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2018

## Not-for-profit entities industry developments - 2018; Audit risk alerts

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# Audit Risk Alert

2018 | Not-for-Profit Entities  
Industry Developments

Strengthening Audit Integrity  
Safeguarding Financial Reporting



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# Audit Risk Alert

**2018** | Not-for-Profit Entities  
Industry Developments

**Strengthening Audit Integrity  
Safeguarding Financial Reporting**

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## Notice to Readers

This Audit Risk Alert (alert) replaces *Not-for-Profit Entities Industry Developments—2017*.

This alert is intended to provide auditors of financial statements of not-for-profit entities with an overview of recent economic, industry, technical, regulatory, and professional developments that may affect the audits and other engagements they perform. This alert also can be used by an entity's internal management to address areas of audit concern.

This publication is an *other auditing publication*, as defined in AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards* (AICPA, *Professional Standards*). Other auditing publications have no authoritative status; however, they may help the auditor understand and apply generally accepted auditing standards.

In applying the auditing guidance included in an *other auditing publication*, the auditor should, using professional judgment, assess the relevance and appropriateness of such guidance to the circumstances of the audit. The auditing guidance in this document has been reviewed by the AICPA Audit and Attest Standards staff and published by the AICPA and is presumed to be appropriate. This document has not been approved, disapproved, or otherwise acted on by a senior technical committee of the AICPA.

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## Feedback

The Audit Risk Alert *Not-for-Profit Entities Industry Developments* is published annually. As you encounter audit or industry issues that you believe warrant discussion in next year's alert, please feel free to share them with us. Any other comments you have about the alert also would be appreciated. You may email these comments to [A&APublications@aicpa-cima.com](mailto:A&APublications@aicpa-cima.com).

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## How This Alert Helps You

**.01** This Audit Risk Alert (alert) helps you plan and perform your audits of not-for-profit entities (NFPs) and can be used by an entity's internal management to identify issues significant to the industry. It also provides information to assist you in achieving a more robust understanding of the business, economic, and regulatory environments in which NFPs operate. This alert is an important tool to help you identify the significant risks that may result in the material misstatement of financial statements, and it delivers information about emerging practice issues and current accounting, auditing, and regulatory developments. For developing issues that may have a significant impact on NFPs in the near future, see the section, "On the Horizon," for information on these topics, including guidance that either has been issued but is not yet effective or is in a development stage. You should refer to the full text of accounting and auditing pronouncements as well as the full text of any rules or publications that are discussed in this alert. Additionally, the AICPA Audit Risk Alert *General Accounting and Auditing Developments—2017/18* explains important issues that affect all entities in all industries in the current economic climate. Refer to the section, "Publications," in this alert for product numbers and additional information about *General Accounting and Auditing Developments—2017/18*.

**.02** It is essential that the auditor 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 the following:

- Risk assessment procedures
- Further audit procedures that comprise
  - tests of controls, when required by generally accepted auditing standards (GAAS) or when the auditor has chosen to do so
  - substantive procedures that include tests of details and substantive analytical procedures

**.03** The auditor should develop an audit plan that includes, among other things, the nature and extent of planned risk assessment procedures, as determined under AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.<sup>1</sup> AU-C section 315 defines *risk assessment procedures* as the 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. As part of obtaining the required understanding of the entity and its environment, paragraph .12 of AU-C section 315 states that the auditor should obtain an understanding of the industry, regulatory, and other external factors, including the applicable financial reporting framework, relevant to the entity. This alert assists the auditor with this aspect of the risk assessment procedures and further expands the auditor's understanding of other important considerations relevant to the audit.

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<sup>1</sup> All AU-C and AT-C sections can be found in AICPA *Professional Standards*.

## Economic and Industry Developments

### The Current Economy

.04 When planning and performing audit engagements, 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.

### Key General Economic Indicators

.05 The following key economic indicators illustrate the state of the U.S. economy during 2017 and entering into 2018.

.06 The gross domestic product (GDP) measures output of goods and services by labor and property within the United States. It increases as the economy grows or decreases as the economy slows. According to the Bureau of Economic Analysis, real GDP increased at an annual rate of 2.5 percent in the fourth quarter of 2017 (second estimate), compared to an increase of 3.2 percent in the third quarter of 2017 (third estimate), resulting in an estimated overall increase in GDP of 2.3 percent for 2017, compared to a rate of 1.5 percent in 2016.

.07 From December 2016 to December 2017, the unemployment rate declined from 4.7 percent to 4.1 percent, the lowest rate since December 2000. An unemployment rate of 4.1 percent represents approximately 6.6 million people. This does not include the 4.9 million workers holding part-time jobs at the end of 2017 who seek but cannot find full-time employment. In December 2007, there were 4.7 million workers in that category. Also excluded are the 1.6 million people who have either given up looking for work because they have not been able to find employment, or people who have had a job in the past year but are not currently employed and haven't looked for work in the past 4 weeks.

.08 The year 2017 was marked by historically low unemployment rates and record highs in the U.S. stock markets. The Federal Reserve raised the federal funds rate three times in 2017, citing strength in the U.S. economy and labor market. Although inflation remains low at less than 2 percent, and will continue to be monitored, additional federal funds rate increases are anticipated in 2018.

.09 The Federal Reserve noted in its December 13, 2017 press release that the

[c]ommittee expects that economic conditions will evolve in a manner that will warrant gradual increases in the federal funds rate; the federal funds rate is likely to remain, for some time, below levels that are expected to prevail in the longer run.

### The State of NFPs

.10 The NFP sector continues to play a large role in the world economy. Currently, more than 1.5 million NFPs are registered with the IRS. Contributions to these entities in 2016 exceeded \$390 billion. Total revenues in the

sector exceeded \$2 trillion, and assets topped \$5 trillion. According to U.S. Department of Labor statistics, 24.9 percent of the U.S. adult population, or 62.6 million people, did volunteer work for NFPs during the year ending September 2015, putting in a total of more than 3 billion hours. According to Giving USA, all 9 sectors of recipient organizations identified (religion; education; human services; giving to foundations; health; public-society benefit; arts, culture, and humanities; international affairs; and environment and animals) experienced growth in the amount of giving received in 2016; and individuals led the way, increasing their giving by 3.9 percent in 2016. Trends continue to show that donor-advised funds are increasingly popular, with contributions into donor-advised funds growing to \$23.3 billion in 2017, according to the National Philanthropic Trust's 2017 Donor-Advised Fund Report. With the adoption of new individual federal tax legislation in 2018, donor-advised funds may become more popular as individuals consider clustering their donations, giving every other year to take advantage of the higher standard tax deductions in off-giving years.

### ***Succession Planning and Leadership Gaps***

.11 Baby boomers (those born between approximately 1946 and 1964) are retiring in staggering numbers and are expected to continue to do so over the next decade. As this large demographic exits the workforce, NFPs likely will be faced with leadership gaps and potential instability in C-suite ranks. Succession planning has never been more top-of-mind as a key risk for boards and executive teams, especially in the nonprofit industry, given the mission-driven activities, personal relationships, and fundraising responsibilities of many NFP executives.

.12 To position NFPs favorably in times of transition, an effective and proactive succession planning process needs to be in place. Some best practices to consider include the following:

- Identify the key positions that need to be addressed; not all will have equal impact.
- Assess the risk of turnover for each of the key positions.
- Define key competencies (that is, a "wish list").
- Assess internal talent.
- Refresh the NFP's list of external connections.
- Create a leadership development program.
- Develop an internal cross-training program.

### ***Delegation of Authority to Management***

.13 Members of an NFP's board of directors are bound by a duty of care that includes a responsibility for overseeing all activities that advance the NFP's effectiveness and sustainability. Exercise of this oversight role naturally requires that certain responsibilities and authorities be delegated by the board to management. Examples of powers that may be delegated to management include spending in excess of the approved budget, addressing the media on behalf of the organization, negotiating agreements on behalf of the organization, designating net assets, and opening bank accounts.

.14 When determining which powers to delegate to management, it is prudent for the board to be strategic and intentional based on the size and complexity of the organization and assess the risks each delegation poses to

the organization (for example, risk of excessive financial loss, risk of reputational damage, and risk of limiting the organization's ability to maintain cash flow).

**.15** All delegations should be approved by a vote of the board and carefully documented, including specific details on the power(s) being delegated and any limits placed on management's authority. For example, when delegating the ability to authorize expenditures that exceed the approved budget, the board should clearly document the following:

- Who in management can approve expenditures in excess of budget (identified by position, not by individual name)
- Any specific dollar or percentage limit on the ability to approve excess spending (for example, up to five percent over the approved budget)
- How a budget overrun will be measured (for example, by department or by line item, quarterly or annually, and so on)
- When the delegation goes into effect (for example, immediately or on a specified date) and when it expires (for example, when amended or revoked by a resolution of the board or until a specified date)
- When management has to report back to the board (for example, budget-to-actual results are reported on a quarterly basis)

**.16** Any powers that traditionally rest with the board and are not explicitly delegated to management are assumed to remain with the board. Once a power has been delegated, the board should ensure that processes and controls are in place to allow the board to monitor whether management carries out its authority properly. This includes setting expectations on the timing and content of management's reporting back to the board, enabling assessment by the board. Although the board can delegate responsibilities to management, it cannot abdicate its duty of care to ensure that all activities of the organization are carried out effectively and sustainably.

### ***Pending Accounting Rule Changes***

**.17** Several accounting rule changes that NFPs should consider disclosing as pending accounting pronouncements will be effective in the near future. NFPs should plan to invest substantive time to determine impacts and prepare for the adoption of these standards. Important considerations include appropriate implementation timing; proper accounting; effects on process, controls, and software; and financial statement format and disclosure impacts. Key standards to prepare for are covered in more detail later in this alert, along with the issues and risks specific to each.

**.18** Given the significance of these changes, NFP accounting and auditing professionals will need a thorough understanding of the requirements of each new standard and will need to plan ahead for the applicable changes, including any necessary adjustments to systems, controls, and communications with internal and external stakeholders. Early adoption is permitted for several of the new standards, and it may be worth considering for some NFPs. Also, NFP auditors may be called upon for assistance with the impact assessments and implementation of new standards and should make sure they do not impair their independence.

## **Cybersecurity**

**.19** In 2017, there were more than 1,300 data breaches affecting 174 million records reported in the United States, according to the Identity Theft Resource Center. This represents a 30 percent increase from 2016.

**.20** Data breaches affect all types and sizes of organizations, and NFPs are no exception. In fact, the Data Breach Incidents, Causes, and Response Survey conducted by the Society of Corporate Compliance and Ethics during October 2016 found that 63 percent of NFPs reported at least one data breach in the last year. According to the Privacy Rights Clearinghouse, health care institutions and educational institutions have incurred the most breaches to date for NFPs.

**.21** NFPs are often the custodians of large volumes of sensitive donor information, including credit card numbers, addresses, phone numbers, bank account information, and other pieces of confidential information, all of which are valuable to hackers.

### *Cybersecurity Threats*

**.22** Most reported breaches are due to hacking, email phishing, or malware—especially ransomware. In fact, the use of ransomware, whereby an attacker locks or encrypts a victim's data until a payment is made, has become one of the biggest threats facing businesses and other organizations today. Mobile ransomware, used when the target system is either a cell phone or tablet computer, has caused an increase in infections. According to the 2017 Kaspersky Lab Malware Report, mobile ransomware infections had risen by over 250 percent during the first quarter of 2017 to 218,625 ransomware files discovered versus 61,832 in the previous quarter.

### *Email Phishing*

**.23** One of the main delivery methods of a ransomware attack is through email phishing, which is a social engineering technique that uses email to deceive end users into providing sensitive information, such as

- passwords,
- Social Security numbers, and
- payment card information.

**.24** A phishing email will typically use a Word, Excel, or PDF attachment to carry the ransomware program and, once opened, it infects the target's computer. Some ransomware variants, such as WannaCry and Petya, have been able to infect multiple systems at once and disable an organization's operations for days, and sometimes even weeks.

### *Consequences*

**.25** The average payment is around \$1,077 for victims who pay the ransom; however, the costs can escalate quickly for larger organizations. For example, a major web-hosting provider recently paid more than \$1 million to attackers to regain control of its data. Regardless of whether an organization pays the ransom, the amount of time it takes to recover from these types of attacks can be crippling.

**.26** In January 2017, an NFP was hacked, and all the agency's data was stripped, encrypted, and taken for ransom. The hackers demanded funds before they would return the data, and when the organization did not make the

payment, the hackers posted sensitive donor information online. Months after the incident, the NFP was still in the process of carefully re-entering donor information and reported that its ability to obtain grant funding was affected by the data loss.

### *Protecting NFPs*

**.27** Cybersecurity breaches are often a result of improperly secured systems and a lack of user education and awareness—and they can often be prevented with a more stringent cybersecurity strategy that includes proper training and technology.

**.28** The main reason ransomware attacks are so prevalent and successful is because end users unknowingly open infected emails and attachments due to a lack of user education and cyber-awareness. As such, organizations can benefit from providing training for these end users.

**.29** Awareness training is an important first step in any security program. It can be particularly effective when provided for all new hires, as well as annually for all employees. In addition, NFPs may wish to employ other methods, such as a monthly email reminder or awareness posters in the break room, to frequently remind end users about safe computing habits.

### *Technology*

**.30** To protect the organization from cyberattacks, it is important that IT systems are current and include rigorous protections to deter and detect attacks, such as the following:

- Network infrastructure design and perimeter protections
- Encryption of sensitive data (both on individual computers and network servers)
- System access limitations, including multifactor authentication
- Anti-malware and data leakage strategy
- Security information and event management solutions
- Incident response procedures
- Backup and restoration processes

**.31** Once these systems are in place, organizations stand to benefit from having them tested annually by an independent and qualified third party to help make sure they are working properly.

**.32** Though time and resources are required, proper training and technology can greatly reduce an NFP's risk of a cybersecurity breach stemming from a ransomware or phishing attack. Additionally, NFPs may find it prudent to obtain cybersecurity insurance to defray any costs to the organization, should they come under attack.

### *AICPA Cybersecurity Resources*

**.33** Cybersecurity is an urgent matter as digital threats continue to rise. No organization or client is entirely safe from cyberattacks, regardless of their size or mission. CPAs are well-positioned to take a leadership role on behalf of their clients or organizations by providing advisory or assurance services that address risks associated with cybersecurity. Visit the AICPA Cybersecurity Resource Center to access cybersecurity news and information at [www.aicpa.org/cybersecurity](http://www.aicpa.org/cybersecurity).

## ***Business Continuity and Disaster Recovery Planning***

**.34** Disaster recovery, particularly the backup of financial systems and data, has been an area addressed in IT controls in financial audits for many years. Recent hurricanes with historic flooding have been a reminder of the critical need for appropriate planning to allow for access to systems during natural disasters. Social threats and the ever-increasing number of cyber breaches, attacks, and vulnerabilities should have equal consideration as a reinforcing concern. One ransomware attack on an NFP that does not have appropriate backups and an incident response plan can cripple the organization's ability to produce reliable financial statements.

**.35** There are many areas pertaining to disaster recovery that should be addressed, and the list of considerations is much broader than whether the organization has a current backup and whether backups are taken offsite. The following discussion of comprehensive business continuity and disaster recovery planning should help NFPs and their auditors familiarize themselves with the planning process and the content of sufficient plans. In-depth reviews of disaster plans by IT professionals often identify weaknesses in many of the areas mentioned. Although auditors may try to limit their perspective to the financial data only, a broader perspective is helpful and relevant in understanding the entity's ability to continue operations and fulfil its mission. The accounting system is often intertwined with many systems, so the entity-wide process should be understood.

### *The Planning Process and Business Impact Analysis*

**.36** Business continuity and disaster recovery planning are no longer the focus of the IT department alone. As more functions shift to the cloud and other electronic storage mediums, it is becoming ever more crucial for organizations to consider and regularly test plans to access this information during an unplanned outage.

**.37** Developing a formal business continuity and disaster recovery plan is an important first step in contingency planning. A strong plan stems from a thorough business impact analysis (BIA). A BIA identifies and evaluates the possible effects of an interruption or complete outage to critical operations as the result of a disaster, accident, or emergency. From there, the NFP can begin to gather and document the information and resources needed to recover from the identified events.

**.38** Although predicting and planning for every possible scenario isn't feasible, there are high-risk, high-probability topics that make good starting points. These can include loss of internet (including cloud computing), primary servers, or connection with key service providers; an extended outage of key service providers; and power issues. Plans should document formal steps to be followed during natural disasters specific to the geographical area, such as hurricanes, tornadoes, earthquakes, floods, fires, and so on. Man-made scenarios also should be considered, including pandemics and terror events. Plans should document concise, easy-to-follow steps and procedures in the event of each considered outage or event.

### *Business Continuity and Disaster Plan Components*

**.39** Once planning for foreseeable general risks has been completed, the next step is to establish more specific procedures for all functional areas. Each

functional area should include responsibilities, the responsible party, and procedures to be followed both during and after an emergency.

