria under GAAP, no objective value can reasonably be determined
  - Endowment funds

49

Matters of Style and Preference

- All financial statements
  - Avoid "miscellaneous" caption as much as possible

50

Matters of Style and Preference

- Statement of financial position
  - If the entity owns significant fixed assets, it may be helpful to users to disaggregate "investment in plant" as part of net assets without donor restrictions
  - This caption should usually equal fixed assets less related long-term debt

51

Matters of Style and Preference

- Statement of financial position
  - It would be unusual to designate an amount of net assets without donor restrictions such that the resulting undesignated portion is negative

52

Matters of Style and Preference

- Analysis of expenses by nature and function
  - Try to keep the number of lines to a minimum
  - A subtotal before depreciation adds nothing to the understanding of the statement
  - Avoid large “other” or “miscellaneous” expense lines

53

Matters of Style and Preference

- Statement of cash flows
  - The direct method is generally more likely to be understood by users than the indirect method

54

Nonprofit Audit Risk Alert

Allen L. Fetterman, CPA, MBA

What is the Audit Risk Alert?

- Provides auditors of not-for-profit entities (NFPs) with an overview of recent economic, industry, technical, regulatory and professional developments that may affect the audits and other engagements they perform
- Can also be used by an NFP's management to address areas of audit concern
- As an *other auditing publication*, it has no authoritative status; however, it may help the auditor understand and apply generally accepted auditing standards

Contents of the Audit Risk Alert

- How this alert helps you
- Economic and industry developments
- Legislative and regulatory developments
- Audit and attestation issues and developments
- Accounting issues and developments
- Recent pronouncements
- On the horizon
- NFP Initiatives
- Resource central
- Appendix – additional Internet resources

How the Alert Helps the Auditor

- Helps auditors plan and perform audits of NFPs
- Provides information to assist in achieving a more robust understanding of the business, economic and regulatory environments in which NFPs operates
- Helps identify the significant risks that may result in the material misstatement of financial statements
- Delivers information about emerging practice issues and current accounting, auditing and regulatory developments

How the Alert Helps the Auditor

- The auditor should understand the meaning of *audit risk* and the interaction of audit risk with the objective of obtaining sufficient appropriate audit evidence
- Auditors obtain audit evidence to draw reasonable conclusions on which to base their opinion by performing
  - Risk assessment procedures
  - Further audit procedures
    - Tests of controls, when required by GAAS or when the auditor chooses to do so
    - Substantive procedures that include tests of details and substantive analytical procedures

How the Alert Helps the Auditor

- The auditor should develop an audit plan that includes the nature and extent of planned risk assessment procedures
- *Risk assessment procedures* are audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and relevant assertion levels

How the Alert Helps the Auditor

- As part of obtaining the required understanding of the entity and its environment, the auditor should obtain an understanding of the industry, regulatory and other external factors relevant to the entity
- The alert assists the auditor in the risk assessment process and expands the auditor's understanding of other important considerations relevant to the audit

Economic and Industry Developments

The Current Economy

- When planning and performing an audit, an auditor should understand both the general and specific economic conditions facing the industry in which the client operates
- Economic activities relating to factors such as interest rates, availability of credit, consumer confidence, overall economic expansion or contraction, inflation, real estate values and labor market conditions are likely to affect an entity's business and, therefore, its financial statements

The State of NFPs

- The full effects of the COVID-19 pandemic are yet to be seen
- Operating during this crisis has been and continues to be challenging for many NFPs
  - Increase in demand for services
  - Loss of staff
  - Staff working remotely
  - Change in internal controls
  - Change in fund-raising plans, with many taking their events online

The State of NFPs

- The U.S. government took unprecedented action to provide funding to individuals, businesses and NFPs
- NFPs needed to figure out the funding: availability, compliance and accounting
- Although 2021 began with some optimism, uncertainty remains
- Auditors should continue to monitor the impacts of economic trends (local, regional and national) on audit risk throughout the year, as more information becomes available

COVID-19 Impact on NFPs

- NFPs should assess the effects of the pandemic on the following major areas
  - Technology
  - Resources
  - Program services
  - Workforce
  - Internal control

COVID-19 Impact on NFPs
Technology

- Flexible and remote working arrangements became essential to continued operations for many NFPs during the pandemic
- Remote work presents unique challenges, particularly for information security controls, because remote work environments do not usually have the same safeguards as office environments
- When people and computers leave the office and work remotely, new risks arise for the organization and additional security policies become necessary

