

Financial Compliance in Focus: Not- for-Profit Accounting & Tax Essentials



Not-for-Profit Accounting Questions and Answers

Presenters



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Learning objectives



- ▲ Determine the appropriate answers to common questions.
- ▲ Determine best practices and practical applications in applying accounting standards.



Does a NFP have to
comply with every
accounting requirement
that relates to its
activities?

Application of U.S. GAAP

- ▲ No!
- ▲ The Codification indicates that immaterial items need not apply
- ▲ Be very careful with what is considered immaterial



Does the NFP financial reporting model in ASC 958 apply to all types of NFP entities, or is it limited only to public charities (501(c)(3) entities)?

Financial statements of Not-for-Profit entities

- ▲ ASC 958-10-15 describes what is considered an NFP
- ▲ An organization qualifies as an NFP if it meets the following:
 - It receives contributions of significant amounts of resources from resource providers who do not expect commensurate or proportionate pecuniary return
 - The organization is not operating to return a profit
 - There are no ownership interests like those of business entities
- ▲ In some cases, an NFP for U.S. GAAP is not tax-exempt for federal income taxes; therefore, tax-exempt status alone is not a determining factor of whether NFP U.S. GAAP applies



Is it a Statement of
Financial Position or a
Balance Sheet?

Financial statements of Not-for-Profit entities

- ▲ The Codification indicates you can use either term.



Are NFPs required to present a classified balance sheet?

Financial statements of Not-for-Profit entities

- ▲ Short answer, no!
- ▲ NFPs may present either a classified or unclassified balance sheet.
- ▲ If it is a NFP qualifies as a healthcare entity, the NFP is required to have a classified balance sheet.
- ▲ If an unclassified balance sheet is used, then assets should be sequenced accordingly to their ability to be converted to cash and liabilities should be sequenced according to the nearness of their maturity and resulting use of cash.



What items are generally permitted to be netted?

Financial statements of Not-for-Profit entities

- ▲ Generally, very few.
- ▲ Investments return, net.
- ▲ Schools with tuition revenue that also provide financial aid should record revenue net of financial assistance because that is what they expect to collect.
- ▲ Bonds/Loans issuance costs – Premiums and discounts are netted with the bonds payable.
- ▲ Special events that are peripheral could have the expenses netted. If not peripheral, there are a few display options.



What are the requirements around the use of an operating measure in the statement of activities?

Financial statements of Not-for-Profit entities

- ▲ Optional and self-defined
- ▲ There are a few things that U.S. GAAP dictates must be included or excluded from operations.
 - Gain or loss on disposal of fixed assets and impairment of fixed assets (which don't involve discontinued operations) should be part of operations.
 - The service cost component of pension expense should be part of operations.
 - Nonservice cost components of pension expense should be nonoperating expenses.
- ▲ There should be a footnote that describes the nature of the reported measure of operations or the items excluded from operations that aligns with the statement of activities



What are some examples of items NFPs might exclude from the operating section of the statement of activities?

Financial statements of Not-for-Profit entities

- ▲ Capital campaign contributions
- ▲ Endowment contributions
- ▲ Bequests
- ▲ Endowment investment return (in total or net of the amount appropriated)
- ▲ Non-endowment investment return
- ▲ Pension-related gain or loss
- ▲ Gains or losses on interest rate swaps
- ▲ Foreign exchange gains and losses
- ▲ Other non-recurring expenses that don't impact operations



Are you permitted to have each of the two net asset classes broken down into greater detail on the statement of financial position and/or statement of activities?

Financial statements of Not-for-Profit entities

- ▲ Yes!
- ▲ It's permissible to have greater detail such as net assets with donor restrictions (i.e., perpetual in nature vs. net assets with donor restrictions which are not perpetual in nature).
- ▲ It is a requirement to present the total of each of the two net asset classes, plus the total of net assets, displayed on the statement of financial position.
- ▲ The total for the change in each of the two net asset classes, plus the total change in net assets, must be displayed on the statement of activities.



Is a CD or treasury note that is due in less than three months from year end considered a cash equivalent?

Cash equivalents

- ▲ Yes and no.
- ▲ The maturity of these to be included in cash and cash equivalents has to be three months or less from the date of acquisition, not from the date of the financial statements.



What types of receivables
does the current
expected credit loss
(CECL) model apply to?

Receivables and CECL

- ▲ If it's a financial asset not held at fair value, you should consider the applicability of CECL.
- ▲ Examples of assets CECL applies to: contract assets and liabilities recognized under Topic 606, trade receivables, loans receivable, programmatic loans receivable, and deferred revenue.
- ▲ Examples of assets CECL does not apply to: pledges receivable, operating lease receivables under Topic 842 (Leases), financial assets measured at fair value, loans and receivables between entities under common control.