**.40** Examples of functional areas beyond the primary operation and mission of the NFP include accounting and finance, human resources, facilities, IT, administration, and remote operations. Interim processing and recovery procedures for all locations, critical functional areas, and IT systems and infrastructure should be documented as part of the plan. These procedures may include restoration for virtual and physical servers (including server-specific applications), alternate internet service providers and firewall and intrusion detection systems, primary network infrastructure, and external data transfers. Data transfers are often key components of financial reporting; for example, donor systems may provide an import file for the accounting system.

**.41** Other key elements of a comprehensive plan include an employee contact list, accurate and current assignment of action to be taken in an emergency, procedures for document storage, procedures for accessing an area that has been declared a disaster zone, and storage of the plan in multiple locations in case the primary location becomes inaccessible.

### *Data Backups*

**.42** A current and comprehensive plan is a key element of contingency preparedness, but without a detailed back-up configuration, operations can come to a standstill during a disaster event. The back-up process should be sufficient to preserve data in the event of a disaster. This requires a comprehensive inventory of the systems to be backed up, including both onsite and cloud systems.

**.43** Cloud vendors perform their own backups, but organizations should consider maintaining their own backup of information stored in the cloud. Although it may not be possible to create a "full backup" for a cloud system (for example, QuickBooks Online) that could be restored in the traditional sense, periodic exports or reports should be generated to ensure there is a complete record of all data. The frequency of server backups or cloud reports and exports should be determined based on the critical nature of the system.

**.44** Back-up media should be encrypted and stored off-site. Storing back-up media at the same location or in proximity to live systems increases the risk of losing data in the event the primary location is destroyed or physical access is temporarily restricted. For this reason, backups should be farther away than a building next door or a few blocks down the street.

**.45** Adequate retention and rotation policies and procedures should also be considered. Retaining periodic backups, whether online or on offline media, is an essential step to ensure all data are available. It is common practice to retain backups at month-end and year-end. This is needed in addition to daily backups to ensure the data can be restored in the event of a dormant virus or similar issue.

**.46** Replication is another great control to ensure the immediate availability of data; however, one common issue is that replicated data is only retained off-site for 24 hours and it is overwritten. Organizations should have additional copies of replicated data to protect against corrupted replication. For example, if ransomware infects a system, it could be replicated to the online backup. A good rule of thumb is the "Rule of Three," which says data should always be in three places at once:



1. With the vendor or on an onsite system
2. At the vendor's hot site, a replicated backup or copy onsite
3. At an additional location (that is, the organization maintains a copy or keeps a backup at another location)

**.47** In the case of a cloud vendor, the third copy may be in the form of exports.

### *Plan Testing*

**.48** Adequate and frequent plan testing and employee training are critical components of disaster planning. Employees should receive annual training to ensure they are familiar with their responsibilities and the procedures to follow in the event of an emergency or disaster. Training should cover all key areas, such as succession plans, alternate locations, expectations for employee reporting in an emergency, details regarding employee communication options and availability of contact information, re-entry requirements, critical functional areas, and emergency team assignments. The size of the NFP will dictate the level of training that may be needed. As a best practice, thorough plan testing should be performed annually, at a minimum.

**.49** Many organizations are surprised to find they don't have reliable backups when the situation requires a data restore. This is becoming more frequent as the occurrences of ransomware attacks increase. It is vital to test the ability to restore not just a single file, but entire systems. In addition to back-up restoration, all plan procedures should be tested at least in a table-top manner (for example, processing payroll without access to the primary system or communicating with key stakeholders, as may be necessary in an emergency).

### *Summary*

**.50** The business continuity and disaster recovery environment is changing every day and new considerations arise frequently. It is critical for NFPs to establish baseline plans, back-up configurations, and training and testing processes to ensure ongoing operations. Auditors who understand the importance of comprehensive planning; the changing environment with new cyber, social, and environmental threats; and the intricacies involved will be more successful at identifying areas of risk.

### *ERP and Cloud Risks and Controls*

**.51** As more and more information technology functions are moved to the cloud, it is critical to understand the controls in place and the risks associated with cloud vendors. The following are items to consider when evaluating cloud providers:

- Geographic location of data stored in the cloud
  - Whether data is stored within the United States. This may be especially important for NFPs doing business with the U.S. government.
- Due diligence with respect to security breaches
  - Cloud provider's security track record
  - Whether the cloud provider takes responsibility with respect to breaches
    - How is that responsibility defined in the agreement?

- Who has what responsibilities when a breach occurs?
- What are the breach notification timelines?
  - Security features offered by the provider to help keep access to data secure, such as multifactor authorization
- With respect to data recoverability, the stability of the system as well as the financial stability of the cloud provider (that is, if there is a problem with the system or the provider, can client data be retrieved?)
- Protocols around confidentiality and the cloud provider's use of client data
  - Is client data kept in a multi-tenant environment?
    - When one tenant's data is subpoenaed and the servers are seized, are there alternate copies of other tenants' data available?
  - Does the cloud provider have access to clients' private data?
  - Does the contract state that client information can't be disclosed or sold to marketers?
- Compensation provided to clients under the service license agreement with respect to outages or security breaches
- Change-in-control provisions of the service agreement (that is, if there is a change in control at the cloud provider, whose contract carries over?)
- How the cloud provider shares internal control information for client and stakeholder verification purposes (for example, do they provide a SOC 1<sup>®</sup> report?)<sup>2</sup>
  - Have procedures been developed to read and evaluate the internal control information received?

**.52** As with their own internal infrastructure and data center, it is important for NFPs to incorporate accepted risk management processes and policies surrounding cloud service providers, as well as

- review service license agreements with cloud software vendors,
- work with reputable, financially stable software companies,
- check client references, and
- obtain uptime statistics of their applications and data centers.

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<sup>2</sup> In 2017, the AICPA introduced the term *system and organization controls* (SOC) to refer to the suite of services practitioners may provide relating to system-level controls of a service organization and system or entity-level controls of other organizations. Formerly, SOC referred to *service organization controls*. By redefining that acronym, the AICPA enables the introduction of new internal control examinations that may be performed (a) for other types of organizations, in addition to service organizations, and (b) on either system-level or entity-level controls of such organizations.

## ***Gifts-in-Kind: Reporting Contributions of Nonfinancial Assets***

**.53** Since the standards for recognizing contributions at their fair value were issued in 1993, NFPs have been challenged to measure the value of the myriad contributions they receive. This controversial area is once again being addressed by watchdog agencies and state attorneys general and, thus, is one that NFPs should navigate with care.

**.54** Determining the fair value of cash and marketable securities is typically straightforward, but for most nonfinancial assets (for example, food, supplies, used clothing and household items, intangibles, medical equipment, and pharmaceuticals), the valuation process is less clear. In 2006, FASB issued its fair value measurement standard (FASB Statement No. 157, later codified as FASB *Accounting Standards Codification [ASC] 820, Fair Value Measurement*), which was broadly written to address both financial and nonfinancial assets. The standard defined *fair value* and provided a principles-based approach for measuring fair value. Although there are examples in the standard that illustrate the application of its basic principles, including application to various nonfinancial assets, the standard did not and could not exhaustively illustrate application to all types of assets contributed to NFPs.

**.55** Accurate valuation and revenue recognition of nonfinancial gifts (commonly referred to as *gifts-in-kind*, or GIK) are a challenge, particularly for GIK that are used by the NFP for program activities and not subsequently sold in the marketplace. (Sales data provides valuation evidence for items sold, so those generally are not problematic transactions.) The basic guiding principles for determining the fair value of GIK have not changed over the years. However, NFPs' understanding of the characteristics and issues surrounding GIK has matured, best practices have developed for addressing issues, and the markets transacting in GIK are evolving.

**.56** Some of the issues and challenges surrounding nonfinancial GIK assets include the following:

- GIK is an important part of the mission for many charities; however, donors, watchdog agencies, and regulators can be skeptical of transactions involving GIK. Because the fair values of GIK are estimates and GIK transactions result in revenues and expenses being recorded in the financial statements that do not result from cash receipts and cash payments, those users may be wary of the information in the financial statements and the ratios computed using that information. Reporting the revenues and expenses resulting from GIK demonstrates how much an NFP depends on noncash contributions to perform its mission. When used properly, GIK can greatly extend the cash resources of NFPs because the GIK often consist of goods and services the organizations would otherwise have to purchase.
- GIK use is often subject to donor restrictions and sometimes legal restrictions. An NFP needs to be thorough in understanding which restrictions are characteristics of the donated assets (and, thus, are restrictions that affect valuation) and which are donor-imposed use restrictions (which are entity restrictions that affect classification of net assets but don't affect measurements of fair value). For example, when pharmaceuticals are sourced in foreign countries (and, thus, unable to be sold in the United States

because the pharmaceuticals do not meet U.S. Food and Drug Administration standards), it is a best practice to assume a rebuttable presumption that international market prices should be used to determine fair value. The inability of the pharmaceutical to be sold in the U.S. marketplace is an asset characteristic to be considered in valuing the GIK. However, a donor-imposed restriction to use the pharmaceutical in Africa is a donor-imposed use restriction, which affects the classification of the contribution revenue but not the valuation of the GIK.

- In some cases, an NFP makes a payment in association with obtaining an asset, and it needs to determine whether the transaction is a purchase (an exchange of equal values) or is, in part, a contribution (a nominal payment for GIK with substantially higher value). For example, a corporation provides a parcel of land to an NFP with a fair value of \$100,000, but it requests that the NFP provide \$10,000 in exchange for the land. The transaction has an inherent contribution because the nominal fee paid is substantially less than the value of the property. The NFP would recognize a \$90,000 contribution, in this case. If, however, the NFP provided \$90,000 in exchange for the land, the fee paid would not be substantially less than the fair value of the property, and the NFP would not recognize a contribution. A best practice for an NFP may be to have a policy with a rebuttable presumption that such exchange transactions are reciprocal transactions or "purchases." Any indication of a bargain purchase or an inherent contribution when a fee is exchanged should be examined, and the NFP should document any exceptions that overcome the purchase presumption.
- Identifying publicly available inputs to fair value measurement can be challenging. Some GIK are items that the NFP would not otherwise buy and, therefore, the NFP may be unfamiliar with the markets for those items. Some GIK items do not trade in active markets that publish pricing information. An NFP may sell GIK items (and, therefore, have exit prices), but if the NFP's sales do not reflect the item's highest and best use, the sales prices are not fair value. Despite the challenges of valuation, NFPs should make a good faith estimate of fair value by searching for transaction data for actual transactions in active markets they can access. For example, for pharmaceuticals, state Medicaid and federal Medicare prices represent transaction prices in active markets. If the pharmaceuticals are salable in the United States, NFPs could use one of these actual market prices for an estimate of the fair value. However, if the pharmaceutical is only salable internationally, prices in the International Medical Products Price Guides, which also represent transaction prices in active markets, could be used for an estimate of the fair value.
- NFPs strategically partner with organizations to provide necessary GIK to beneficiaries who would not otherwise have access, and GIK is increasingly a component of a corporation's charitable giving program. In some of these partnerships, it can be challenging to determine if the NFP is acting as an agent (either for the donor or the partner) or if the GIK received is actually a contribution received.

- NFPs need to refresh their understanding and consider new market data on a regular basis. This likely will result in changes in valuations of similar items over time, as it should, because markets and values aren't static. NFPs have the responsibility to ensure that fair value knowledge is regularly updated. This means not only updating values but also updating the understanding of markets. Independent auditors will assess management's GIK valuation methodology, but the burden of support for all fair value determinations lies with management.

.57 Additional considerations and resources related to auditing GIK are presented later in this alert.

### ***Changing Demographics and Expectations Around Transparency With Donors at Faith-Based Organizations***

.58 The way in which NFPs solicit contributions and foster relationships with donors and constituents continues to evolve across all sectors of the NFP industry. The needle is moving significantly in faith-based organizations. The millennial generation is driving the change, raising the bar on expectations around digital communication and transparent engagement over fiscal activities and program funding. Many churches, synagogues, and mosques are limiting the number of paper bulletins or newsletters, and many are eliminating weekly collection envelopes in favor of automatic bank withdrawals for ease and convenience of congregants. There has been significant activity on Facebook and in text messaging, and even Pope Francis has a Twitter handle! As with any shift in the way an NFP conducts business, change introduces risks, and management teams and auditors should consider some areas of focus and priority:

- Evaluate the data being used before sharing and publishing.
- Determine needs for constituent communications and level of transparency.
- Evaluate digital giving options and their impact on budget, operations, and controls (very often, this results in increased giving because members do not need to be in attendance to give).
- Consider style in method of communications (that is, text vs. Facebook vs. paper bulletin).
- Because digital communication allows broader reach, consider re-connecting with the entire community, not just those who regularly attend services.
- Use new outreach to search for vacancies in volunteer leadership roles.

### ***The State of Higher Education***

.59 After two years of a stable outlook for higher education, Moody's revised its outlook to negative for 2018. It cited an expected increase in operating revenues of just under three percent that is not expected to keep pace with estimated expenses of almost four percent. Moody's expects softening in tuition revenue growth, research funding, and state appropriations. Also of concern is the potential impact of federal policy and funding, as well as the scheduled reauthorization of the Higher Education Act. Moody's noted that changes to the Pell Grant and direct lending programs could affect affordability and access and further suppress tuition revenue growth.

**.60** The expected decline in net tuition revenue can be attributed, in part, to the continued increase in tuition discounts. According to the National Association of College and University Business Officers (NACUBO) *2016 Tuition Discounting Study*, the average institutional discount rate—or the percentage of total gross tuition and fee revenue that institutions give back to students as grant-based financial aid—was 44.2 percent for undergraduates; up from a record 42.5 percent in the prior year.

**.61** The College Board, in its *Trends in Higher Education Pricing 2017*, reported that average published tuition and fees rose by less than 4 percent. The companion *Trends in Student Aid 2017* report noted that grant aid has continued to rise to help pay these higher charges. In 2016–2017, undergraduate students received, on average, more than \$14,000 in total financial aid (grants, loans, work-study, and education tax credits). On a positive note, although total grant aid has increased, the amount students are borrowing has continued to fall. In 2016–2017, loans made up just 36 percent of total financial aid to undergraduates.

**.62** Strong financial markets resulted in increases in endowment balances in 2017, but the annualized 10-year average return fell to 4.6 percent, down from 5 percent in 2016. The annual NACUBO-Commonfund Study of Endowments reported average gains of 12.2 percent in fiscal year 2017 for the 800-plus institutions that participated in the study. In 2016, schools had average losses of 1.9 percent. Many respondents indicated that they increased spending from endowment funds in 2017 to support student financial aid, research, and other essential programs, despite the lower long-term returns.

### ***Pressures of Deferred Campus Maintenance***

**.63** Being several years out of the economic decline, many higher education institutions' executive leadership and boards are turning their attention and budget allocations to deferred campus maintenance. The set-asides necessary to address future maintenance are not an exciting or fun part of planning for most institutions, but those that are most fiscally responsible have ensured this is part of all budget discussions. With many aging buildings and programs focused on energy-efficient opportunities, deferred campus maintenance has become a "hot topic" of discussion.

**.64** The following are key steps to ensuring that the issue stays top of mind while navigating the discussion and competing for limited budget dollars:

- Create a long-term plan that is relevant and actively monitored. Update it annually, and add new buildings as they are constructed and updated.
- Budget for depreciation.
- Collaborate and create a planning committee. Include members across campus (facilities and key departments) to ensure that a complete picture of needs is assessed.
- Communicate clearly with those charged with governance. Generally accepted accounting principles (GAAP) financial statements may not clearly tell the story of deferred maintenance; consider preparing a crosswalk from the financial statements to the plan for the board or finance committee to review.

## Legislative and Regulatory Developments

### IRS Exempt Organization Function

**.65** The IRS Tax Exempt and Governmental Entities section (TE/GE) underwent several changes in 2017. First, 2017 brought the following realignment, which consolidates five segments into three:

- Indian Tribal Governments (ITG) and Tax-Exempt Bonds (TEB) have been grouped into one function (ITG/TEB).
- Federal, State and Local Governments (FSLG) has been moved into Exempt Organizations (EO) and will now be referred to as Federal, State, Local/Employment Tax (FSL/ET).
- Employee Plans (EP) remains a separate element.

**.66** The section has stated that their values and vision for the future include continuous improvement, data-driven decision making, risk management, employee engagement, and knowledge management. One of the fruits of the IRS EO "knowledge management" function has been the establishment of Knowledge Networks (K-Nets). These EO K-Nets issued 13 "Charities and Non-Profits" Issue Snapshots in 2017.

**.67** In 2017, the IRS EO function also worked on removing technical information, such as summaries of Revenue Rulings and court cases, from the Internal Revenue Manual (IRM) and replaced this information with "Audit Technique Guides" (ATGs). These may be found at [www.irs.gov/charities-non-profits/audit-technique-guides-atgs-for-exempt-organizations](http://www.irs.gov/charities-non-profits/audit-technique-guides-atgs-for-exempt-organizations).