COVID-19 Impact on NFPs
Technology

- Information security and remote working best practices NFPs should consider
  - Establishing and communicating remote work security policies, e.g., avoiding public wireless networks and use of personal devices to store or process work information
  - Addressing authorization and authentication of information
  - Ensuring employees are aware of current phishing and malware campaigns
  - Securing communication channels
  - Providing vigilant IT support
  - Encrypting sensitive data

COVID-19 Impact on NFPs
Resources

- Many sources of revenue have been affected by the pandemic
  - Special events canceled
  - Schools closed
  - Uncollectible pledges
  - Decline in membership
  - Decline/changes in government funding
- NFPs are faced with how to continue to provide services with less resources
- NFPs must consider the impact of the reduction in resources on the financial viability of the organization, both in the short term and the long term

COVID-19 Impact on NFPs
Resources

- NFPs with going concern issues have had to immediately assess their current situation and create financial plans going forward, including
  - Taking strategic cost-saving measures
  - Increasing spending from endowments
  - Using board-designated funds
  - Asking donors to reclassify restricted contributions for general operations

COVID-19 Impact on NFPs
Program Services

- NFPs that provide direct services, e.g., health and human service organizations, have seen increased demand for those services
- However, their ability to provide those services has been hampered due to the impact of COVID-19
  - Reduction in funding
  - Staff who were sick, quarantined or working remotely
  - Inability to obtain personal protective equipment in a timely manner
- Many NFPs had to close certain programs because it was impractical or impossible to provide the services

COVID-19 Impact on NFPs
Workforce

- Many NFPs provide services, which tend to be labor intensive
- At the beginning of the pandemic, many NFPs were not set up for remote work and had difficulty transitioning
- Flexibility and a focus on security and communication were critical, as well as the health, safety and well-being of staff
- Challenges included staff retention and recruitment, as budget cuts impacted compensation, benefits and staffing plans
- For NFPs that are hiring, recruitment and onboarding processes have had to be conducted remotely

COVID-19 Impact on NFPs
Internal Control

- Remote work environments have brought changes to internal control systems, increasing risk in these areas
- Many NFPs have had to reevaluate existing controls for unintended gaps and have needed to design and implement new or mitigating controls
- Updates to existing policies and creation of new policies have been needed to accommodate adjustments in roles and responsibilities, new funding sources, changes in IT, etc.

COVID-19 Impact on NFPs
Internal Control

- The challenge of maintaining an appropriate segregation of duties was magnified by the pandemic environment
  - The virtual work environment has necessitated changes in processes and duties
- Management needs to consider
  - Who holds physical custody of assets
  - Who is responsible for recordkeeping for assets
  - Who can authorize and approve transactions
- Management needs to ensure that these functions remain separate

COVID-19 Impact on NFPs
Internal Control

- Thorough explanations and supporting documentation for management estimates, including assumptions and methodologies applied, will be more important given the heightened risk in areas such as asset impairment, debt covenants and assessments of an entity's ability to continue as a going concern
- Detailed recordkeeping also will be necessary for any COVID-19-related funding received and costs incurred

Remote Work Risks
Data Management

- Data is arguably an organization's most important asset
- Organizations must maintain the confidentiality, integrity and availability of critical, sensitive and proprietary data
- When data is housed solely on an internal network, controls to protect the data are relatively simple and manageable
  - Organizations generally know where the data is, how it is accessed and by whom
- With the move to more remote work, managing data becomes more complex

Remote Work Risks
Data Management

- Staff members may, without malicious intent, implement applications to increase productivity or to fill a need that they are not getting from their IT department
- If organizations do not know what technologies staff are implementing, they cannot secure it
  - The staff member could be unknowingly exposing organization data to outsiders

Remote Work Risks
Physical Device Management

- When systems are connected to an organization's network, it is easier for the IT department to apply controls and investigate and resolve discrepancies
- When devices leave the managed network, implementing and monitoring controls may be more difficult
- Organization-owned devices are usually equipped to meet baseline security standards
- However, personal devices may be unsecured, may not have anti-malware protection, may not be updated and may not be encrypted

Remote Work Risks
Physical Device Management

- The risk of loss of the confidentiality and integrity of data grows if devices are shared with other members of the staff member's household, e.g., children attending school virtually or using the devices for recreational purposes
- The use of public wireless or home networks by staff members to access organization resources further increases the risk