Polling question #1





What are the potential financial reporting implications of the federal funding freeze?

Federal Funding Freeze

- ▲ Federal funding does not create a barrier that would be considered a conditional contributions
- ▲ Uncertainty may result in the reevaluation of the collectability of the receivables
- ▲ For exchange transactions, does the change result in a contract modification under Topic 606?
- ▲ Potential disclosure in the financial statements for the uncertainty
- ▲ Does it have an impact on the assessment of an entity's ability to continue as a going concern?



Do I need to derive a new discount rate for existing leases each year?

Leases

- ▲ No!
- ▲ The discount is set at the beginning of the lease agreement and is not modified during the lease term.



Is a recognition threshold for leases allowable under U.S. GAAP (similar to a capitalization threshold for fixed assets)?

Leases

- ▲ Yes!
- ▲ Similar to fixed assets, a reasonable threshold could be established in light of materiality.
- ▲ Best practice is to use your auditor as a sounding board.



What do you do if you have leased space with your landlord and you downgrade to a smaller leased space in the middle of the lease term?

Leases

- ▲ This would be a lease modification.
- ▲ The NFP would remove the existing lease liability and ROU assets with a potential gain or loss.
- ▲ Then, record a new lease liability and ROU asset for the new smaller space.



How does a NFP account for the lease of space if no rent is paid (in-kind donation)?

Leases – In-kind (no rents)

- ▲ The free use of space as an in-kind contribution and corresponding rent expense at fair value (typically using comparable market rental rates).
- ▲ If the free use of space is month-to-month or otherwise not promised into the future, then the NFP records the in-kind contribution and rent expense each month as the space is used.
- ▲ If the free use of space is promised over multiple periods (for example, in a long-term lease agreement), then the NFP records a pledge receivable equal to the present value of the in-kind contribution over the promised time period.
- ▲ The contribution revenue recorded is donor restricted for time.
- ▲ Each period, the rent expense and a reduction to the pledge receivable is recorded, along with a release of restriction.



How does a NFP account for the lease of space if the rents are significantly below market rates?

Leases – Below market rents

- ▲ A lease liability and right-of-use asset are recorded in accordance with Topic 842 based on the required rental payments based on the rental agreement.
- ▲ An in-kind contribution is recorded following the guidance in the prior question.
- ▲ The contribution equals the difference between the fair value (market rental rate) and the required rental payments.
- ▲ Judgment is required to determine if there truly is an in-kind contribution.



What are the financial reporting considerations if a NFP “borrows” money from its donor-restricted endowment fund?

Endowments

- ▲ Consider the relevant state laws on whether this is an allowable activity and consult with an attorney if necessary.
- ▲ The investment account is reduced for the amount borrowed.
- ▲ There is no reduction in the corresponding balance of net assets with donor restrictions.
- ▲ There is no receivable/payable recorded as this is an intra-entity borrowing.
- ▲ U.S. GAAP requires additional disclosure regarding the reason for the deficiency in the endowment fund..
- ▲ The need to “borrow” from the endowment fund may be an indicator of financial stress on the organization; and the disclosure requirements in ASC 205-40, Going Concern, should be considered.



Do I need to derive a new discount rate for existing pledges receivable each year?

Revenue recognition – Contributions

- ▲ It depends.
- ▲ If contribution receivables are recorded at fair value, they are adjusted each year for changes in discount rates.
- ▲ If contribution receivables are not recorded at fair value, it is set it (during the year in which the pledge was made) and forget it.



When do you record a donor's bequest in a will?

Revenue recognition – Contributions

- ▲ In most cases, bequests are not recognized as a contribution until it passes probate as the donor technically still has the ability to revoke the bequest.
- ▲ You may have wording in the notice of the bequest that makes it recordable (i.e., irrevocable).



If a NFP receives a restricted gift which also has a right of return, should the NFP consider it conditional?

Revenue recognition – Contributions

- ▲ No!
- ▲ To be conditional, the gift must have both a barrier that must be overcome and a right of return/release from obligation.



Are all gifts from a
capital campaign
restricted for capital?

Donor restrictions and releases of restriction

- ▲ It depends.
- ▲ You really need to be careful of the wording in the solicitation materials.



Do I need to disclose the categories of how I met donor restrictions/release from restrictions?

Donor restrictions and releases of restriction

- ▲ No!
- ▲ There is no requirement to disclose the categories of net assets with donor restrictions, or the releases thereof.
- ▲ However, the Codification does say it is good practice to include a breakdown.