**.68** The IRS EO function continues to sharpen its data-driven decision-making process. Currently, it reports that there are over 200 "queries" run on Form 990-series returns. The goal is to identify returns filed by exempt organizations with the highest risk of noncompliance. It has stated that it will continue to improve Form 990, 990-EZ, and 990-PF compliance models and test the newly developed model for Form 5227, Split Interest Trust Information Return.

**.69** In 2018, the EO function will engage in the following "compliance checks" to determine whether an entity is adhering to recordkeeping and information reporting requirements:

- Combined Annual Wage Reporting (CAWR) employment tax: Tax-exempt employers that had discrepancies between Form W-2 and Form 941 or Form 944
- CAWR—Federal Unemployment Tax Act (FUTA): Exempt organizations that are required but fail to file Form 940
- Form 990-T Non-filer: IRC Section 501(c)(7) organizations that reported investment income on Form 990 or Form 990-EZ but did not file Form 990-T
- Financial Assistance Policy: Tax-exempt hospital organizations that did not comply with IRC Section 501(r)(4)

### IRS Issue Snapshots

**.70** In 2017, the IRS EO function issued 13 "Issue Snapshots." Interestingly, 9 of these concerned unrelated business activities issues. Of special interest to many charities were the following titles:

- Volunteer Labor Exclusion from Unrelated Trade or Business (5/12/17)
- Exclusive Provider Arrangement within Qualified Sponsorship Agreements (06/16/17)
- Rents from Personal Property, "Mixed Leases," and the Rental Exclusion from Unrelated Business Taxable Income (UBTI) (10/18/17)
- Unrelated Business Income from Debt-Financed Property under IRC Section 514 (11/15/17)

.71 To read these and other Issue Snapshots, visit [www.irs.gov/government-entities/tax-exempt-and-government-entities-issue-snapshots](http://www.irs.gov/government-entities/tax-exempt-and-government-entities-issue-snapshots).

## Department of the Treasury and the IRS Issue Priority Guidance Plan for 2017–2018

.72 The joint Department of the Treasury and IRS Priority Guidance Plan for 2017–2018 contains the following items of interest to tax-exempt organizations:

- Updated revenue procedures on grantor and contributor reliance under IRC Sections 170 and 509, including updates to Revenue Procedure 2011-33 for EO Select Check.
- Final regulations on IRC Section 509(a)(3) supporting organizations. Proposed regulations were published on February 19, 2016.
- Guidance under IRC Section 512 regarding methods of allocating expenses relating to dual use facilities.
- Guidance on IRC Section 529(c)(3)(D) on the re-contribution within 60 days of refunded qualified higher education expenses as added by Section 302 of the Protecting Americans from Tax Hikes Act of 2015.
- Final regulations under IRC Section 529A on qualified ABLE Programs as added by Section 102 of the ABLE Act of 2014. Proposed regulations were published on June 22, 2015.
- Guidance under IRC Section 4941 regarding a private foundation's investment in a partnership in which disqualified persons are also partners.
- Update to Revenue Procedure 92-94 on IRC Sections 4942 and 4945.
- Guidance regarding the excise taxes on donor-advised funds and fund management.
- Final regulations under IRC Section 6104(c). Proposed regulations were published on March 15, 2011.
- Final regulations designating an appropriate high-level Treasury official under IRC Section 7611. Proposed regulations were published on August 5, 2009.

.73 On February 7, 2018, the second quarter update to the 2017–2018 Priority Guidance Plan was released. Under the heading, "Part 1. Initial Implementation of Tax Cuts and Jobs Act (TCJA)," three new provisions affecting not-for-profit organizations are listed:



- Guidance on computation of unrelated business taxable income for separate trades or businesses under new IRC Section 512(a)(6)
- Guidance regarding opportunity zones under IRC Sections 1400Z-1 and 1400Z-2. (See also Rev. Proc. 2018-16)
- Guidance on certain issues relating to the excise tax on excess remuneration paid by "applicable tax-exempt organizations" under IRC Section 4960

.74 Additional information on these and other topics is available at [www.irs.gov/uac/priority-guidance-plan](http://www.irs.gov/uac/priority-guidance-plan).

## Listing of Published Guidance—2017

.75 Readers should be aware that the IRS website contains a digest of published guidance for tax-exempt entities. The IRS has been issuing the digest since 1995, and it can be found at [www.irs.gov/charities-non-profits/charitable-organizations/published-guidance-exempt-organizations](http://www.irs.gov/charities-non-profits/charitable-organizations/published-guidance-exempt-organizations). The published guidance includes Treasury regulations, revenue rulings, revenue procedures and notices, and announcements of recently published issues of interest to tax-exempt entities. Additionally, the IRS has a useful tool for NFPs to assist with maintaining their tax-exempt status through compliance with IRS requirements. The publication *Compliance Guide for 501(c)(3) Public Charities* is available at [www.irs.gov/pub/irs-pdf/p4221pc.pdf](http://www.irs.gov/pub/irs-pdf/p4221pc.pdf).

## Unrelated Business Taxable Income Issues

.76 The IRS continues to use data-driven decision making to produce "case selection models" for potential examinations (audits). In addition, the EO function has stated that they are monitoring Form 990-T non-filers.

.77 The 2017 Tax Cuts and Jobs Act (TCJA) process brought three significant new unrelated business income tax (UBIT) provisions into play. First, Section 13702 of the new law contains a provision whereby unrelated business taxable income is "separately computed for each trade or business activity." Second, although not a distinct UBIT provision, Section 13302 modifies the net operating loss (NOL) deduction wherein—after 2017—NOL deductions may not be carried back (but may be carried forward indefinitely) and are limited to the lesser of (a) the aggregate of the NOL carryovers to such a year or (b) 80 percent of taxable income. Finally, Section 13703 of the new law provides that unrelated business income is increased by the amount of certain fringe benefits, including transportation fringes, parking facilities, and on-premises athletic facilities.

.78 Ultimately, it would appear that the IRS will need to update Form 990-T to conform with the various changes. The form has not had a significant revision since 1951.

## Dual-Use Property Issues

.79 One of the 10 "exempt organization" items in the IRS's 2017-18 Priority Guidance Plan relates to the guidance for "methods of allocating expenses relating to dual use facilities."

.80 What are *dual use facilities*? Treasury Regulation 1.512(a)-1(c) states, "Where facilities are used both to carry on exempt activities and to conduct unrelated trade or business activities, expenses, depreciation and similar items attributable to such facilities (as, for example, items of overhead), shall be allocated between the two uses on a reasonable basis."

**.81** The term *reasonable basis* has been an area of contention over the years. Private Letter Rulings and court decisions abound on what is and is not a reasonable basis for expense allocations.

**.82** One example might be a university that owns, operates, and maintains a football stadium. The stadium hosts 7 home football games per year. In addition, each May, the university hosts a big rock concert. Would a reasonable allocation of expenses to the rock concert be 1/8 of all allocable expenses (for example, depreciation, overhead, and similar items) because the concert is 1 of 8 events conducted per year? Or, as the IRS has asserted in some court cases and rulings, should the expenses allocable to the rock concert be 1/365 of all allocable expenses because the concert takes place approximately 1 out of 365 days per year? The difference would be 12.5 percent versus .274 percent, or \$125.00 per \$1,000 versus \$2.74 per \$1,000 of allocable expenditures—quite a difference in terms of millions of dollars of expenses.

**.83** One of the main court cases in this arena is *Rensselaer Polytechnic Institute v. Commissioner* from 1984. In this case, the taxpayer used its fieldhouse many hours per week for functions related to its exempt purpose. In addition, the university received dual-use rental income from a hockey team. The taxpayer calculated allocations for fixed expenses of the fieldhouse based upon the relative times of actual use between exempt and taxable activities. The IRS argued that the appropriate method of allocating fixed costs between exempt and non-exempt activities should be based upon the total time available for use. The Second Circuit affirmed the tax court's decision that Rensselaer's allocation method was "reasonable."

### **Debt-Financed Property**

**.84** Although there is an exemption from UBIT for rentals of real property, debt-financed property rentals are generally subject to UBIT. There are several exclusions regarding debt-financed property, including an exclusion for qualified educational institutions, substantially related use, and the neighborhood land rule.

**.85** The delineation of whether a property is "debt-financed" concerns whether the asset is subject to acquisition indebtedness. *Acquisition indebtedness* is defined in IRC Section 514(c)—with respect to any debt-financed property—as the unpaid amount of

- a. the indebtedness incurred by the organization in acquiring or improving such property;
- b. the indebtedness incurred before the acquisition or improvement of such property if such indebtedness would not have been incurred but for such acquisition or improvement; and
- c. the indebtedness incurred after the acquisition or improvement of such property if such indebtedness would not have been incurred but for such acquisition or improvement and the incurrence of such indebtedness was reasonably foreseeable at the time of such acquisition or improvement.

**.86** Acquisition indebtedness is figured on the basis of each property or facility owned by an organization. There may be situations when a certain property is not "secured" by the acquisition indebtedness but would still be considered debt-financed property.

## Functional Expenses

**.87** FASB Accounting Standards Update (ASU) No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*, provides for enhanced disclosures regarding expenses, including amounts of expenses by both their natural and functional classifications and method(s) used to allocate costs among program and support functions.

**.88** The instructions for Form 990 Part IX, Statement of Functional Expenses, are very specific about which expenses are reported; yet, this part of Form 990 is a source of common errors. 2018 may be a good time for NFPs to look closely at the new requirements under GAAP, along with the Form 990 instructions, and consider whether they need to update their reporting methodologies to improve efficiency, consistency, and accuracy.

## Discrepancies Between FASB ASU No. 2016-14 and Form 990

**.89** ASU No. 2016-14 contains changes to NFP financial reporting standards that generally do not correspond to the presentation in the current Form 990. Awaiting conforming changes from the IRS, Form 990 filers who have implemented ASU No. 2016-14 in conformity with GAAP will have to decide how they will navigate their reporting on "non-updated" IRS forms.

**.90** Ultimately, the largest issue that early adopters of ASU No. 2016-14 and 2018 (and beyond) Form 990 filers will have to navigate relates to Form 990, Part X, Lines 27–29. Currently, those lines read as follows:

- 27. Unrestricted net assets
- 28. Temporarily restricted net assets
- 29. Permanently restricted net assets

**.91** ASU No. 2016-14 replaces three classes of net assets with two:

- Net assets without donor restrictions
- Net assets with donor restrictions

**.92** In addition, Form 990, Part IV, Line 10 is a "trigger" question that currently asks, "Did the organization, directly or through a related organization, hold assets in temporarily restricted endowments, permanent endowments, or quasi-endowments? If 'Yes,' complete Schedule D, Part V."

**.93** Following that line of reporting, Schedule D (Form 990), Part V, Endowment Funds, requires detailed information reporting of endowment funds for the most recent five-year period. Part of that reporting includes reporting on Part V, Lines 2a–2c the percentage of the total endowment funds at the end of the current year broken out among:

- Line 2a Board designated or quasi-endowment \_\_\_\_\_%
- Line 2b Permanent endowment \_\_\_\_\_%
- Line 2c Temporarily restricted endowments \_\_\_\_\_%

**.94** On May 10, 2017, the AICPA's Exempt Organizations Taxation Technical Resource Panel sent a letter to Margaret Von Lienen (Acting Director, Exempt Organizations, Internal Revenue Service) respectfully requesting updates to Form 990 to align with the tenets of ASU No. 2016-14.

.95 The updates requested in the letter concern the following parts of Form 990 and its associated schedules (along with the corresponding instructions):

- Form 990, Part IV, Line 10
- Form 990, Part X, Lines 27–29
- Schedule D (Form 990), Part V
- Form 990 Glossary

.96 The letter recommended specific updates to the form as well as methods for those who have adopted ASU No. 2016-14 early to complete the form if it is not updated by their filing deadline.

.97 Read the letter at [www.aicpa.org/content/dam/aicpa/advocacy/tax/downloadabledocuments/aicpa-comments-on-asu-2016-14-form-990-impact-5-10-17.pdf](http://www.aicpa.org/content/dam/aicpa/advocacy/tax/downloadabledocuments/aicpa-comments-on-asu-2016-14-form-990-impact-5-10-17.pdf).

## Tax Cuts and Jobs Act

.98 Provisions of the TCJA are expected to have significant impacts on charitable giving, among other changes that will affect NFPs.

.99 The following are highlights of interest to NFPs:

- *Decrease in corporate tax rate.* The corporate tax rate drops from a top rate of 35 percent to 21 percent.
- *Charitable contributions.* The income-based limitation for cash contributions to public charities and certain private foundations is increasing from 50 percent to 60 percent. The provision retains the five-year carryover period to the extent that the contribution amount exceeds 60 percent of the donor's adjusted gross income (AGI).
- *Educational savings plans.* IRC Section 529 plans will be available for elementary and secondary tuition.
- *Excise tax on some private colleges and universities.* There is a 1.4 percent excise tax on the net investment income (to be defined) of private colleges and universities who are "applicable educational institutions" (AEIs)—generally meaning the school has at least 500 full-time students, and 50 percent of its students are located in the United States. The "threshold" computation applies to AEIs with an aggregate fair market value of the assets at the end of the preceding taxable year (other than those assets that are used directly in carrying out the institution's exempt purpose) of at least \$500,000 per student.
- *Each unrelated business activity stands alone with respect to profit and loss.* A deduction from one trade or business for a taxable year may not be used to offset income from a different unrelated trade or business for the same taxable year. For an organization with more than one unrelated trade or business, the provision requires that unrelated business taxable income first be computed separately with respect to each trade or business and without regard to the specific deduction. There is a transition rule that says NOLs arising in a taxable year before January 1, 2018, that are carried forward to a future taxable year are not subject to this rule.

- *Net operating losses.* The new law contains a "modification of net operating loss deduction" wherein—after 2017—NOL deductions may not be carried back but may be carried forward indefinitely. In addition, NOLs are limited to the lesser of the aggregate of the NOL carryovers to such a year or 80 percent of taxable income.
- *Estate tax.* The estate tax is retained, with the exemption amount doubled. (Expires in 2026.)
- *Excess compensation.* There is a 21 percent excise tax on compensation in excess of \$1 million paid to a covered employee (that is, one of the five highest compensated employees of the organization) by an applicable tax-exempt organization when there is no substantial risk of forfeiture of the rights to such remuneration (as defined at IRC Section 457(f)(3)(B)). There are several limitations and exemptions to this rule.
- *UBIT on certain fringe benefits.* Unrelated business taxable income includes any expenses paid or incurred by a tax-exempt organization for qualified transportation fringe benefits, a parking facility used in connection with qualified parking, or any on-premises athletic facility, provided such amounts are not deductible under IRC Section 274.
- *Repeal of advance refunding bonds.* Interest on advance refunding bonds (that is, refunding bonds issued more than 90 days before the redemption of the refunded bonds) is taxable. Interest on current refunding bonds continues to be tax-exempt. The provision is effective for advance refunding bonds issued after December 31, 2017.
- *Suspension of moving expenses.* The provisions suspend the moving expense deduction and qualified moving expense reimbursements through 2025, with exclusions for active duty military.

**.100** The following provisions of interest to NFPs did not make it into the final bill:

- *Political campaign activity.* The current "Johnson Amendment," which prohibits any political activity by 501(c)(3) organizations, is not affected.
- *Private foundation taxes.* The current 1 percent or 2 percent structure for taxes on investment income of private foundations is not changed from current law.
- *Tuition reduction and remission rules not affected.* Qualified tuition reductions will remain non-taxable.
- *Employer-provided educational assistance intact.* The Section 127 provision for the nontaxability of certain employer educational assistance is not repealed.
- *Housing for the convenience of the employer.* The House bill contained a provision to provide limits on the amount that could be excluded from an employee's income for employer-provided housing. This provision is not in the final bill.
- *UBIT on research activities.* The House bill included a modification that subjected income from research activities whose results were not publicly available to UBIT. The final bill does not include this provision.

- *Donor-advised fund reporting.* The final bill does not incorporate the House provision to increase reporting and disclosure of donor-advised funds.
- *Private activity bonds.* The House bill included a provision to make interest on private activity bonds taxable. This provision is not included in the final bill.
- *Inflation adjustment for charitable mileage deduction.* The House proposed a provision to repeal the statutory charitable mileage rate and instead provide that the standard mileage rate used for determining the charitable contribution deduction should be a rate that takes into account the variable costs of operating an automobile. This is not included in the final bill.