Remote Work Risks
Risk of Misstatement

- If unmanaged, these risks could significantly affect not only the general security of the organization and its data, but also its financial statements
- If an organization does not know where its data is and/or fails to secure it, that data may be vulnerable to exploitation and compromise via malware, ransomware and other forms of corruption or loss
- All of these risks tie to the financial statements
- If the data is unrecoverable and cannot be recreated, information presented on the financial statements may be inaccurate or incomplete

Remote Work Risks
Meeting the Challenge

- Organizations should measure their risk by defining who is working remotely and how and why they are accessing and storing data via applications, hardware and other technology
- Once this assessment is completed, controls can be monitored and enforced
- When enforcement and centralization are not possible, enhanced acceptable use policies and increased training and awareness may be necessary to ensure that end users understand their role in securing the organization's data

Remote Work Risks
Meeting the Challenge

- Organizations should plan for the inevitable
- Organizations should ensure that their incident management policies and procedures support timely identification, containment and resolution when remote data, applications or systems are compromised

Remote Work Risks
Financial Statement Audits

- Organizational shifts to remote working environments may prompt audit teams to consider remote risks when evaluating the technology controls over financial reporting
- Additional testing may be necessary

Disclosure of Risks and Uncertainties
Arising From the COVID-19 Pandemic

- The COVID-19 pandemic has already had sweeping effects on NFPs, but much uncertainty remains
- For many organizations, there may be future risks and uncertainties that are relevant to GAAP-based financial statement users
- Management will need to determine whether the COVID-19 pandemic has created disclosable circumstances that exist as of the date the financial statements are issued, or available to be issued, and whether they are expected to continue into the future

Disclosure of Risks and Uncertainties Arising From the COVID-19 Pandemic

- NFPs and their auditors will need to consider how these future risks and uncertainties might affect the NFP's GAAP-based financial statements and the accompanying independent auditor's report

Managing the Ransomware Threat

- Ransomware is malicious software that blocks access to a system or data until a sum of money is paid
- Cyberattackers have become more numerous, more persistent and cunning enough to make incident prevention alone an inadequate strategy
- Most security experts agree that it's no longer a question of whether an attack will occur and succeed, but when
- Organizations can take steps to minimize the effects of an attack

Managing the Ransomware Threat

- Cyber resilience is a concept that draws together practices related to security, disaster recovery, business continuity and incident response into a comprehensive readiness and response strategy aimed at minimizing the damage when an incident occurs
- Organizations should proactively manage the risk because waiting until a ransomware event occurs can be catastrophic
- Educating management on the risk could help get appropriate resources allocated to help the organization prepare

Fiscal Sponsorships

- With many NFPs and programs in distress as a result of the pandemic, the important needs they serve are at risk
- Fiscal sponsorship is one option for saving programs when the NFPs that operate them cannot be saved
- A fiscal sponsorship is an arrangement between an NFP with 501(c)(3) tax-exempt status (the sponsor NFP) and another party without tax-exempt status
- Often, the other party is an organization, group or individual that wants to conduct a charitable project or activity

Fiscal Sponsorships

- The fiscal sponsorship should conform to IRS criteria
  - Contributions are given to a 501(c)(3) organization (the sponsor NFP) that accepts responsibility for the funds for a project or activity that does not have tax-exempt status
  - The sponsor NFP uses the funds for a project or activity that furthers the sponsor NFP's tax-exempt purpose
  - The sponsor NFP retains discretion and control of the funds, i.e., variance power
  - The sponsor NFP maintains adequate records to substantiate the use of the funds for tax-exempt purposes

Fiscal Sponsorships

- The sponsor NFP accounts for the sponsored project or activity as one of its own activities
  - The assets and liabilities of the sponsored project or activity are reported on the sponsor NFP's balance sheet
  - The contributions and other revenues and expenses are reported on the sponsor NFP's statement of activities
  - Usually the contributions received for the sponsored project or activity are donor restricted

Fiscal Sponsorships

- A fiscal sponsorship arrangement is different from a fiscal agency arrangement, in which the NFP serving as agent receives and disburses funds on behalf of another party's project or activity
  - The NFP serving as agent has no variance power over how the funds are disbursed
  - Contributions are tax deductible only if the other party is a tax-exempt organization
  - The NFP serving as agent records the assets received on its balance sheet with an offsetting agency liability
  - The NFP serving as agent does not record any revenues or expenses for the activity, except for any fees received for providing the service