If a donor makes a pledge and specifies the pledge will be paid in installments over multiple years, does that payment plan create a donor restriction?

Donor restrictions and releases of restriction

- ▲ Yes!
- ▲ The future installments are under an implicit time restriction, unless there are explicit donor stipulations or circumstances surrounding the receipt of the pledge and make clear the donor intended it to be used to support activities of the current period.
- ▲ The future installments should be discounted to present value using a discount rate commensurate with the risk involved.



Should a time restricted pledge receivable be released from restriction in the year it is scheduled to be paid, even if the donor has not paid (i.e., the pledge is past due)?

Donor restrictions and releases of restriction

- ▲ Yes!
- ▲ The net assets should be released from restriction in the period the pledge is scheduled to be paid regardless of whether its collected.
- ▲ It should be noted that if the pledge is overdue, there arises a concern regarding its collectability and the potential necessity for a partial or full allowance.



Should all pledges
receivable at the end of
the period be considered
as time restricted?

Donor restrictions and releases of restriction

- ▲ No!
- ▲ Only those pledges where the donor specified payments will be made in future periods should be considered as time restricted.
- ▲ See the immediately prior question and answer.



How should donated auction items be accounted for if they are received at the end of one fiscal year, but the auction is held, and the items sold, in the following fiscal year?

Special events, galas, auction items, etc.

- ▲ Record the revenue, and corresponding assets, at fair value in the period the auction items are received.
- ▲ When the donated items are sold in the auction, recognize the cash proceeds, derecognize the asset, and record an adjustment (positive or negative) to revenue for the difference.



How do I record
sponsorship revenue?

Special events, galas,
auction items, etc.


- ▲ Sponsorships are often contributions.
- ▲ You need to look at the wording of the agreement to determine if any commensurate value is given in return or if it is just a naming opportunity with little benefit in return.



When is a NFP required to include “going concern” disclosures in the footnotes?

Going concern

- ▲ Disclosure is required when substantial doubt is raised about the NFP’s ability to continue as a going concern.
- ▲ This exists when conditions and events, considered in the aggregate, indicate that it is probable that the NFP will be unable to meet its obligations (including funding operations) as they become due within one year after the financial statements are available to be issued.

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Annual Not-For-Profit Summit

Tax Essentials

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Melissa has been with BerryDunn for over 11 years and has focused on Not-For-Profit tax for the last 8 years. She works with all types of clients – schools, hospitals, social services, private foundations, etc.



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Agenda

-  **1** Learning Objectives
-  **2** House of Representatives & Senate Budget Reconciliation Bill Provisions
-  **3** Next Steps
-  **4** Questions

Learning objectives



- ▲ Overview of provisions of the House of Representatives & Senate One Big Beautiful Bill that would impact Not-for-Profit organizations
- ▲ Outline the next steps for this bill

Section 1

House of
Representatives & Senate
budget reconciliation bill
provisions



Proposed provisions – House of Representatives

- ▲ Parking tax
- ▲ Excise tax on compensation in excess of \$1,000,000 and excess parachute payments expanded to all employees
- ▲ Non-itemizer charitable deductions – \$300 joint, \$150 single



Proposed provisions – Senate Updates

- ▲ Parking tax
- ▲ Excise tax on compensation in excess of \$1,000,000 and excess parachute payments expanded to all employees
- ▲ Non-itemizer charitable deductions – \$2,000 joint, \$1,000 single

Private foundation excise tax increase – House of Representatives

Asset Level	Excise Tax
Assets less than \$50,000,000	1.39%
Assets \$50,000,000 – \$250,000,000	2.78%
Assets \$250,000,000 – \$5,000,000,000	5%
Assets over \$5,000,000,000	10%



Excise tax rate on investment income of private colleges and universities increases – House of Representatives

Adjusted Endowment Value Per Student	Excise Tax
\$500,000 – \$750,000	1.4%
\$750,000 – \$1,250,000	7%
\$1,250,000 – \$2,000,000	14%
\$2,000,000+	21%

Excise tax rate on investment income of private colleges and universities increases – Senate

Adjusted Endowment Value Per Student	Excise Tax
\$500,000 – \$749,999	1.4%
\$750,000 – \$1,999,999	4%
\$2,000,000+	8%



Proposed provisions – House



- ▲ Expanding Rural Emergency Hospital designation
- ▲ Expanding the use of Section 529 plan fund uses
 - Homeschooling costs
 - Education-related therapies
 - Vocational/certificate programs

Polling question #2





Section 2

Next steps

What is next?