**.101** Other provisions of interest include the following:

- *Individual tax brackets.* Seven individual tax brackets are set at 10 percent, 12 percent, 22 percent, 24 percent, 32 percent, 35 percent, and 37 percent.
- *Standard deduction.* The final bill nearly doubles the standard deduction, increasing it to \$24,000 for married couples and \$12,000 for individuals.
- *Personal exemptions.* The final bill repeals the deduction for personal exemptions.
- *Individual mandate.* The individual mandate of the Affordable Care Act is effectively repealed.
- *Child Tax Credit.* The Child Tax Credit doubles to \$2,000 per child and is refundable up to \$1,400 per child. A phaseout starts at \$400,000 of income for joint filers. (This provision is set to expire after 2025.)
- *Alternative minimum tax.* The corporate alternative minimum tax is repealed. The individual alternative minimum tax remains, with the phase-out threshold increased to \$1 million for married couples.
- *SALT "buffet."* The final bill provides a state and local tax (SALT) "buffet," with up to \$10,000 of property taxes, state and local income taxes, and sales taxes being deductible in any combination up to the limit.
- *Mortgage interest.* The mortgage deduction does not change, but the limitation on the mortgage amount is now \$750,000, down from \$1 million.
- *Medical expenses.* Medical expenses exceeding 7.5 percent of AGI will be deductible for 2017 and 2018.

**.102** For additional information and resources on the TCJA, visit the AICPA's Tax Reform Resource Center at [www.aicpa.org/taxreform](http://www.aicpa.org/taxreform).

**.103** FASB staff issued five Staff Q&A documents that address various financial accounting and reporting implementation issues related to the TCJA. They can be found at [www.fasb.org/jsp/FASB/Page/BridgePage&cid=1176169774397#section\\_3](http://www.fasb.org/jsp/FASB/Page/BridgePage&cid=1176169774397#section_3).

## Matters Affecting Higher Education

### Form 1098-T, Tuition Statement

**.104** The 2015 PATH Act contained a provision that eliminated the option for educational institutions to either report on Form 1098-T payments received (Box 1) or amounts billed (Box 2). For forms required to be filed for 2016 and 2017, the IRS announced that it would not impose penalties if an institution reported the aggregate amount billed for the calendar year for expenses paid (Box 2). Ultimately, the relief extended the rules in effect prior to the PATH Act. However, the IRS announced in 2017 that no further "Box 1" relief would be granted after 2017.

**.105** In fact, the 2018 Form 1098-T has Box 2 shaded out, leaving the only option as Box 1—"Payments received for qualified tuition and related expenses." The 2018 instructions state the following:

Box 1. Shows the total payments received by an eligible educational institution in 2018 from any source for qualified tuition and related expenses less any reimbursements or refunds made during 2018 that relate to those payments received during 2018.

Box 2. Reserved.

### Tax Cuts and Jobs Act

**.106** The following TCJA provisions, which include some listed previously in the legislative and regulatory discussion of the act, are particularly relevant to higher education institutions:

- *Excise tax on some private colleges and universities.* There is a 1.4 percent excise tax on the net investment income (to be defined) of private colleges and universities who are AEIs—generally meaning the school has at least 500 full-time students, and 50 percent of its students are located in the United States. The "threshold" computation applies to AEIs with an aggregate fair market value of the assets at the end of the preceding taxable year (other than those assets that are used directly in carrying out the institution's exempt purpose) of at least \$500,000 per student.
- *Each unrelated business activity stands alone with respect to profit and loss.* A deduction from one trade or business for a taxable year may not be used to offset income from a different unrelated trade or business for the same taxable year. For an organization with more than one unrelated trade or business, the provision requires that unrelated business taxable income first be computed separately with respect to each trade or business and without regard to the specific deduction. There is a transition rule that says NOLs arising in a taxable year before January 1, 2018, that are carried forward to a future taxable year are not subject to this rule.
- *Excess compensation.* There is a 21 percent excise tax on compensation in excess of \$1 million paid to a covered employee (that is, one of the five highest compensated employees of the organization) by an applicable tax-exempt organization when there is no substantial risk of forfeiture of the rights to such remuneration (as defined at IRC Section 457(f)(3)(B)). There are several limitations and exemptions to this rule.

- *College athletic event seating rights.* Historically, special rules applied to certain payments to institutions of higher education in exchange for which the donor or payor who met certain criteria received the right to purchase tickets or seating at an athletic event. Specifically, the donor or payor could treat 80 percent of a payment as a charitable contribution. The new law includes a denial of this deduction for periods after December 31, 2017.
- *UBIT on certain fringe benefits.* Unrelated business taxable income includes any expenses paid or incurred by a tax-exempt organization for qualified transportation fringe benefits, a parking facility used in connection with qualified parking, or any on-premises athletic facility, provided such amounts are not deductible under Section 274.
- *Repeal of advance refunding bonds.* Interest on advance refunding bonds (that is, refunding bonds issued more than 90 days before the redemption of the refunded bonds) is taxable. Interest on current refunding bonds continues to be tax-exempt. The provision is effective for advance refunding bonds issued after 2017.

## Matters Affecting Religious Organizations

### Ministerial Housing Allowances

**.107** Housing allowances are a decades-old tax benefit used by churches, ministries, and other employers to help offset expenses associated with the home a minister lives in while serving the respective church or ministry. It is especially helpful for small and rural congregations or those in high-cost areas who are not able to pay high enough salaries to recruit and retain pastors.

Challenges have been raised recently about the constitutionality of the ministers' housing allowance. In 2011, the Freedom From Religion Foundation (FFRF) filed a lawsuit (*Freedom From Religion Foundation, Inc. v. Lew*) challenging the constitutionality of IRC Section 107, also known as the *parsonage exemption*. The exemption excludes the value of employer-provided housing benefits from the gross income of any "minister of the gospel."

**.108** In 2012, the district court agreed that the plaintiffs had standing to challenge IRC Section 107(2) and held that the subsection is an unconstitutional establishment of religion under the First Amendment.

**.109** The district court decision was appealed. In November 2014, the U.S. Court of Appeals for the Seventh Circuit issued a decision concluding that the federal tax code provision that treats church-provided housing allowances to ministers as income-tax-free must stand. In doing so, the appeals court overturned the previous decision of the lower district court that had ruled in favor of the FFRF.

**.110** The appeals court decided it had to dismiss the case on the procedural ground of standing before it could even analyze the constitutionality of the law. The court determined that the FFRF and its leaders were not proper parties to challenge the law in federal court because they had not suffered any concrete, personal injury.

**.111** The plaintiffs argued that they did have standing because they were denied a benefit (a tax exemption for their employer-provided housing allowance) that is conditioned on religious affiliation. This argument failed,



however, because the plaintiffs were never denied the parsonage exemption because they never asked for it. Absent any personal denial of a benefit, the plaintiffs' claim amounts to nothing more than a generalized grievance about IRC Section 107(2)'s unconstitutionality, which does not support standing.

**.112** In 2017, the FFRF brought a similar case to the same district court and same judge, adjusting its approach to overcome the standing hurdle. In October 2017, the judge once again ruled that the ministers' housing allowance is unconstitutional. The court issued its ruling without any damages or other remedies awarded, so there is no immediate effect on eligible ministers that take the housing exclusion under current law.

**.113** Looking ahead, the district court's decision likely will be appealed, and a higher court will need to determine whether it agrees that the FFRF has standing and, if so, whether the higher court agrees with the district court's ruling that the housing allowance is unconstitutional. In the meantime, religious organizations and ministers should monitor developments in this matter and consider the possible effects of the ministers' housing allowance (IRC Section 107(2)) being struck down. Potential issues include the following:

- An increase in clergy taxes could present the need for increased quarterly estimated tax payments.
- Budgets could be affected by the need to increase ministers' compensation to offset the negative impact of significant additional taxable income.
- Ministers who are considering the purchase or refinancing of a new home may need to factor in the potential that the ministers housing allowance may not be available in the future.

## Impact of Rising Minimum Wage Law on NFPs

**.114** As advocates pushed for increased minimum wage rates as high as \$15 per hour in more than 20 states across the United States during 2017, NFPs, especially those that are heavily dependent on government funding, are finding it increasingly challenging to meet operating and budgetary needs. Direct-care workers—front-line caretakers serving vulnerable populations (children, the aging, and the developmentally disabled) who would be largely affected by the proposed increases—make up a significant portion of the workforce within many social service organizations. Despite the positive economic benefit to these employees, without increased rates of reimbursement to address the wage increases, there could be negative impacts to the organizations.

**.115** The operations of many social service organizations are more than 90 percent funded by government (primarily Medicaid and Medicare) sources. Of that funding, on average, more than 80 percent is used to pay wages of direct-support professionals. In the last decade, these organizations have seen average reimbursement rate increases of only 0.5 percent annually, which has hindered their ability to provide market wage adjustments over time, leading to vacancies and competition with for-profit retail and fast food establishments.

**.116** NFPs may need to seek additional sources of funding to close this gap if they are in a state that is seeking or anticipating minimum wage increases. Without similar increases in reimbursement rates, potential risks include

- decreases in both quality and quantity of care provided due to staff turnover and vacancies,
- further increased turnover as other industries (retail, restaurant industries, and so on) compete for talent,
- increases in safety violations,
- fewer programs and activities being offered,
- increases in compliance issues, and
- closure or merging of smaller organizations.

## General Data Protection Regulation

**.117** In December 2015, the European Union (EU) General Data Protection Regulation (GDPR) was finalized. The aim of the GDPR is to reinforce data protection rights of individuals, consolidate data protection regulations, and update requirements.

**.118** GDPR will be effective on May 25, 2018. This regulation applies to any organization that controls or processes the data of an EU resident. Organizations based in the United States are affected to a greater extent than was initially anticipated when the GDPR was passed in April 2016. The breadth of the GDPR is extensive and affects organizations across all business lines and functional units, ranging from technology to risk and compliance to human resources.

**.119** Many organizations have not initiated the work necessary to meet the compliance requirements. A few questions NFPs should consider in determining whether GDPR may be applicable to them include the following:

- Is the NFP or its service provider a processor or controller located in the EU (for example, does the NFP have an affiliate organization in the EU)?
- Is the NFP or its service provider a processor or controller that offers goods or services in the EU, or does the NFP accept contributions from people located in the EU?
- Is the NFP or its service provider a processor or controller that monitors behavior in the EU?
- Does the NFP process data of EU citizens who reside in the United States?

**.120** NFPs should evaluate the implications if GDPR applies, as the GDPR regulation includes the following requirements:

- Penalties for failing to comply with the basic processing principles of GDPR may subject the organization to fines up to 20 million or 4 percent of the organization's total global revenue, whichever is greater.
- Organizations have to implement changes and comply with GDPR obligations by May 2018.
- The GDPR imposes new obligations for both controllers and processors of personal data.
- The GDPR places a greater emphasis on accountability and requires greater documentation and records.

.121 For more information, read the full regulation at <https://gdpr-info.eu/>.

## Audit and Attestation Issues and Developments

### Audit Risks for NFPs

.122 As discussed in AU-C section 315 and AU-C section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, some possible audit responses to significant risks of material misstatement include increasing the extent of audit procedures, performing procedures closer to year-end, or modifying audit procedures to obtain more persuasive evidence. Additionally, given constantly changing economic conditions that could affect NFP clients, auditors may consider changes in the environment throughout the audit and potentially modify audit procedures to ensure that risks are adequately addressed.

.123 Although it is impossible to predict and include all accounting, auditing, and attestation issues that may affect NFP engagements, this alert covers primary areas of concern. Auditors should continue to remain alert to economic, legislative, and regulatory developments as well as the associated accounting, auditing, and attestation issues as engagements are performed.

### New Auditing Standard on Going Concern

.124 In February 2017, the Auditing Standards Board (ASB) issued Statement on Auditing Standards (SAS) No. 132, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern* (AU-C sec. 570), which addresses the auditor's responsibilities in the audit of financial statements relating to the entity's ability to continue as a going concern and the implications for the auditor's report. This SAS supersedes SAS No. 126 of the same name.

.125 SAS No. 132 considers the accounting provisions of ASU No. 2014-15, *Presentation of Financial Statements—Going Concern (Subtopic 205-40): Disclosures of Uncertainties about an Entity's Ability to continue as a Going Concern*, and GASB Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*. Both of these standards establish guidance related to management's responsibilities for assessing going concern. SAS No. 132 does not reflect any revisions to International Standard on Auditing (ISA) 570 (Revised), *Going Concern*, related to the convergence with the International Auditing and Assurance Standards Board's other auditor reporting standards because those revisions will be considered with the ASB's overall auditor's report project.

.126 SAS No. 132 requires auditors to consider, during the risk assessment procedures and throughout the audit, if there are conditions or events (considered in the aggregate) that raise substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, which would be the same period used by management when applying the applicable financial reporting framework.

.127 These are a few of the key changes in SAS No. 132:

- Clarification that the auditor's objectives include separate determinations and conclusions with respect to

- whether the entity should be using the going concern basis of accounting in the preparation of the financial statements and
  - whether substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time exists, based on the audit evidence obtained
- A new requirement when management's plans include financial support by third parties or the entity's owner-manager. In these situations, the auditor is required to obtain sufficient appropriate audit evidence about the intent and ability of such parties to provide that financial support. This can be accomplished by obtaining written evidence from management about the third party's commitment or confirming directly with the supporting party. The application material of the SAS contains illustrative wording for a third-party support letter. The SAS indicates that failure to obtain the written evidence constitutes a lack of sufficient appropriate audit evidence regarding the intent of the supporting parties to provide financial support.
  - A requirement for the auditor to ask management about conditions or events beyond the period of management's evaluation that may affect the entity's ability to continue as a going concern. The inquiries are not intended to require management to extend its evaluation period but may affect other disclosure requirements or consideration of whether the financial statements are fairly presented.

**.128** SAS No. 132 is framework neutral. Therefore, the requirements of SAS No. 132 are applied to all audits of a complete set of financial statements even if the applicable financial reporting framework used in the preparation of the financial statements does not include an explicit requirement for management to make a specific evaluation of the entity's ability to continue as a going concern. The auditor maintains its responsibilities to conclude, based on the audit evidence obtained, whether substantial doubt exists and to evaluate the possible financial statement effects of that conclusion.

**.129** SAS No. 132 is effective for audits of financial statements for periods ending on or after December 15, 2017, and for reviews of interim financial information for interim periods beginning after fiscal years ending on or after December 15, 2017. More information is available at [www.aicpa.org/interestareas/frc/auditattest](http://www.aicpa.org/interestareas/frc/auditattest).

## **New Auditing Standard on Auditor Involvement With Exempt Offering Documents**

**.130** In July 2017, the ASB issued SAS No. 133, *Auditor Involvement With Exempt Offering Documents* (AU-C sec. 945), to address the auditor's responsibilities with respect to offerings of securities exempt from registration under the Securities Act of 1933 and to franchise offerings. AU-C section 925, *Filings With the U.S. Securities and Exchange Commission Under the Securities Act of 1933*, addresses offerings of securities that are subject to registration under the Securities Act of 1933.

**.131** SAS No. 133 amends AU-C section 925 and AU-C section 560, *Subsequent Events and Subsequently Discovered Facts*. It becomes effective for

exempt offering documents with which the auditor is involved that are initially distributed, circulated, or submitted on or after June 15, 2018. Some of the key aspects of this standard are discussed in the text that follows.

### **Conditions Establishing Auditor Involvement**

**.132** Paragraph .08 of AU-C section 945 provides two conditions that must both exist to establish involvement with an offering:

- a. The auditor's report is included or incorporated by reference in the official statement that offers the securities for sale and provides appropriate information about the offering.
- b. The auditor performs one or more of the following activities with respect to the official statement:
  - i. Assists the entity in preparing information included in the official statement. Assistance in preparing information is predicated upon the auditor being reasonably aware that the information will be included in a specific official statement. Such assistance may be requested or voluntarily provided. (Note: "Information" in this context does not include the audited financial statements or interim financial information covered by the auditor's report, required supplementary information, or other information that accompanied financial statements already considered during the audit or review.
  - ii. Reads a draft of the official statement at the entity's request. This encompasses situations in which the auditor reads the official statement at the entity's request, even if the auditor does not ultimately provide written or oral comments.
  - iii. Issues a comfort or similar letter in accordance with AU-C section 920, *Letters for Underwriters and Certain Other Requesting Parties*, or an agreed-upon procedures report in accordance with AT-C section 215, *Agreed-Upon Procedures Engagements*, in lieu of a comfort or similar letter on information included in the official statement. These are commonly requested by underwriters as part of the due diligence process.
  - iv. Participates in due diligence discussions with underwriters, placement agents, broker-dealers, or other financial intermediaries in connection with the exempt offering. Underwriters and their counsel may ask to discuss the official statement, either formally or informally, with the entity's auditors. The discussion typically focuses on the audit engagement, the entity's financial statements, and the entity's system of internal control over financial reporting. Auditors who choose to participate in due diligence discussions use professional judgment in determining which questions can be addressed.
  - v. Issues a practitioner's attestation report on information relating to the exempt offering. For example, management or its legal advisers may engage a practitioner to perform agreed-upon procedures on the entity's compliance with

the revenue coverage requirements on outstanding debt securities. Regardless of whether the attestation report is referred to or included in the exempt offering document, if the attestation engagement practitioner is the financial statement auditor whose report is included in the exempt offering document, the auditor is deemed to be involved with the official statement.