Legislative and Regulatory Developments

PPP Loan Forgiveness and Form 990

- According to the instructions for Form 990, Schedule A, updated on December 10, 2020, organizations may report forgiven PPP loan amounts on line 1 as contributions from a governmental unit in the tax year when the amounts are forgiven
- Therefore, this should not cause an otherwise qualifying public charity to fail to meet the public support tests

Audit and Attestation Issues and Developments

Auditing in a COVID-19 Environment
Performing Effective Remote Audits

- As the COVID-19 pandemic hit the U.S., a new way of conducting fieldwork became an immediate necessity
- Firms had to quickly pivot and adjust standard operating procedures to ensure that audit quality was maintained
- Performing virtual and remote audits may extend into the foreseeable future
- Audit procedures should be designed to uphold audit quality and adhere to audit standards

Auditing in a COVID-19 Environment
Performing Effective Remote Audits

- Use available technology
  - Turning computer cameras on during all virtual meetings allows auditors to read body language and guage nonverbal clues
  - Making it convenient for clients to scan and upload documents to the audit firm's secure portal can be beneficial in compiling audit evidence
  - Using screen sharing and video conferencing to replicate certain work environments and gain comfort about documentation legitimacy, e.g., asking a client to hold up a specific piece of supporting documentation so that it can be seen and reviewed

Auditing in a COVID-19 Environment
Performing Effective Remote Audits

- Keep lines of communication open
  - Ongoing communication with clients is critical
  - Build client communication into the audit plan
  - Team-based chat software or private chat rooms segregated by client and engagement team can help to simulate an advantageous working environment
  - Client staff may also be working remotely
    - It will be necessary to build in more time for client staff to scan and organize document selections and deliver them to the audit team

Auditing in a COVID-19 Environment
Performing Effective Remote Audits

- Monitor cybersecurity
  - Increased reliance on technology increases the risk of hackers obtaining private information
  - Auditors should be vigilant when receiving data or email attachments
  - Audit firms should evaluate cybersecurity policies and procedures

Auditing in a COVID-19 Environment
Performing Effective Remote Audits

- Auditing standards require auditors to obtain an understanding of internal controls relevant to the audit
- As NFPs have adjusted operations and employees are substantially working remotely, new systems, controls and documentation procedures have come into play
- Auditors should look at what controls are new, due to the pandemic and client staff working remotely
- Auditors should consider which controls are no longer functioning properly, or at all, in the current environment

Auditing in a COVID-19 Environment
Performing Effective Remote Audits

- Understanding and evaluating internal controls without physically being on-site will require a new way of thinking
- Most of an NFP's employees may continue to work remotely or they may have a hybrid system of both on-site and remote work
- Video conferences with key NFP employees and audit team members likely will be needed to discuss the design of controls, both old and new
- Testing the implementation of controls could still be accomplished in a remote environment via scanning and uploading or screen sharing

Auditing in a COVID-19 Environment
Performing Effective Remote Audits

- However, observing NFP employees applying controls might not be possible in the current environment
- Auditors may need to brainstorm and collaborate with clients to determine how to obtain sufficient evidence about the design and implementation of controls relevant to the audit
- Auditors will also need to assess what new fraud risks may result from the pandemic
  - Consider the “pressure” element of the fraud triangle, e.g., are employees likely to feel entitled to the NFP’s assets due to pay cuts or were furloughed employees disgruntled enough to take actions detrimental to the organization

Auditing PPP Loans

- Some auditors may decide to perform eligibility tests related to a client’s PPP loans based on their risk assessment
- The method that the NFP applies to account for a PPP loan may factor into an auditor’s testing procedures
  - Use of the debt model may reduce the need for extensive eligibility testing because the liability would not be derecognized until is legally released
- Under the conditional contribution model, an NFP might recognize full or partial forgiveness at the balance sheet date, prior to receiving formal forgiveness from the SBA

Auditing PPP Loans

- Auditors that test forgiveness eligibility might conduct procedures such as
  - Recalculating the amount of forgiveness recognized
  - Verifying that the expenditures were allowable and in compliance with SBA requirements
  - Reviewing the forgiveness application for completeness and vouching it to related support for accuracy and cutoff

Asset Impairment Considerations

- Given the duration, severity and economic impact of the pandemic, it is likely that extra care will be needed with respect to impairment assessments, e.g., the COVID-19 environment could affect collectibility and payment terms for receivables
- Auditors will need to apply professional skepticism when evaluating forecasts, underlying assumptions and areas where significant judgment was applied