Passage by the House is the first major hurdle



Bill is currently with the Senate



Once passed by Senate, will go back to the House



Expecting to get to the President by July 4th



Treasury proposal

- ▲ Private, nonprofit schools lose exempt status
 - Favor any racial groups – financial assistance, loans, use of facilities or other programs
- ▲ Being drawn up as a revenue procedure
 - Form of guidance for interpreting and enforcing tax laws which could take effect without congressional approval
- ▲ Race is being defined as including color and national or ethnic origin
- ▲ Effectively require schools to adopt race-blind policies or risk exemption
- ▲ This proposal has not been approved and could still be changed or rescinded

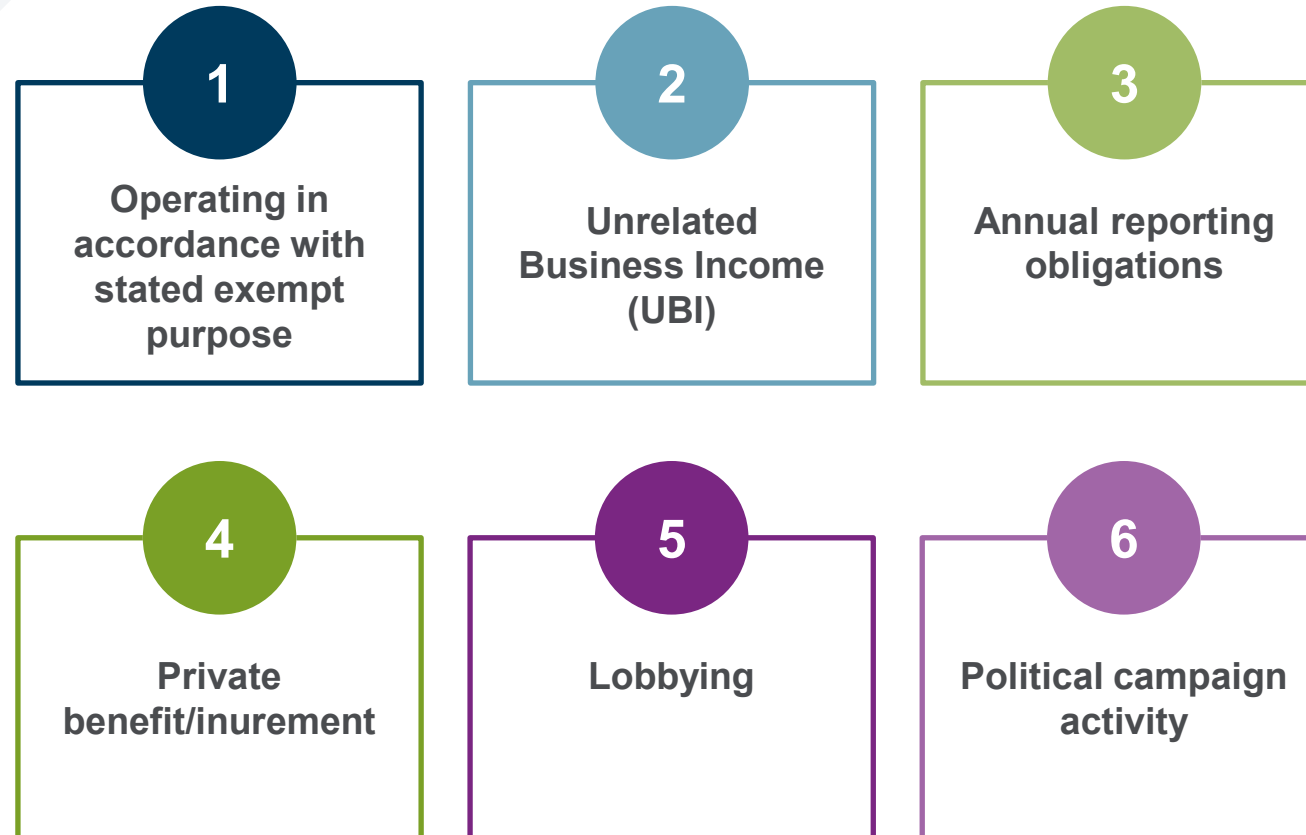
Section 3

Tips to avoid exempt
status revocation

Polling question #3



Key compliance areas





How to maintain compliance

- ▲ Provide education on requirements for tax exempt status
 - Board members
 - Staff
- ▲ Review and update policies regularly
- ▲ Establish financial management practices and internal controls
- ▲ Seek legal counsel for complex tax requirements

Questions?



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