If the attestation engagement practitioner is not the financial statement auditor, then the attestation engagement practitioner is not deemed to be involved with the official statement in the manner described in AU-C section 945.

- vi. Provides a written agreement for the use of the auditor's report in the official statement. Although there is generally no regulatory requirement for auditors to provide written permission to use the auditor's report in an offering of municipal securities, they may be asked to. In such case, the auditor may provide an inclusion letter indicating that the auditor agrees to the inclusion or incorporation by reference of the auditor's report in the official statement. See AU-C section 945 for a sample inclusion letter.
- vii. Updates an auditor's report for inclusion in the official statement. This involves, for example, signing an updated report when the previously issued financial statements are corrected for an accounting error. Providing a copy of or resigning a previously issued auditor's report and revising a report to eliminate references to supplementary information, for example, do not constitute an update in this context.

**.133** Auditors may become aware of an offering through a communication from an entity or through the receipt of a draft official statement from an underwriter, placement agent, broker-dealer, or the entity. Awareness of an exempt offering by the auditor does not, by itself, constitute involvement. Conversely, there is nothing that precludes the auditor from following the procedures in AU-C section 945 if the conditions are not met.

### ***Auditor Responsibilities When Involved in an Offering Document***

**.134** The objectives of the auditor when involved with an official statement are to perform procedures specified in AU-C section 945 and respond appropriately as follows:

- a. When the auditor determines that information included or incorporated by reference in the official statement could undermine the credibility of the financial statements and the auditor's report thereon
- b. To facts that become known to the auditor after the date of the auditor's report that, had they been known to the auditor at that date, may have caused the auditor to revise the auditor's report.

**.135** Because municipal securities offerings have multiple stages, a single offering could involve multiple applications of the required procedures. Therefore, it is important for management to keep auditors apprised of the progress so they can complete their consideration of events between the date of the auditor's report and the distribution of the final offering statement.

**.136** In accordance with paragraph .09 of AU-C section 945, the auditor should perform the procedures described in paragraphs .06–.18 of AU-C section 720, *Other Information in Documents Containing Audited Financial Statements*, on the official statement. If management refuses to correct a material inconsistency or misstatement of fact in the official statement, the auditor should notify those charged with governance and take any further action. With exempt offerings, such action may include determining whether to withhold the auditor's agreement to include the auditor's report, in which case, the auditor may wish to obtain legal advice.

**.137** In addition to the procedures related to other information, paragraph .10 of AU-C section 945 requires the following when the auditor is involved with an official statement of a municipal security offering:

- a. Perform procedures designed to identify events occurring between the date of the auditor's report and the date of the distribution, circulation, or submission of the official statement that, had they been known to the auditor as of the date of the auditor's report, may have caused the auditor to revise the auditor's report (that is, "subsequent events" in the context of SAS No. 133). Such procedures should include the following:
  - i. Obtaining an understanding of any procedures that management may have performed to identify such events
  - ii. Inquiring of management and, when appropriate, those charged with governance about whether any such events have occurred that might affect the financial statements
  - iii. Reading minutes, if any, of the meetings of the entity's management and those charged with governance that have been held since the date of the auditor's report and inquiring about matters discussed at any such meetings for which minutes are not yet available
  - iv. Reading the entity's most recent subsequent interim financial statements, if any
- b. Obtain updated written representations from management about the following:
  - i. Whether any information has come to management's attention that would cause management to believe that any of the previous representations should be modified
  - ii. Whether any events have occurred after the date of the auditor's report that would require adjustment to, or disclosure in, the financial statements
  - iii. That management provided complete minutes of the meetings of the entity's management and those charged with governance, or summaries of actions of recent meetings for which minutes have not yet been prepared
  - iv. That management provided communications received from regulatory agencies concerning noncompliance with, or deficiencies in, financial reporting practices since previous representations were provided.

**.138** Paragraphs .11–.12 of AU-C section 945 provide requirements and guidance when a predecessor auditor's report on a prior period is included in

the official statement and when a predecessor auditor of an acquired entity is involved with an official statement.

**.139** Paragraphs .13–.14 of AU-C section 945 state that if the auditor (a) identifies subsequent events that may require adjustment of, or disclosure in, the audited financial statements or reviewed interim financial information or (b) becomes aware of subsequently discovered facts, the auditor should not agree to the inclusion of the auditor's report in the official statement until the auditor's consideration of the subsequent events or facts, including the effect on the auditor's report, has been satisfactorily evaluated in accordance with AU-C section 560.

**.140** If management does not revise the financial statements in circumstances in which the auditor believes they need to be revised, in addition to following the requirements in AU-C section 560, paragraph .15 of AU-C section 945 states that the auditor should not agree to the inclusion of the auditor's report in the official statement.

### ***Clarification in the Official Statement When There Is No Auditor Involvement***

**.141** The auditor may include in the terms of the engagement a provision that any official statements issued by the entity with which the auditor is not involved will clearly indicate that the auditor is not involved with the contents of such offering document. An example disclosure related to an official statement may read as follows:

[Name of Firm], our independent auditor, has not been engaged to perform and has not performed, since the date of its report included herein, any procedures on the financial statements addressed in that report. [Name of Firm] also has not performed any procedures relating to this official statement.

### ***Reference in the Official Statement When There Is Auditor Involvement***

**.142** When performing procedures in accordance with AU-C section 945, the auditor should determine that the auditor's role is not described in the official statement in a way that indicates that the auditor's responsibility is greater than the auditor intends. When an entity refers to the auditor's role in connection with an exempt offering, that section of the document would generally be titled, "Independent Auditors" (or something similar), rather than "Experts," with no reference to the auditor as an expert anywhere in the official statement.

### ***Using Government Auditing Standards Reports and References in an Official Statement***

**.143** NFPs sometimes request that auditors revise an originally issued auditor's report to eliminate references made by the auditor to *Government Auditing Standards* for use in a municipal security offering. Issuing a separate GAAS only report is permitted for this purpose because *Government Auditing Standards* acknowledge that an auditee may need a financial statement audit for purposes other than to comply with a requirement calling for an audit in accordance with *Government Auditing Standards*.



## Recent Changes to SOC 1 Service Auditor Reports

**.144** The ASB issued Statement on Standards for Attestation Engagements (SSAE) No. 18, *Attestation Standards: Clarification and Recodification*, which became effective for practitioners' reports dated on or after May 1, 2017. Under the new standard, AT section 801, *Reporting on Controls at a Service Organization*, is superseded by AT-C section 320, *Reporting on an Examination of Controls at a Service Organization Relevant to User Entities' Internal Control Over Financial Reporting*.

**.145** The following are key changes that those who rely on system and organization controls reports should be aware of.

### Terminology

**.146** Those who previously referred to SOC 1 reports as "SSAE 16 reports" might expect to now refer to them as "SSAE 18 reports." This is not the case, however, because SSAE No. 18 clarifies and codifies multiple attestation standards, not just those applicable to SOC 1 engagements. Therefore, as of May 1, 2017, reports related to the examination of controls at a service organization relevant to user entities' internal control over financial reporting will only be called "SOC 1 reports."

### Risk Assessment

**.147** In accordance with AT-C section 320, the SOC 1 engagement requires management to acknowledge and accept responsibility for identifying and mitigating the risks that threaten the achievement of the control objectives described in the report. In addition, service auditors must understand management's process for and evaluate management's completeness and accuracy in identifying those risks.

### Subservice Organization Monitoring

**.148** AT-C section 320 defines *complementary subservice organization controls* as "controls that management of the service organization assumes, in the design of the service organization's system, will be implemented by the subservice organizations and are necessary to achieve the control objectives stated in management's description of the service organization's system." The SOC 1 engagement now requires service organizations to monitor the effectiveness of complementary subservice organization controls using activities such as the following:

- Reviewing and reconciling output reports
- Holding periodic discussions with the subservice organization
- Making regular site visits to the subservice organization
- Testing controls at the subservice organization by members of the service organization's internal audit function
- Reviewing type 1 or type 2 reports on the subservice organization's system prepared pursuant to AT-C section 320 or AT-C section 205, *Examination Engagements*
- Monitoring external communications, such as customer complaints relevant to the services by the subservice organization

**.149** For more information, consult the full standard, AT-C section 320, at [www.aicpa.org/content/dam/aicpa/research/standards/auditattest/downloadabledocuments/at-c-00320.pdf](http://www.aicpa.org/content/dam/aicpa/research/standards/auditattest/downloadabledocuments/at-c-00320.pdf).

## Auditing Functional Expense Classifications

**.150** When auditing an NFP's financial statements, auditors should address the risk of material misstatement related to the reporting of expenses by functional category. As many donors, charity-rating organizations, and other stakeholders place importance on the level of program expenditures, there could be significant motivation for management to manipulate the financial statements by overstating program expenses in the presentation of functional expenses. As with any risk of misstatement, auditors should properly assess the potential magnitude of misstatement, understand where misstatement is most likely to occur, and plan and perform adequate audit procedures to reduce the risk of material misstatement to an acceptable level.

**.151** When assessing the potential magnitude of misstatement, the auditor should perform planning procedures to gain an understanding of the NFP's ongoing activities in support of its mission, the types of activities and expenditures incurred to support operations, and any major changes in operations that may require a change in the method for allocating expenses. Such procedures may include the following:

- Reviewing board and committee meeting minutes for the year
- Interviewing key employees, both inside and outside the finance office, including a discussion on the types of activities they perform in support of programs, administration, and fundraising activities
- Reviewing the organization's strategic plan, long-term budget, or annual donor report for information related to changes in programs, special events, or other key activities that may be expected to affect the functional expense presentation
- Reviewing changes in organizational structure or job duties during the year that might affect expense allocation methods

**.152** When identifying where misstatement is most likely to occur, the auditor must also obtain an understanding of the organization's controls and processes over capturing and allocating costs among the various functions. Critical to this step, the auditor should pay attention to the skills and knowledge of the employees involved in the cost-allocation process. Employees should be trained and knowledgeable about cost allocation methods, and allocations should go through a supervisory review process.

**.153** Auditors must consider both the potential for intentional manipulation and the potential for error. In considering the potential for intentional manipulation, the auditor should gain an understanding of how management and those charged with governance view the importance of the functional expense presentation, what functional allocation pressures exist for the organization, including watchdog agency rating calculations, and where there may be motivation to manipulate the allocation. For example, does the organization advertise a targeted minimum percentage of expense that will be program-related, or do key grants or contributions require maintenance of certain ratios for program expenses?

**.154** Auditors should also consider where errors in expense allocation are most likely to occur. A common error in allocation occurs from a failure to adjust for changes in circumstances that should result in a change in the allocation method or calculation (for example, the addition of a new program, changes in the use of office space, or changes in the job responsibilities of key employees).

Auditors should perform procedures to review management's expense allocation methods and key inputs each year to ensure they are still reasonable.

**.155** Other areas where misstatements of functional expenses commonly occur include the following:

- Improper use of net vs. gross reporting (for example, reporting common discounts as expenses instead of netting them with revenue or failing to functionalize expenses that are netted against "special events" revenue on the statement of activities)
- Failure to properly apply the guidance contained in FASB ASC 958-720-55 on allocating joint costs of certain solicitations that support both program services and fundraising or management activities
- Failure to identify and allocate costs of time spent by program employees on fundraising and management activities

**.156** Once the risk of misstatement has been assessed, the auditor should design procedures to reduce the risk of misstatement to an acceptable level. Auditors commonly start with an overall analytical procedure comparing the amounts reported to the prior year. Although this procedure can provide a useful comparison of allocated amounts and help to quickly identify where expense allocations have changed significantly, it is less effective at identifying situations when management failed to update allocation methods for changing facts and circumstances. Auditors should keep this limitation in mind and perform additional procedures where warranted. Such additional procedures may include obtaining a matrix of expenses by both nature and function and testing management's method for allocating significant line items. This would include verifying the underlying data used in the allocation. When auditing organizations with large personnel expenses, focused procedures on the allocation of employee time between functions may be warranted. Often, formal or informal interviews with key personnel about their job responsibilities, or a review of job descriptions compared to the payroll cost allocation, may be a useful first step. The auditor may then need to perform detailed testing of personnel allocations, including a review of timesheets or other evidence of personnel activity, to obtain appropriate audit evidence supporting the allocation.

## Confirmations

**.157** Independent, third-party confirmations are an important and prevalent source of audit evidence. Advancements in technology and the resulting evolution of how audit confirmations are processed require auditors to remain vigilant in relation to potential risks of reliance on confirmations. When evaluating their external confirmation audit approach, auditors should review guidance in AU-C section 505, *External Confirmations*, which addresses key considerations in executing the confirmation process.

**.158** A primary area of concern addressed in the guidance is ensuring that confirmation addresses are accurate. Paragraph .A7 of AU-C section 505 indicates that depending on risk assessment, auditors may need to test the validity of some or all of the addresses on the confirmation requests before they are sent out, regardless of the confirmation method used.

**.159** Additionally, when confirmation requests are sent or received via email, the related audit guidance discusses other factors auditors need to consider in order to assess validity. For example, when sending confirmations via

email, the auditor's determination that the request is being directed to the appropriate confirming party may include performing procedures to test the validity of some or all of the email addresses supplied by management. The nature and extent of the necessary procedures is dependent on the risks associated with the particular type of confirmation or address.

**.160** Responses received electronically also involve risks relating to reliability because proof of origin or identity of the confirming party may be difficult to establish, and alterations may be difficult to detect. The auditor should assess the extent of such risks and determine the need for additional procedures to validate the authenticity of the response, such as contacting the confirmation recipient by phone.

**.161** Another confirmation-related issue that deserves special consideration involves situations in which confirmations are not returned. In the case of each nonresponse, audit guidance indicates that the auditor should perform alternative procedures to obtain relevant and reliable audit evidence. In addition, when confirmations are not returned, auditors need to continue to maintain their professional skepticism in evaluating why a response may not have been received. Nonresponses to confirmations may indicate a previously unidentified risk of material misstatement. In such situations, the auditor may need to revise the assessed risk of material misstatement and consider the need to modify audit procedures.

**.162** Auditors can access AU-C section 505 at [www.aicpa.org/content/dam/aicpa/research/standards/auditattest/downloadabledocuments/au-c-00505.pdf](http://www.aicpa.org/content/dam/aicpa/research/standards/auditattest/downloadabledocuments/au-c-00505.pdf).

## Auditing Funds Held at Nonfinancial Institutions

**.163** The AICPA Audit and Accounting Guide *Not-for-Profit Entities* describes the different types of investment pools managed by third parties and the related valuation method (see chapter 4, paragraphs .59–.63 of the guide). The most common third-party managers are

- community foundations,
- colleges and universities that hold funds for supporting organizations, and
- national organizations holding funds for local affiliated organizations.

**.164** Common pool structures and related fair value methods are as follows:

- *Interest similar to an interest in a mutual fund or unit in a hedge fund.* The unit of account is the interest in the fund, not the underlying investments. The interest would be reported as a beneficial interest in an identifiable pool (FASB ASC 958-605-25-33(d)) or, if certain criteria are met, net asset value per share as a practical expedient may be used per FASB ASC 820-10-15, paragraphs 4–5).
- *Interest similar to a brokerage account in which the investments owned are specifically identified.* The investments would be reported as if owned directly, similar to any other investment held in a brokerage account on behalf of the NFP.

- *Interests that are effectively a deposit with a money market fund.* Such funds are valued similar to deposits held at a bank or money market account. Classification as cash, cash equivalent, or investment depends on the circumstances.

**.165** Similar to most investments held by an NFP investee, the two key audit assertions for such investments are *existence* and *valuation*, both of which must be addressed when the item is material from a qualitative or quantitative perspective. Testing existence is usually not problematic and is most often accomplished through confirmation with the third-party manager.

**.166** The challenge with funds held at other than financial institutions is centered on valuation because confirmations are proof of existence only, not valuation. In many cases, the third-party manager does not provide sufficient information regarding the method of measuring fair value or the detail of the underlying investments held in the pool to properly address the valuation assertion. If, however, the third-party manager provides confirmation information for the pool on a security-by-security basis, that information, combined with the existence information, would be sufficient to properly address the valuation assertion.

**.167** Another challenge is that most pools are audited as a part of the overall financial statements for the third-party manager; the pool is not separately audited. For example, many community foundations have multiple "risk pools" that investees can choose from to match their investment risk tolerance. Such pools are typically included within the investment line item in the financial statements of the community foundation; they are not presented as separate, discrete line items. When the community foundation provides an audited footnote disclosure that includes the aggregate fair value of each risk pool, the NFP investee and the auditor have sufficient, appropriate information for valuation purposes. Nonfinancial institution third-party managers are becoming more aware of the valuation and audit challenges presented by such investments and, as a result, audited footnote disclosures about the fair value of investment pools is becoming more common.