Going Concern Considerations

- The COVID-19 pandemic may result in a greater number of NFPs experiencing operational deterioration and uncertain financial positions
- These conditions and events, in the aggregate, could raise substantial doubt about an NFP's ability to continue as a going concern for a reasonable period of time
- Auditors must keep the accounting and auditing requirements regarding going concern in mind

New Statements on Auditing Standards

- During 2019 and 2020, the Auditing Standards Board issued Statements on Auditing Standards (SAS) Nos. 134-140
- As amended by SAS No. 141, the new standards are effective for audits of fiscal years ending after December 15, 2021 (calendar year-end 2021 and fiscal year-end 2022 financial statements)
- Early adoption permitted
- Codified in the AU-C sections identified in the SASs
- Current standards have been archived to the pre-SAS No. 134 AU-C sections using their original number plus a suffix "B"

Accounting Issues and Developments

Risk Related to New Accounting Guidance

- Adoption of new accounting guidance and the related implementation of new requirements increase the risk of material misstatement
- Significant accounting changes are areas for increased auditor focus
- Key Accounting Standards Updates (ASUs) becoming effective for NFPs this year and potential auditing considerations are discussed in the “Accounting Issues and Developments” section of the Audit Risk Alert

Assessing the Risk of Material Misstatement of the Financial Statements

- To repeat an earlier slide:
  - As part of obtaining the required understanding of the entity and its environment, the auditor should obtain an understanding of the economic, industry, legislative, regulatory and other external factors relevant to the entity
  - The alert will assist the auditor in the risk assessment process
- In this session, we have reviewed some of these factors
- During an audit, in carrying out this process, we may identify significant risks of material misstatement of the financial statements

Responses

- Some possible audit responses to significant risks of material misstatement include
  - Increasing the extent of audit procedures
  - Performing procedures closer to year-end
  - Modifying audit procedures to obtain more persuasive evidence
- Auditors should remain alert to economic, industry, legislative and regulatory developments as well as auditing and accounting issues
- Auditors should consider changes in the environment throughout the audit and potentially modify audit procedures to ensure that risks are adequately addressed

Tax-Exempt Status – Jeopardizing Activities

Allen L. Fetterman, CPA, MBA

Jeopardizing Tax-Exempt Status

- Section 501(c)(3) organizations may not be used for the private benefit of any individual, nor may their earnings inure to the benefit of insiders
- Section 501(c)(3) organizations may only engage in legislative activities to a limited extent
- Section 501(c)(3) organizations are forbidden to engage in political activities
- A Section 501(c)(3) organization will lose its exempt status if it operates for primary purpose of carrying on an unrelated trade or business

Private Benefit

- An organization must serve a public interest to qualify for exemption under Section 501(c)(3)
- If the organization serves public and private interests, the private benefit must be incidental to the public benefit

Inurement

- No part of a Section 501(c)(3) organization's net earnings may inure to the benefit of a private individual
- Inurement refers to benefits conferred on insiders such as officers, directors or key employees
- Examples of prohibited inurement include unreasonable compensation and the transfer of real or personal property for less than fair market value
- The prohibition on inurement is absolute
  - Any amount of inurement is grounds for loss of tax-exempt status

Inurement

- Prohibited inurement does not include reasonable payments for services rendered or payments made for the fair market value of property

Inurement
Excess Benefit Transactions

- An excess benefit transaction is any transaction between a Section 501(c)(3) or 501(c)(4) organization and a disqualified person in which the economic benefit is greater than the value of the consideration provided for the benefit, e.g., unreasonable compensation for services, a nonfair market value transaction
- A disqualified person is any person, at any time during the 5-year period ending on the date of the transaction, in a position to exercise substantial influence over the affairs of the organization

Inurement
Excess Benefit Transactions

- An excise tax equal to 25% of the excess benefit is imposed on each excess benefit transaction between a tax-exempt organization and a disqualified person
- If the 25% tax is imposed and the excess benefit transaction isn't corrected within the taxable period, an additional excise tax equal to 200% of the excess benefit is imposed on any disqualified person involved

Inurement
Excess Benefit Transactions

- If tax is imposed on a disqualified person for any excess benefit transaction, an excise tax equal to 10% of the excess benefit is imposed on an organization manager who knowingly participated in an excess benefit transaction, unless such participation was not willful and was due to reasonable cause
- An organization manager is any officer, director, or trustee of a tax-exempt organization, or any individual having similar powers or responsibilities, regardless of title

Inurement
Excess Benefit Transactions

- Payments under a compensation arrangement are presumed to be reasonable if the following three conditions are met (rebuttable presumption of reasonableness)
  - The transaction is approved by an authorized body of the entity that is composed of individuals who do not have a conflict of interest concerning the transaction
  - Before making its determination, the authorized body obtained and relied upon appropriate data as to comparability
  - The authorized body adequately documents the basis for its determination concurrently with making the determination

Lobbying

- A Section 501(c)(3) organization may conduct lobbying activities provided they do not comprise a substantial part of its activities
- Lobbying is defined as an attempt to influence legislation
- Influencing legislation is contacting (*direct lobbying*), or urging the public to contact (*grassroots lobbying*), members or employees of a legislative body for the purposes of proposing, supporting or opposing legislation

Lobbying

- The following are not treated as lobbying
  - Nonpartisan analysis and research, public education (public meetings and distributing educational materials) and provision of advice to a governmental body in response to a request
  - Grassroots organizing, litigation and communications between the organization and its members with respect to legislation, unless the communication urges the members to lobby
  - Self-defense lobbying, i.e., communications to legislators regarding the organization's existence or tax-exempt status

Lobbying

- If lobbying activities are substantial, a 501(c)(3) organization risks losing its tax-exempt status and may be subject to an excise tax
- Private foundations are subject to IRS penalties for **any** lobbying activity
- Substantiality is measured by one of the following two tests
  - Substantial part test
  - Expenditure test

Lobbying
Substantial Part Test

- The substantial part test determines substantiality on the basis of all the pertinent facts and circumstances in each case
- The IRS considers many factors, including the time devoted (by both compensated and volunteer workers) and the expenditures devoted to the activity
- This is a very subjective determination
- Under the substantial part test, an organization that conducts excessive lobbying in any taxable year may lose its tax-exempt status and may be subject to an excise tax

Lobbying
Expenditure Test

- Public charities may elect to use the expenditure test under Section 501(h), which is an objective test using formulas to set ceilings for lobbying expenditures, varying from 5% to 20% of exempt purpose expenditures, and capped at $1,000,000
  - Churches and private foundations may not use the expenditure test
- Organizations may elect to use the expenditure test by filing Form 5768 at any time during the year for which it is to be effective
- The election remains in effect until it is revoked by the organization

Lobbying
Expenditure Test

- Section 501(h) establishes *lobbying nontaxable amounts* based on a sliding scale of exempt purpose expenditures for
  - Total lobbying (maximum of $1 million)
  - Grassroots lobbying (25% of total lobbying nontaxable amount)

Lobbying
Expenditure Test

- Exempt purpose expenditures means the total of the amounts paid or incurred (including depreciation and amortization, but not capital expenditures) by an organization for the tax year to accomplish its exempt purposes, including
  - Administrative expenses paid or incurred for the organization's exempt purposes
  - Amounts paid or incurred for the purpose of influencing legislation, whether or not the legislation promotes the organization's exempt purposes
- Exempt purpose expenditures do not include fund-raising expenditures

Lobbying Expenditure Test

- Expenditures in excess of either amount of excess lobbying expenditures in any tax year are subject to an excise tax on the greater excess amount
- In addition, an organization may lose its exemption if it spends more than 150% of either of its lobbying nontaxable amounts over a four-year period
- The law imposes a tax on organizations if they no longer qualify under section 501(c)(3) by reason of having made disqualifying lobbying expenditures

Lobbying Expenditure Test

- Organization managers may also be liable for a tax on lobbying expenditures that result in the disqualification of the organization if the manager agreed to the expenditures knowing that they were likely to result in the organization's not being described in section 501(c)(3)

Lobbying by Section 501(c)(4), (5) and (6) Organizations

- 501(c)(4), 501(c)(5) and 501(c)(6) organizations may lobby
- However, there is no tax deduction allowed for donations or membership dues used for lobbying
- Section 501(c)(4), (5) and (6) organizations must notify its members that a portion of dues are not deductible because they relate to lobbying activities

Lobbying by Section 501(c)(4), (5) and (6) Organizations

- However, an organization does not have to provide the notice if it establishes that substantially all the dues paid to it are not deductible by the members
- If member dues are used for lobbying and the dues are deductible by the members and notifications are not sent to members, the organization must pay a proxy tax on lobbying expenditures
  - Tax paid with Form 990T

Political Campaign Activity

- Section 501(c)(3) organizations are prohibited from directly or indirectly participating or intervening in any political campaign on behalf of or in opposition to any candidate for elective public office
- Includes
  - Making or soliciting contributions for, on behalf of, or against any candidate for public office (national, state or local) or to a political party
  - Endorsing or opposing a particular candidate or political party
  - Rating a candidate, no matter how objective the rating may be