**.168** When the third-party manager does not provide audited information at the investment-pool level, the valuation assertion may be addressed through procedures to understand how the third-party manager

- addresses valuation for the pool in total,
- allocates income within the pool, and
- issues, redeems, and allocates new shares or units issued.

**.169** The preceding information, the number of pool shares or units held by all investors at the beginning and end of the period, and income for the period may be used to address the valuation assertion. All that information, combined with the NFP investee's initial and subsequent investments to and divestitures from the pool may provide sufficient information to satisfy existence and valuation audit assertions.

**.170** The quantity and quality of information needed to support the valuation and existence assertions varies in direct proportion with the materiality of the investment compared to the NFP's overall financial statements. When auditors are unable to satisfy themselves with regard to one or both of the relevant audit assertions, they should consider whether that presents a scope limitation that would result in a qualification or disclaimer of their opinion in the audit

report under AU-C section 705, *Modifications to the Opinion in the Independent Auditor's Report*.

**.171** Additionally, the auditor may consider whether the NFP's processes and controls around its investment held at a nonfinancial institution represents a control deficiency that should be communicated to those charged with governance in accordance with AU-C section 265, *Communicating Internal Control Related Matters Identified in an Audit*. When the NFP is relying solely on a periodic statement from the third-party manager—with no additional due diligence, processes, or controls—that situation most likely represents a control deficiency with a magnitude that will be influenced by the overall materiality of the investment.

## Challenges in Auditing GIK

**.172** Assessing an NFP's policies and procedures related to valuing material GIK transactions is an important part of an NFP audit. Because there is no single source of pricing that is appropriate for valuing GIK donations, it falls on the NFP to arrive at an appropriate estimate of fair value. Developing an accurate estimate could involve significant time, effort, and cost, and the NFP should take that into account when deciding to accept a GIK donation. The due diligence process, level of effort by the NFP, and the facts and circumstances for each transaction vary and make auditing GIK contributions received especially challenging. Some key considerations when assessing these estimates are discussed in the following sections.

### ***What Does a "Fair Value Measurement" Mean When It Comes to GIK Contributions?***

**.173** *Fair value* is defined as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date" (FASB ASC Glossary). However, an NFP receives these assets as a contribution, not as a market participant. Thus, the NFP has a hypothetical consideration: Which market would it use if it were to sell the goods? Would the goods be sold in an exit market as a retailer, wholesaler, or manufacturer, or would they be sold in some other market? What if the NFP does not have access to sell the goods in any market?

**.174** Certain GIK may not have a readily determinable marketplace, but typically, they have a base utility that is marketable to someone. NFPs should consider that base utility when determining market values for GIK.

### ***Consideration of Legal Restrictions***

**.175** Legal restrictions fall into one of two buckets—those that affect the entity or those that affect the asset. Legal restrictions that affect only the NFP do not affect the underlying asset's fair value because a hypothetical buyer would not consider the restrictions in a purchase decision because that buyer's use of the asset would not be affected by the restriction imposed on the entity. On the other hand, legal restrictions that could limit a buyer's use of the GIK may affect the assets' fair value. For example, a land conservation easement that limits the use of a piece of land would be considered by a hypothetical buyer and may affect the land's value. An NFP may never actually sell the GIK, but a hypothetical sale should be considered in determining fair

value. An NFP needs to identify any legal restrictions on the GIK and determine if they would affect a hypothetical buyer's use and, thus, the fair value measure.

### Valuation

.176 The following four areas addressed in FASB ASC 820 are particularly challenging when it comes to determining fair value of GIK:

- *Market participants.* NFPs often distribute GIK free of charge or for a nominal fee to beneficiaries who can use the goods but generally do not have access to them. These beneficiaries are not market participants. In addition, nominal fees charged are not prices for the GIK's highest and best use; they are prices that reflect the NFP's mission objectives. Market participants are entities who would transact for the goods and are able to buy the product at its market price. Because of the nature of GIK, a hypothetical market participant scenario may need to be developed to identify potential market participants. These may include other NFPs, governmental agencies, or other entities (including for-profit entities), depending on the goods involved.
- *The principal (or most advantageous) market.* Fair value should be determined using inputs from the *principal market* (defined as the market with the greatest volume and level of activity for the asset), or if there is no principal market, from the *most advantageous market* (defined as the market that maximizes the amount that would be received to sell the asset). Certain GIK, such as pharmaceuticals, clothing, toys, and so on, are regularly obtained subject to entity restrictions prohibiting the NFPs from selling the assets. In those cases, there is no market in which the reporting entity could sell the asset. FASB ASC 820-10-35-6B states that although a reporting entity must be able to access the market, it does not need to be able to sell the particular asset or transfer the particular liability on the measurement date to be able to measure fair value on the basis of the price in that market. Further, the Financial Reporting Executive Committee (FinREC) believes that limitations imposed by IRC Section 170(e)(3) (which provides a larger deduction to the donor if the NFP agrees to use the GIK, rather than sell them), as well as donor-imposed restrictions limiting the geographic area in which GIK may be distributed, are restrictions specific to the entity. Because those restrictions are not a characteristic of the asset that would transfer to market participants, such restrictions would not be considered in pricing the asset.
- *Inputs to valuation techniques.* Once the proper marketplace is identified, it is necessary to identify a source for exit prices in that market. Locating sources is not always easy or inexpensive. Accounting standards provide only broad, general guidance, and many NFPs struggle to find useful guidelines to help determine the value of donated assets. Sometimes, inputs can be found, but the prices may need to be adjusted for differences between the source item and the GIK or for differences between the source price (which could be a list price) and an exit price. The AICPA

Audit and Accounting Guide *Not-for-Profit Entities* provides the following examples.

If GIK are received in wholesale quantity but only retail values are readily available to use as inputs to fair value, then a wholesale discount generally would be applied. Similarly, if the GIK have earlier expiration dates than those of products typically sold in the marketplace or if technological advances have made the GIK less desirable than similar items in the marketplace, a discount should be applied. Whenever GIK differ from the item observed in the marketplace transaction, the NFP should consider whether an adjustment is needed to determine fair value. For some types of GIK, a range of valuation inputs are available, which can result in dramatically different valuations, especially if observed inputs have not been properly adjusted. Small and mid-sized NFPs may not have the resources to access that type of market data. Even NFPs with the resources to purchase the data have discovered that identifying the relevant variables and making the necessary adjustments can be very complicated. Management should consider the potential materiality of the GIK and determine how best to use its limited resources to find inputs.

- *Use of hypothetical markets.* Due to the constraints outlined in the three preceding items, the markets and transactions used for valuation are often hypothetical; yet, this remains the most likely source for determining fair value of certain GIK. All entities that could have access to the hypothetical market should be considered, including for-profit entities, and the value determined in such a hypothetical market would be derived from the hypothetical market participant's perspective as opposed to the reporting entity's perspective.

In other words, if the NFP does not have the ability to sell in any market, FASB ASC 820-10-35-6C states

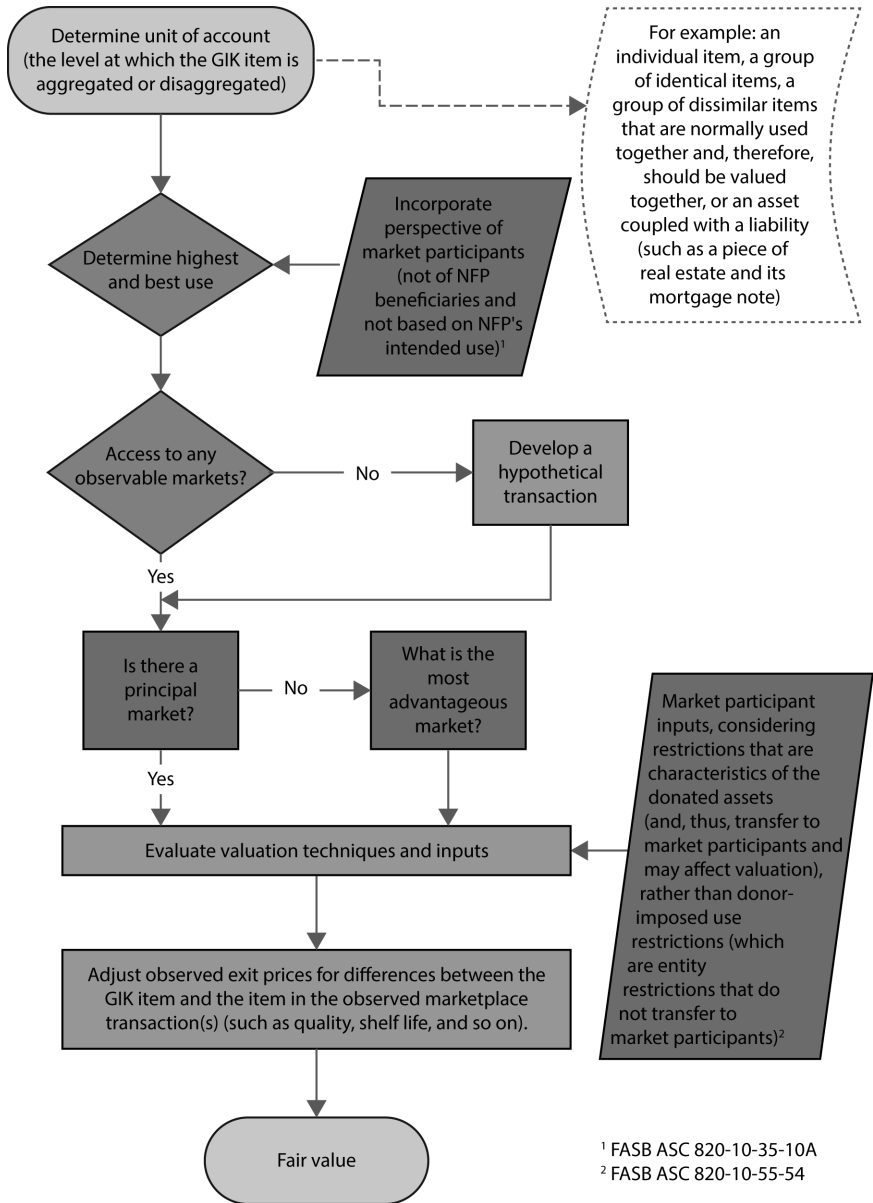
Even when there is no observable market to provide pricing information about the sale of an asset or the transfer of a liability at the measurement date, a fair value measurement shall assume that a transaction takes place at that date, considered from the perspective of a market participant that holds the asset or owes the liability. That assumed transaction establishes a basis for estimating the price to sell the asset or to transfer the liability.

Therefore, the NFP should construct an assumed transaction in a hypothetical or "most likely" market based on its own assumptions about what participants in that market would consider in transacting a sale of the asset. It is reasonable to conclude that activity in inaccessible known markets may be considered in developing the inputs that would be used in a hypothetical market if the reporting entity does not have access to any known or observable markets.

### **Flowchart for GIK of Nonfinancial Assets**

.177 The following is a flowchart describing considerations for the valuation of GIK of nonfinancial assets.





**.178** For GIK received, NFPs can look at the characteristics of the GIK, as well as assumed transactions, to determine appropriate fair values. Though the valuation and contribution considerations are complex, an NFP would be well-served to develop and document a consistent, reasonable process to assess and record the fair value of GIK in accordance with U.S. GAAP. Significant judgment may be involved with GIK. Management's documentation of its assessments and all the GAAP considerations is key.

.179 Readers can obtain additional fair value information from the following sources:

- FASB ASC 820
- AICPA Audit and Accounting Guide *Not-for-Profit Entities*, chapter 5, paragraphs .130–.146, "Fair Value Measurement of Gifts-in-Kind"

.180 Auditors can obtain information on auditing fair value accounting estimates from AU-C section 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*.

.181 Standards developed and published by Accord Network (formerly AERDO) could assist NFPs and their auditors. These standards offer best practices and additional guidance for NFPs in applying GAAP and IRS rules for GIK acceptance, accounting, and reporting. The standards can be found at [http://gikstandards.com/docs/GIK\\_Standards\\_Ver2009.pdf](http://gikstandards.com/docs/GIK_Standards_Ver2009.pdf). Note that although they have been developed with every effort to follow GAAP, Accord's GIK standards are nonauthoritative under FASB ASC.

## Transformative Technology on the Horizon

.182 Advances in technology have had a significant impact on auditors and financial reporting professionals in the last 10 to 20 years. However, certain new innovations that are just beginning to take hold could have an even greater impact on the CPA profession. The primary technology advances in question include blockchain, data analytics, and artificial intelligence.

.183 Though different in nature, these technologies are tied together by their potential to profoundly change financial reporting and the audit profession, broadly speaking, and among NFPs. The discussion that follows is intended to introduce these new technologies. Additional sources of information are widespread and can be researched to discover more in-depth information on these emerging technologies.

.184 *Blockchain* is a "decentralized, transparent public ledger where individuals can share information without having to trust a third party to verify the information. Multiple people can access copies of the ledger simultaneously, allowing transactions such as contracts to be recorded and verified without a principal authority." Blockchain technology's ability to verify the reliability of electronic files has potentially far-reaching implications for how transactions are tracked, processed, and ultimately audited.

.185 Another technology-related area that is currently affecting the profession is data analytics. All organizations, including NFPs, are generating and retaining vast amounts of data in their operations. These data are being analyzed to provide information and insight regarding critical business issues. The presence of these data also presents a significant opportunity for auditors to rethink how they approach and execute certain audit procedures.

.186 The AICPA *Guide to Audit Data Analytics* defines *audit data analytics* as "the science and art of discovering and analyzing patterns, identifying anomalies, and extracting other useful information in data underlying or related to the subject matter of an audit through analysis, modeling, and visualization for planning or performing the audit." Simply put, audit data analytics can be used to perform a variety of procedures to gather audit evidence. Areas unique to NFP audits likely to be affected due to their significant volume of

data may include charitable donations, student tuition, and membership revenue, among others. Many audit firms and technology companies are making investments in this technology and anticipate that it will significantly affect the nature of audit procedures in coming years.

**.187** With this mountain of data, the need to analyze it, draw conclusions, and make effective decisions is critical. This is where artificial intelligence and machine learning enter the picture. Artificial intelligence, and machine learning in particular, have advanced significantly in recent years. *Machine learning*, a form of artificial intelligence, is generally defined as a computer's ability to learn without having to be specifically programmed. Although the use of this technology in the CPA profession is still in its early stages, advancements have been made in the way audit procedures are conducted. Examples include using machine learning in the performance of tasks such as reading contracts, analyzing bank credit files, and scanning transactions for evidence of fraud.

**.188** These technologies individually, and especially in combination, present the potential for rapid change and disruption in the world of audit and financial reporting. Many believe that companies using these technologies today have merely scratched the surface of their capabilities. The future success of NFPs and the auditors who serve them could be highly linked to the effective implementation of these technologies.

## Accounting Issues and Developments

### Revenue From Contracts With Customers

**.189** In May 2014, FASB and the International Accounting Standards Board (IASB) issued their much-anticipated converged standard on revenue recognition. FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers*, and the IASB issued International Financial Reporting Standard (IFRS) 15, both titled *Revenue From Contracts With Customers*. With only some minor differences, FASB and IASB guidance represent a single, global, principles-based revenue recognition model.

**.190** In August 2015, FASB issued ASU No. 2015-14, *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date*, which extended the effective date for all entities by one year. As a result, most NFPs will apply the new standards for annual reporting periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019.

**.191** However, NFPs that have issued, or are conduit bond obligors for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market are required to apply the standards for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Earlier application is permitted.

**.192** The new revenue recognition model replaces virtually all existing guidance for revenue recognition of exchange transactions. However, guidance for non-exchange, or contribution, transactions remains unchanged. The guidance affects all entities—public, private, and NFP—that enter into contracts with customers to transfer goods or services or to transfer nonfinancial assets. Unless those contracts are within the scope of other standards (such as for

leases, financial instruments, or insurance contracts), the impact of the new rules should be considered.

**.193** The extent of the impact on an entity will differ depending on various factors such as the transaction, its complexity, and the industry in which the entity operates. In some cases, there may be no change to the amount and timing of revenue recognition. In other cases, there will be changes, and those changes could be significant.

**.194** The industries most affected by changes in the amount and timing of revenue recognition will include telecommunications, aerospace, construction, real estate, and software. New qualitative and quantitative disclosure requirements about revenue and contracts with customers will have an impact on almost all entities.

### **Impact on NFPs**

**.195** The AICPA formed 16 industry task forces to assist in developing a new guide on revenue recognition that provides insights and illustrative examples on how to apply the new standards. Revenue recognition implementation issues identified by the Not-for-Profit Entities Revenue Recognition Task Force are available at [aicpa.org](http://aicpa.org). The AICPA Not-for-Profit Revenue Recognition Task Force (NFP RRTF) has been discussing a number of issues that could affect exempt organizations upon implementation of this particular standard:

- Contributions are excluded from the standard because a donor is not considered a *customer* as defined in the ASU.
- Certain transactions will require bifurcation between an exchange transaction and a contribution. For example, membership dues or special events (for example, golf outings) may have elements of an exchange transaction and a contribution. Generally, the organization will determine the exchange component of the transaction under the new revenue recognition standard and apply contribution accounting to the remainder.
- An area being addressed in a proposed ASU is applying this new standard when accounting for private and government grants. Depending on the facts and circumstances, under the terms of some grant agreements, the government or other grantor may not be considered a customer because it is not receiving something of approximately equal value in return for the grant funds but, rather, its constituents or society as a whole receives the respective value. Due to the new definitions related to revenue, NFPs implementing this standard may need to reevaluate their classification of grants between exchange transactions and contributions. Those grants that previously fit the criteria of exchange transactions may better align with the definition of *conditional contribution* than that of a contract with a customer.

### **Disclosures**

**.196** Detailed qualitative and quantitative disclosures are required about (a) the entity's contracts with its customers, (b) significant judgments made in applying the revenue recognition guidance to those contracts, and (c) information about any assets recognized for contract costs.

## ***Effective Dates and Transition***

**.197** As mentioned previously, public entities must adopt the new revenue recognition standard for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. All other entities must adopt the new guidance effective for annual and interim reporting periods beginning after December 15, 2018.

**.198** ASU No. 2014-09 provides two methods of applying the changes resulting from the application of the new rules. FASB allows either option to be elected by public and nonpublic entities; no alternative transition option is provided for nonpublic entities.

**.199** The first option allows an entity to retrospectively apply the new revenue recognition standard to each prior reporting period presented. When using this application option, any of the following practical expedients can be elected:

- For completed contracts, the entity is not required to restate contracts that begin and end within the same annual reporting period.
- For completed contracts having variable consideration, the entity may use the transaction price at the date the contract was completed, rather than estimating variable consideration amounts in the comparative reporting periods.
- For all reporting periods presented before the date of initial application, an entity does not have to disclose the amount of the transaction price allocated to remaining performance obligations and the explanation of when the entity expects to recognize that amount in revenue.

**.200** The second option allows an entity to adopt the new guidance retrospectively, with the cumulative effect recognized in the opening balance of net assets at the date of initial application. Comparative periods presented would not have to be restated. Under this option, the new rules would be applied only to contracts that are uncompleted at the date of initial application. When selecting this application method, the entity should provide additional disclosures about the amount by which application of the new rules affected each financial statement line item in the current accounting period compared to the guidance that was in effect before the change, along with an explanation of the reasons for significant changes.

**.201** A third option for NFPs could be to present single-year financial statements, rather than comparative financial statements, in the year of adoption. However, NFPs should consider whether a single-year presentation would meet the needs of financial statement users.

## ***Developing an Implementation Plan***

**.202** Whether an NFP plans to implement the new revenue recognition requirements prior to the effective date or at the last possible moment, taking the following steps now will help the NFP prepare for a smooth transition:

- Read the standard and all relevant commentary from audit firms, attend related training courses, and read the FASB/IASB Joint Transition Resource Group for Revenue Recognition materials.

- Assign individual staff to become subject matter experts on specific revenue categories or by section to lead a group of staff to understand and implement the new standard. Include relevant staff outside of accounting: internal audit, legal, and so on.
- Compile a list of all organizational revenue streams. Here are some examples:
  - Membership dues
  - Royalties
  - Advertising revenue
  - Sponsorship revenue
  - Federal, state, or private grants
  - Investment income
  - Contributions
  - Retail sales
  - Educational service fees
  - Pass-through funds
  - Tuition
  - Fee for service
  - Refunds
  - Miscellaneous
  - For-profit affiliate revenues
- Develop and document a position paper on each revenue stream:
  - Determine whether the revenue stream is within the scope of the standards
  - Document the current process (if applicable).
  - Identify the relevant guidance, being as specific as possible when options are presented.
  - Support any position with facts, including facts about why a specific requirement may not be applicable.
  - Document the conclusion on how to recognize revenue.
  - Review with the external auditor.
  - Finalize and approve the new recognition policy.
- Consider discussing issues with similar organizations in the same industry.
- If a change is required, is it material?
  - If no, document, discuss impact with auditors (annual passed adjustment?), and continue with prior recognition methodology.
- If a change in recognition is required, consider the impact on the following:
  - Any needed verbiage changes for new related contracts

- Recognition processes within the accounting system
  - Technical changes within the accounting or supporting systems
  - Monthly and annual financial close process
  - Internal financial reporting
  - Audited financial statements
  - Forecast and budget processes
  - Dashboard goals
- Communicate changes to CFO, board, audit and finance committee, senior staff, key programmatic stakeholders, auditors, internal auditors, contract signers, banks, bondholders, and so forth.
  - Determine requirements to retrospectively adopt the new standard.
  - Develop a plan for staff training.

**.203** Additional information and resources are available at the AICPA Revenue Recognition Center at [www.aicpa.org/revenuerecognition](http://www.aicpa.org/revenuerecognition).

### ***Grants and Contracts Under FASB ASC 606***

**.204** Stakeholders (including the Not-for-Profit Advisory Committee, the AICPA Not-for-Profit Expert Panel, NFP RRTF, and others) raised concerns regarding difficulty and diversity in practice among NFPs with the following two issues:

- Issue 1: Characterizing grants and similar contracts with government agencies and others as reciprocal transactions (exchanges) or nonreciprocal transactions (contributions)
- Issue 2: Distinguishing between conditions and restrictions for nonreciprocal transactions

**.205** Despite the degree of existing guidance, there is significant diversity in practice on the conclusions being reached for issues 1 and 2 for many grants and contracts, particularly those with governmental entities. In some instances, similar grants and contracts are accounted for as nonreciprocal transactions (generally conditional) by some NFPs and as reciprocal transactions (exchanges) by other NFPs. Although these issues have been a long-standing problem prior to the issuance of ASU No. 2014-09, the new guidance has placed renewed focus on the issues due to the elimination of limited exchange transaction guidance in FASB ASC 958-605 and additional disclosure requirements that do not seem relevant to these types of transactions.

**.206** To improve and clarify existing guidance, FASB issued an exposure draft, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made*, in August 2017.

**.207** The proposed ASU attempts to clarify how an entity determines whether a resource provider (including a private foundation, a government agency, or other) is participating in an exchange transaction by evaluating whether the resource provider is receiving commensurate value in return for the resources transferred. Two important clarifications follow:

- A resource provider is not synonymous with the general public. Indirect benefits received by the public as a result of the assets transferred is not equivalent to commensurate value received by the resource provider.
- Execution of a resource provider's mission or the positive sentiment from acting as a donor would not constitute commensurate value received by a resource provider for purposes of determining whether a transfer of assets is a contribution or an exchange.

**.208** In addition, once a transaction is deemed to be a contribution, stakeholders have indicated that it can be difficult in practice to distinguish between conditional and unconditional contributions. There also is diversity in practice in determining whether the likelihood of failing to meet a condition is remote, which can affect when a contribution is recognized. This is an important distinction because the contribution guidance in FASB ASC 958-605 requires an entity to determine whether a transaction is conditional or unconditional, which affects the timing of the revenue recognized.

**.209** The amendments in the proposed ASU would require that an entity determine whether a contribution is conditional on the basis of whether an agreement includes a barrier that must be overcome in order for the NFP to be entitled to the assets transferred and either a right of return of those assets or a right of release of a promisor's obligation to transfer assets. Several indicators used as guidance in this assessment of whether an agreement contains a barrier are included in the proposed ASU.

**.210** Overall, the diversity in both issues discussed previously occurs for grants and contracts from various types of funders, but government grants and contracts appear to cause the most concern among stakeholders. The conclusions can affect the timing and net asset classification of the revenue recognized in such transactions.

**.211** In practice, many nonprofits treat grants and contracts with governmental entities as exchange transactions, regardless of the underlying substance of the contract. This is done for two key reasons:

- Many equate the government with the general public. Even though the government isn't getting a direct commensurate value in return for the services provided, the general public is.
- Many believe the government does not make "contributions."

**.212** Under the proposed ASU, the Master Glossary definition of *contribution* would be updated as follows:

**Contribution**—An unconditional transfer of cash or other assets to an entity or a settlement or cancellation of its liabilities in a voluntary nonreciprocal transfer by another entity acting other than as an owner. Those characteristics distinguish contributions from:

- Exchange transactions, which are reciprocal transfers in which each party receives and sacrifices approximately commensurate value;
- Investments by owners and distributions to owners, which are nonreciprocal transfers between an entity and its owners;



- Other nonreciprocal transfers, such as impositions of taxes or legal judgments, fines, and thefts, which are not voluntary transfers.

In a contribution transaction, the resource provider often receives value indirectly by providing a societal benefit. In an exchange transaction, the potential public benefits are secondary to the potential proprietary benefits to the resource provider.

**.213** Entities would be required to assess whether the "resource provider is receiving commensurate value in return for the resources transferred" when determining whether a transfer of assets is an exchange transaction.

**.214** Upon factoring in the proposed clarified definition of *contribution*, many grants and some contracts could be considered nonreciprocal. Does that mean grants and contracts that entities may have previously accounted for as "exchange" transactions would now be contributions? Not exactly. There is one more clarification in the proposed ASU: conditional contributions.

**.215** A contribution could be considered conditional if the agreement between the donor/grantor/agency and the nonprofit includes (a) a barrier, and (b) either a right of return of assets transferred or a release of the donor/grantor/agency from its obligation to transfer assets.

**.216** Several indicators of barriers are listed in the proposed ASU, including measurable performance-related requirements, primary purpose agreements, and limited recipient discretion over how funds are spent.

**.217** The proposed ASU includes a flowchart to help NFPs navigate through the determination of a contribution versus an exchange, in which the decision point is based on its reciprocal nature. If the transaction is deemed a contribution, the next decision point is whether there are conditions that indicate a right of return or release, as well as a barrier. Once the entity is past the conditions, because they either do not exist or they have been met, it should assess if there are restrictions, such as use being limited to a specific purpose or time.

**.218** The potential impact of the proposed ASU on NFPs may include the following differences:

- Agreements that an NFP previously reported as exchange transactions may need to be reported as conditional or unconditional contributions. Unconditional contributions, would be classified as donor restricted or without donor restrictions.
- If an NFP currently accounts for grants and contracts as exchange transactions using a cost-based reimbursement model, the timing of revenue recognition likely would be the same under the proposed ASU. Under existing guidance, NFPs recognize revenue as they incur the expenses (that is, perform the required service). Under the proposed guidance, they likely would do the same because once they meet the condition by spending the money according to the terms of the grant, the revenue would be recognized.

**.219** More information is available at [www.fasb.org](http://www.fasb.org).

## Accounting Standards Updates Effective in 2017

**.220** The following ASUs have specific relevance for NFPs and became effective for, or are likely to be implemented early for, periods ending in 2017 or 2018.

### ***FASB NFP Financial Statement Presentation Standard***

**.221** On August 18, 2016, FASB issued ASU No. 2016-14. The purpose of this ASU is to simplify and improve how an NFP classifies its net assets, as well as the information it presents in financial statements and notes about its liquidity, financial performance, and cash flows.

**.222** The ASU requires improved presentation and disclosures to help NFPs provide more relevant information about their resources, and the changes in those resources, to donors, grantors, creditors, and other users.

### ***Required Changes***

**.223** ASU No. 2016-14 makes several changes to the current reporting requirements of an NFP to address, among others, the following issues:

- Complexities about the use of three classes of net assets that focus on the absence or presence of donor-imposed restrictions and whether those restrictions are temporary or permanent
- Deficiencies in the transparency and utility of information useful in assessing an entity's liquidity caused by potential misunderstandings and confusion about the term "unrestricted net assets" and how restrictions or limits imposed by donors, grantors, laws, contracts, and governing boards affect an entity's liquidity, classes of net assets, and financial performance
- Inconsistencies in the type of information provided about expenses of the period—for example, some, but not all, NFPs provide information about expenses by both nature and function
- Impediment of having to prepare the indirect-method reconciliation when the direct method is used to present operating cash flows

**.224** With respect to the statement of financial position, this ASU requires that the statement should focus on the NFP as a whole and should report the following:

- Total assets
- Total liabilities
- Total net assets
- Total net assets with donor restrictions
- Total net assets without donor restrictions

**.225** The amounts for net assets with donor restrictions and net assets without donor restrictions are based on the existence or absence of donor-imposed restrictions. Information about the nature and amounts of different types of donor-imposed restrictions should be provided either by reporting their amounts on the face of the statement of financial position or by including relevant details in notes to financial statements.

**.226** The two required net asset classes (with donor restrictions and without donor restrictions) are a minimum classification presentation. However, as

with all FASB requirements, they are applicable to the extent they are material to the financial statements. If an NFP does not have net assets with donor restrictions, that heading would not be presented. Additionally, an NFP can choose to further disaggregate the two net asset classes. For example, an NFP may wish to disaggregate net assets with donor restrictions between those expected to be maintained in perpetuity and those expected to be spent over time or for a particular purpose.

**.227** Examples of items that an NFP may wish to present as separate line items within net assets with donor restrictions or in notes to financial statements to distinguish between various types of donor-imposed restrictions, could include the following:

- Assets, such as land or works of art, donated with stipulations that they be used for a specified purpose, be preserved, and not be sold
- Assets donated with stipulations that they be invested to provide a permanent source of income
- Support of particular operating activities
- Investment for a specified term
- Use in a specified future period
- Acquisition of long-lived assets
- Split-interest agreements held by third-party trustees

**.228** Endowment funds are established either by a donor or by a governing board and could be either with or without donor restrictions. Endowment funds with donor restrictions, referred to as *donor-restricted endowment funds*, result from a gift with a stipulation that the resources be invested either for a long, specified period or in perpetuity. Endowments without donor restrictions are referred to as *board-designated endowment funds*. A board-designated endowment fund is created when a governing board designates or earmarks a portion of its net assets without donor restrictions to be invested, generally for a long, but possibly unspecified, period.

**.229** This ASU requires an NFP to report the net assets of an endowment fund in a statement of financial position based on the existence or absence of donor-imposed restrictions. A donor-restricted endowment fund would be classified as net assets with donor restrictions. A board-designated endowment fund, which generally results from an internal designation of net assets without donor restrictions, would, thus, generally be classified as net assets without donor restrictions.

**.230** This ASU also indicates that it is useful for NFPs to provide information about self-imposed limits, including information about voluntary resolutions by the governing board of an entity, such as resolutions to designate a portion of its net assets without donor restrictions to function as an endowment or to designate a portion for a specific future expenditure, referred to as *board-designated net assets*. Information about the amounts and purposes of board designations of net assets without donor restrictions should be provided in notes to or on the face of financial statements.

**.231** Generally, restrictions apply to net assets, not to specific assets. Assets need not be disaggregated based on the presence of donor-imposed restrictions on their use; for example, cash available for current use and without donor restrictions need not be reported separately from cash received with donor-imposed restrictions that is also available for current use. However, cash or

other assets received with donor-imposed restrictions that limit their use to long-term purposes should not be classified with cash or other assets that are without donor restrictions and are available for current use. The kind of asset whose use is limited either by a donor-imposed restriction or by governing board designations should be described in the notes to the financial statements if the nature of the restriction or designation (that is, amount and purpose) is not clear from the description on the face of the statement of financial position.

**.232** ASU No. 2016-14 also requires an NFP to present on the face of the statement of activities the amount of the change in each of the two classes of net assets, rather than that of the currently required three classes. An NFP is required to aggregate items of revenue, expenses, gains, and losses into reasonably homogeneous groups and classify and report them as increases or decreases in net assets with donor restrictions or net assets without donor restrictions. An NFP would continue to report the currently required amount of the change in total net assets for the period.

**.233** A statement of activities should report expenses as decreases in net assets without donor restrictions, except for investment expenses, which should be netted against investment return and reported in the net asset category in which the net investment return is reported. Additionally, there is no longer a requirement to disclose the amount of those netted investment expenses.

**.234** Gains and losses recognized on investments and other assets (or liabilities) should be reported on a statement of activities as increases or decreases in net assets without donor restrictions, unless their use is restricted by explicit donor stipulations or by law that extends donor restrictions.

**.235** In the United States, most donor-restricted endowment funds are subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 that extends a donor's restriction to use of the funds, including the investment return, until the funds are appropriated for expenditure by the governing board. Thus, if a donor or law imposes a restriction on the investment return, those returns should be reported within net assets with donor restrictions until appropriated for expenditure. Conversely, for an endowment fund that is created by a governing board (that is, a board-designated endowment fund), assuming no other purpose-type restrictions from donors exist on the use of those funds, that original fund and all investment returns are free of donor restrictions and should be reported in net assets without donor restrictions.