Political Campaign Activity

  - Making statements in support of or in opposition to a candidate or a political party
  - Using the organizations resources, e.g., office space, telephones, employee time, to engage in political campaign activity
  - Not inviting all candidates to speak in a public forum
- Generally, 501(c)(3) organizations are allowed to conduct nonpartisan activities that educate the public and help them participate in the electoral process
  - For example, presenting at public forums and publishing voter education guides so long as the activity is conducted in a nonpartisan manner

Political Campaign Activity

- Violation of this prohibition may result in revocation of tax-exempt status and/or the imposition of an excise tax on the political expenditures
- An excise tax may also be imposed against organization managers who agreed to the expenditures knowing they were political
- The political campaign activity prohibition is not intended to restrict free expression on political matters by officers, directors and employees of organizations speaking for themselves in their capacity as private individuals (should clearly state that)

Political Campaign Activity

- 501(c)(4), 501(c)(5) and 501(c)(6) organizations are allowed to be involved in campaign activity, so long as it is not their primary activity
- The expenses incurred in connection with such political activity are subject to tax
- However, if a 501(c)(3) organization provides funds to a 501(c)(4), 501(c)(5) or 501(c)(6) organization that engages in political activity, the 501(c)(3) organization must assure that the funds are used solely for 501(c)(3) exempt activities and not for political campaign activity

Unrelated Business Income

- An exempt organization is not taxed on its income from an activity substantially related to its charitable, educational, or other purpose that is the basis for the organization's exemption
- Such income is exempt even if the activity is a trade or business
- However, if an exempt organization regularly carries on one or more trades or businesses not substantially related to its exempt purposes, the organization may be subject to tax on its income from these activities (UBI)

Unrelated Business Income

- Use by the organization of the profits derived from this activity in furtherance of its exempt purposes does not make the activity substantially related to its exempt purposes

Unrelated Business Income

- The tax on unrelated business income (UBIT) applies to most organizations exempt from tax under section 501(a)
- These organizations include charitable, religious, scientific, and other organizations described in section 501(c)
- Section 501(c)(3) organizations may engage in income-producing activities unrelated to its tax-exempt purposes so long as the unrelated activities are not a substantial part of the organization's overall activities

Unrelated Business Income

- Net income from such activities will be subject to UBIT if three conditions are met
  - The activity constitutes a trade or business
  - The trade or business is regularly carried on
  - The trade or business is not substantially related to the exercise or performance of the organization's exempt purposes

Unrelated Business Income
Trade or Business

- The term *trade or business* includes any activity carried on for the production of income from selling goods or services
- An activity must be conducted with intent to make a profit to constitute a trade or business

Unrelated Business Income
Trade or Business

- An activity doesn’t lose its identity as a trade or business merely because it is conducted within a larger group of similar activities that may or may not be related to the exempt purposes of the organization
- For example, soliciting, selling, and publishing commercial advertising is a trade or business even though the advertising is published in an exempt organization's periodical that contains editorial matter related to the organization's exempt purposes

Unrelated Business Income
Trade or Business

- Examples of unrelated trade or business activities
  - Sale of merchandise and publications
  - Advertising
  - Debt management plan services
  - Gaming (except bingo)
  - Rental income (when there is associated acquisition indebtedness)

Unrelated Business Income
Exclusions

- Exclusions from UBI include
  - Dividends, interest and other investment income
  - Royalties
  - Rents from real property
    - Rents from personal property are not excluded
    - Special rules for "mixed leases" of real and personal property
  - Gains from the disposition of property
- These exclusions do not apply to debt financed income, i.e., when there is acquisition indebtedness related to the property

Unrelated Business Income
Income From Debt-Financed Property

- Generally, income derived from debt-financed property (rents, investment income) is included in unrelated business income
- Acquisition indebtedness is the unpaid amount of debt incurred by an organization:
  - When acquiring or improving the property
  - Before acquiring or improving the property if the debt would not have been incurred except for the acquisition or improvement
  - After acquiring or improving the property if:
    - The debt would not have been incurred except for the acquisition or improvement, and
    - Incurring the debt was reasonably foreseeable when the property was acquired or improved

Unrelated Business Income
Income From Debt-Financed Property

- If substantially all (85% or more) of the use of any property is substantially related to an organization's exempt purposes, the property is not treated as debt-financed property
- If less than 85% of the use of any property is devoted to an organization's exempt purposes, only that part of the property used to further the organization's exempt purposes is not treated as debt-financed property

Unrelated Business Income
Exclusions From Trade or Business

- Excluded from the definition of *trade or business*
  - Bingo, if it meets certain requirements
  - Activities conducted for the convenience of members, students, patients, officers or employees
  - Convention and trade show activity
  - Distribution of low-cost articles incidental to the solicitation of contributions
  - Exchange or rental of member or donor lists between organizations described in section 501 that are eligible to receive charitable contributions
  - Sales of donated merchandise
  - Substantially all the work is performed without compensation

Unrelated Business Income
Bingo

- For bingo to be excluded from the definition of trade or business, the bingo game must
  - Meet the legal definition of bingo
    - "Instant bingo," in which a player buys a prepackaged bingo card with pull-tabs that the player removes to determine if he or she is a winner, does not qualify
  - Be legal where it is played
  - Be played in a jurisdiction where bingo games are not regularly conducted by for-profit organizations

Unrelated Business Income
Regularly Carried On

- Business activities are considered regularly carried on if they show frequency and continuity and are pursued in a manner similar to commercial activities of nonexempt organizations
- Examples
  - A hospital auxiliary's operation of a sandwich stand for two weeks at a state fair would not be the regular conduct of a trade or business, since the stand would not compete with similar facilities that a nonexempt organization would ordinarily operate year-round
  - However, operating a commercial parking lot every Saturday, year-round, would be the regular conduct of a trade or business

Unrelated Business Income
Substantially Related

- An activity is not substantially related to an organization’s exempt purpose if it does not contribute importantly to accomplishing that purpose (other than through the production of income)
- Whether an activity contributes importantly depends in each case on the facts involved
- In determining whether activities contribute importantly to the accomplishment of an exempt purpose, the size and extent of the activities involved must be considered in relation to the nature and extent of the exempt purpose that they are intended to serve

Unrelated Business Income
Deductions

- To qualify as allowable deductions in computing UBTI, expenses and losses generally must be directly connected with carrying on the unrelated trade or business to which they relate
  - They cannot be directly connected with excluded income
- Examples
  - Trade or business expenses
  - Interest expense
  - Losses
- In addition, deductions are allowed for
  - Charitable contributions
  - $1,000 specific deduction

Unrelated Business Income
Tax Cuts and Jobs Act

- The Tax Cuts and Jobs Act (TCJA) requires tax-exempt organizations subject to UBIT to compute UBTI, including any net operating loss deduction, separately for each trade or business (referred to as a "silo") for tax years beginning after December 31, 2017
- Tax-exempt organizations are not permitted to deduct any net loss from unrelated business activities against the net income from other unrelated business activities

Unrelated Business Income
Tax Cuts and Jobs Act

- In November 2020, IRS issued final regulations that provide guidance on how an exempt organization subject to UBIT determines if it has more than one unrelated trade or business and, if so, how to calculate UBTI
- Also provide guidance on how an exempt organization should allocate deductions between separate unrelated trades or businesses

Unrelated Business Income
Tax Filing

- Part VIII of Form 990 is used to assign all forms of revenues, except contributions, to
  - Related to exempt function revenue
  - Unrelated business income
  - Revenue excluded from tax
- File form 990-T if gross unrelated business income is $1,000 or more
  - 990-T is a public document
  - For nontrust exempt organizations, the tax rates are the same as for C corporations

Unrelated Business Income Tax Filing

- Form 990-T is due the 15th day of the 5th month following the end of the tax year
- May request an automatic six-month extension of time to file by using Form 8868
- If more than one unrelated trade or business, complete Parts I and II of 990-T for one trade or business, attach a separate Schedule A for each additional trade or business, then complete the balance of 990-T

Unrelated Business Income Tax Filing

- Tax-exempt organizations subject to UBIT must make estimated tax payments if the total estimated tax for the tax year is $500 or more, subject to an underpayment penalty
- Use Form 990-W
- For a calendar or fiscal year organization, the payments are due by the 15th day of the 4th, 6th, 9th, and 12th months of the tax year
  - For a calendar year organization, the payments are due by April 15, June 15, September 15, and December 15

Unrelated Business Income
Further Information

- IRS Publication 598, *Tax on Unrelated Business Income of Exempt Organizations*
- The IRS has created a page for information about Publication 598 at *IRS.gov/Pub598*
    - Information about any future developments affecting Publication 598 (such as legislation enacted after it is released) will be posted on that page