**.236** The amount of net assets with donor restrictions in a donor-restricted endowment fund is reduced when the governing board appropriates amounts for expenditure from the endowment fund. Upon such appropriation, the restriction expires to the extent of the amount appropriated as long as all the time restrictions have lapsed and all the purpose restrictions have been met. At that time, the appropriated amount is reclassified from net assets with donor restrictions to net assets without donor restrictions. However, if purpose restrictions from a donor have not yet been met, those funds should remain in net assets with donor restrictions until the purpose restrictions have been satisfied.

**.237** The ASU also requires an NFP to use, in the absence of explicit donor stipulations, the placed-in-service approach for reporting expirations of restrictions on gifts of cash or other assets to be used to acquire or construct a long-lived asset. NFPs that use the option to release the donor-imposed restriction over the estimated useful life of the asset should reclassify any amounts from

net assets with donor restrictions to net assets without donor restrictions for such long-lived assets that have been placed in service as of the beginning of the period of adoption.

**.238** NFPs will be required to report expenses by nature and function because this information is useful in associating expenses with the service efforts and accomplishments of the organization. All NFPs should report information about all expenses in one location—on the face of the statement of activities, as a schedule in the notes to financial statements, or in a separate financial statement. The relationship between functional classification and natural classification for all expenses (except for investment expenses that are netted against investment return) should be presented in an analysis that disaggregates functional expense classifications, such as major classes of program services and supporting activities, by their natural expense classifications, such as salaries, rent, electricity, supplies, interest expense, depreciation, awards and grants to others, and professional fees.

**.239** To the extent that expenses are reported by other than their natural classification (such as salaries included in cost of goods sold or facility rental costs of special events reported as direct benefits to donors), they should be reported by their natural classification in the functional expense analysis. For example, salaries, wages, and fringe benefits that are included as part of the cost of goods sold on the statement of activities should be included with other salaries, wages, and fringe benefits in the functional expense analysis.

**.240** External and direct internal investment expenses that have been netted against investment return should not be included in the functional expense analysis. Certain items that are typically reported in other comprehensive income of for-profit entities are considered gains or losses and, like other gains and losses, may not be included in the functional expense analysis.

**.241** With respect to the statement of cash flows, NFPs continue to present on the face of the statement of cash flows the net amount for operating cash flows using either the direct or indirect method of reporting but are no longer required to provide the presentation or disclosure of the indirect method (reconciliation) if using the direct method.

**.242** ASU No. 2016-14 requires certain enhanced disclosures about the following:

- Amounts and purposes of governing board designations, appropriations, and similar actions that result in self-imposed limits on the use of resources without donor-imposed restrictions as of the end of the period.
- Composition of net assets with donor restrictions at the end of the period and how the restrictions affect the use of resources.
- Qualitative information that communicates how an NFP manages its liquid resources available to meet cash needs for general expenditures within one year of the date of the statement of financial position.
- Quantitative information, either on the face of the statement of financial position or in the notes, and additional qualitative information in the notes as necessary, that communicates the availability of an NFP's financial assets at the date of the statement of financial position to meet cash needs for general expenditures

within one year of the date of the statement of financial position. Availability of a financial asset may be affected by (a) its nature, (b) external limits imposed by donors, grantors, laws, and contracts with others, and (c) internal limits imposed by governing board decisions.

- Method(s) used to allocate costs among program and support functions.
- Underwater endowment funds, which include required disclosures of
  - an NFP's policy, and any actions taken during the period, concerning appropriation from underwater endowment funds;
  - the aggregate fair value of such funds;
  - the aggregate of the original gift amounts (or level required by donor or law) to be maintained; and
  - the aggregate amount by which funds are underwater (deficiencies).

**.243** If a donor-restricted endowment fund is an underwater endowment fund, the accumulated losses should be included together with that fund in net assets with donor restrictions.

### *Example Presentation and Disclosures*

**.244** The unique nature of the operations and mission of many organizations in the NFP sector will likely result in variation in the form and content of these requirements in financial statements. To provide further insight, the following series of examples has been included to illustrate the impact of these requirements on varying types of NFPs. Though not exhaustive, these examples should provide context for the ultimate impact related to some of these requirements.

**.245** *Liquidity and Availability of Resources.* ASU No. 2016-14 requires NFPs to provide qualitative information about how they manage their liquidity and quantitative information (and qualitative information, as necessary) about the availability of financial assets at the balance sheet date to meet cash needs for general expenditures within one year of that date. The disclosures are intended to clarify the effects of restrictions and other limitations on financial assets, such as those imposed by donors, grantors, laws, contracts, or board decisions. Even NFPs that present a classified balance sheet to provide information about liquidity will need to evaluate whether they should provide more quantitative information about the availability of current financial assets that are free of restrictions or limits.

**.246** ASU No. 2016-14 doesn't provide standards about the types of qualitative or quantitative information to include. However, there are examples of notes that meet the requirements in FASB ASC 958-205-55 and FASB ASC 958-210-55. Those examples include qualitative disclosures about the following:

- The organization's responsibility to maintain resources to meet donor restrictions, which may make those resources unavailable for general expenditures
- The organization's goals for maintaining financial assets

- The organization's policies for investing excess cash
- The organization's policies for spending from board-designated (quasi) endowment funds
- Contractual agreements that make certain financial assets unavailable to fund general expenditures
- Lines of credit that would be drawn down if the organization did not have any liquid, available financial assets.

**.247** ASU No. 2016-14 does not define *general expenditures*. Because the determination of which expenditures are general expenditures affects the determination of whether a financial asset is available to meet cash needs for general expenditures, the additional qualitative information required by FASB ASC 958-210-50-1A(b) may need to include a description of how both general expenditures and availability of financial resources are determined by the NFP.

**.248** Here are three examples of how an NFP could provide **qualitative** information about how it manages its liquidity.

**.249** Example 1: NFP A is substantially supported by restricted contributions. Because a donor's restriction requires resources to be used in a particular manner or in a future period, NFP A must maintain sufficient resources to meet those responsibilities to its donors. Thus, financial assets may not be available for general expenditure within one year. As part of NFP A's liquidity management, it has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due. In addition, NFP A invests cash in excess of daily requirements in short-term investments. There is a cash management reserve of \$150,000 established by the governing board that may be drawn upon in the event of financial distress or an immediate liquidity need resulting from events outside the typical life cycle of converting financial assets to cash or settling financial liabilities. In the event of an unanticipated liquidity need, NFP A also could draw upon its \$1 million unused line of credit (as further discussed in Note X).

**.250** Example 2: NFP B is substantially supported by program revenues. As part of NFP B's liquidity management, it has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due. NFP B has \$2 million of investments that may be drawn upon in the event of unanticipated financial distress or an immediate liquidity need resulting from events outside the typical life cycle of converting financial assets to cash or settling financial liabilities. NFP B could also draw upon its \$1 million unused line of credit (as further discussed in Note X).

**.251** Example 3: NFP C is primarily supported by contributions. NFP C reviews its liquidity monthly with the finance committee of the board of directors. The NFP has an operating reserve of \$50,000, which historically has been sufficient to allow the organization to satisfy its liquidity needs during months of lower revenues. In the event of an unanticipated liquidity need, NFP C also has \$100,000 available on its line of credit of \$150,000 at December 31, 20X1.

**.252** Following are three examples of **quantitative** information (and qualitative information, as necessary) about the availability of financial assets at the balance sheet date to meet cash needs for general expenditures within one year of that date.

**.253** Example 1: NFP D has \$850,000 of financial assets available within one year of the statement of financial position date to meet cash needs for

general expenditures consisting of cash of \$50,000, contributions receivable of \$500,000, and short-term investments of \$300,000. None of the financial assets are subject to donor-imposed or other contractual restrictions that make them unavailable for general expenditures within one year of the statement of financial position. Contributions receivable are subject to implied time restrictions but are expected to be collected within one year.

**.254** Example 2: The following reflects NFP E's financial assets as of the balance sheet date, reduced by amounts not available for general expenditures because of contractual or donor-imposed restrictions within one year of the balance sheet date. Amounts not available include amounts set aside for long-term investing in endowments (including board-designated endowments) that could be drawn upon if the governing board approves that action, as well as split-interest agreements held by third parties. However, amounts already appropriated for general expenditure, from either the donor-restricted endowment or board-designated endowment, within one year of the balance sheet date have not been subtracted as unavailable.

Financial assets, at year-end	\$ 700,000
Less those unavailable for general expenditures within one year due to:	
Contractual or donor-imposed restrictions:	
Restricted by donor with time or purpose restrictions	(200,000)
Subject to appropriation and satisfaction of donor restrictions	(170,000)
Board designations:	
Quasi-endowment fund, primarily for long-term investing	(50,000)
Amounts set aside for liquidity reserve	(100,000)
Financial assets available to meet cash needs	
for general expenditures within one year	\$ 180,000

**.255** Example 3: NFP F's financial assets available within one year of the balance sheet date for general expenditures are as follows.

Cash and cash equivalents	\$ 100,000
Accounts and interest receivable	75,000
Contributions receivable	10,000
Short-term investments	25,000
Other investments appropriated for current use	50,000
Total	\$ 260,000

**.256** NFP F's endowment funds consist solely of donor-restricted endowments. Income from donor-restricted endowments is restricted for specific purposes and, therefore, is not available for general expenditures. Although NFP F does not intend to spend from its long-term investment portfolio other than amounts appropriated for general expenditure as part of its annual budget



approval and appropriation process, additional amounts could be made available if necessary.

### *Net Asset Presentation*

**.257** ASU No. 2016-14 requires changes to the presentation and disclosures of net assets in NFP financial statements.

**.258** The change to the presentation of net assets is that the three classes of net assets (unrestricted, temporarily restricted, and permanently restricted) are now presented as two classes—net assets without donor restrictions and net assets with donor restrictions. As a result, the statement of financial position should report total assets, total liabilities, total net assets without donor restrictions, total net assets with donor restrictions, and total net assets. An example of the net asset section of the statement of financial position is as follows:

Net Assets:	
Without donor restrictions	\$25,056
With donor restrictions	162,268
Total Net Assets	\$87,324

**.259** The preceding example illustrates the minimum presentation required. NFPs still have the option to provide more detail on the statement of financial position than just the minimum and may further disaggregate the totals for net assets without donor restrictions and total net assets with donor restrictions. The following is an example of optional disaggregation:

Net Assets:	
Without donor restrictions-	
Undesignated	\$24,931
Operating reserve	25,000
Designated by the board for capital projects	75,125
	\$125,056
With donor restrictions-	
Time-restricted for future periods	\$2,783
Purpose-restricted	11,066
Endowment fund	148,419
	\$162,268
Total Net Assets	\$287,324

**.260** The statement of activities will also need to be modified to present the two classes of net assets. The statement of activities, at a minimum, should report the total change in net assets without donor restrictions, total change in net assets with donor restrictions, and total change in net assets. An example of a basic statement of financial position using the common "columnar format" is as follows:

	<i>Without Donor Restrictions</i>	<i>With Donor Restrictions</i>	<i>Total</i>
<b>Revenues and Other Support:</b>			
Contributions	\$11,989	\$15,531	\$27,520
Fees	7,083		7,083
Investment return	113	(3,618)	(3,505)
Net assets released from restrictions	6913	(6,913)	—
<b>Total Revenues and Other Support</b>	<b>\$26,098</b>	<b>\$5,000</b>	<b>\$31,098</b>
<b>Expenses:</b>			
Program A	\$13,960		\$13,960
Program B	\$5,497		\$5,497
Management and general	\$4,609		\$4,609

.261 NFPs will continue to have flexibility in the preparation of the statement of activities. Accordingly, NFPs may optionally choose to disaggregate the activity in the net asset classes in different ways to best communicate the activity. The following is just one example of how an NFP could further disaggregate the activity in the statement of activities. Note that this example uses the same data as in the prior example but disaggregates the net assets with donor restrictions activity to segregate donor-restricted endowment funds from other donor-restricted activity.

	<i>With Donor Restrictions</i>				
	<i>Without Donor Restrictions</i>	<i>Program Restrictions</i>	<i>Endowment Funds</i>	<i>Total</i>	<i>Total</i>
<b>Revenues and Other Support:</b>					
Contributions	\$11,989	\$3,487	\$2,044	\$5,531	\$27,520
Fees	7,083				7,083
Investment return	113		(3,618)	(3,618)	(3,505)
Net assets released from restrictions	6913	(1,112)	(5,801)	(6913)	—
<b>Total Revenues and Other Support</b>	<b>\$26,098</b>	<b>\$2,375</b>	<b>\$2,625</b>		
	<b>\$5,000</b>	<b>\$31,098</b>			
<b>Expenses:</b>					
Program A	\$13,960				\$13,960
Program B	\$5,497				\$5,497

*Net Asset Disclosure*

**.262** ASU No. 2016-14 also requires changes to the disclosures related to net assets. NFPs will still be required to disclose information about the nature and amount of donor restrictions. However, because ASU No. 2016-14 collapses temporarily restricted and permanently restricted net assets into a single net asset class (net assets with donor restrictions), the related disclosures will need to be likewise combined. Additionally, because NFPs will no longer use the terms *temporarily restricted* and *permanently restricted* as classifications for donor restrictions, the disclosure will likely need updated wording to describe the nature of donor-restrictions on balances. ASU No. 2016-14 requires the disclosure to focus on how and when the resources can be used rather than applying a bright line to distinguish temporary and permanent restrictions. ASU No. 2016-14 includes the following example of the required disclosures of net assets with donor restrictions, including updated wording.

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Net assets with donor restrictions are restricted for the following purposes or periods:

**Subject to Expenditure for Specified Purpose:**

Program A activities-

Purchase of equipment	\$3,060
Research	950
Educational seminars and publications	240

Program B activities-

Disaster relief	745
Educational seminars and publications	280

Program C activities, general

Buildings and equipment	2,150
Annuity trust agreements for research	2,815

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\$10,450

**Subject to the Passage of Time:**

For periods after June 30, 20XX \$3,140

**Subject to NFP's Spending Policy and Appropriation:**

Investment in perpetuity (including amounts above original gift amount of \$122,337), the income from which is expendable to support:

Program A activities	\$33,300
Program B activities	15,820
Program C activities	16,480
Any activities of the organization	109,100

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\$174,700

**Subject to Appropriations and Expenditure When a Specified Event Occurs:**

Endowment requiring income to be added to original gift until fund's value is \$2,500 \$2,120

*(continued)*

Paid-up life insurance policy that will provide proceeds upon death of an insured for an endowment to support general activities	80
	<b>\$2,200</b>
<b>Not Subject to Appropriation or Expenditure:</b>	
Land required to be used as a recreation area	\$3,000
<b>Total Net Assets With Donor Restrictions</b>	<b>\$193,490</b>

**.263** ASU No. 2016-14 adds a new requirement for NFPs to disclose the amount, purpose, and type of board designations on net assets. The ASU provides the following Master Glossary definition of *board-designated net assets*:

Net assets without donor restrictions subject to self-imposed limits by action of the governing board. Board-designated net assets may be earmarked for future programs, investment, contingencies, purchase or construction of fixed assets, or other uses. Some governing boards may delegate designation decisions to internal management. Such designations are considered to be included in board-designated net assets.

**.264** Because board designations are not donor restrictions, board designations on net assets are reported as a component of net assets without donor restrictions. Following are example board-designation disclosures.

**.265** This first example is a text-based footnote disclosure that describes an NFP with board designations consisting of a quasi-endowment and an operating reserve:

**Note X—Net Assets Without Donor Restrictions**

The board of directors of XYZ Organization has several standing board policies that affect the presentation of board designations on net assets. Bequests without donor restrictions are designated for long-term investment (quasi-endowment). The quasi-endowment fund balance totaled \$35,000 at December 31, 20XX. Additionally, the board of directors has established an operating reserve with the objective of setting funds aside to be drawn upon in the event of financial distress or an immediate liquidity need. The operating reserve balance totaled \$1,300 at December 31, 20XX.

**.266** This second example is for the same NFP but is presented in tabular format. This table could be included in the footnotes, or alternatively, as a component of the net asset section of the statement of financial position.

<b>Net Assets Without Donor Restrictions:</b>	
Undesignated	\$56,377
Quasi-endowment	35,000
Operating reserve	1,300
<b>Total Net Assets Without Donor Restrictions</b>	<b>\$92,677</b>

**.267** The preceding two examples are for illustrative purposes only. A quasi-endowment and an operating reserve are just two examples of board designations that an NFP could have, but there could be various others. NFPs with board designations on net assets will need to assess the appropriate amount

and format of disclosures needed to adequately meet the objective of describing the amount, purpose, and type of board designations on net assets.

### *Investment Income and Investment Disclosures*

**.268** ASU No. 2016-14 changes the required presentation of investment income and investment expenses on the statement of activities. The ASU requires all NFPs to report investment income net of investment expenses on the face of the statement of activities. Additionally, the expenses netted against investment income are to be excluded from the required analysis of expenses by function and nature.

**.269** The expenses netted against investment income are limited to external and direct internal expenses. External expenses are those paid to third parties (for example, fees paid to an investment management company engaged by the NFP to manage the NFP's investments). Direct internal investment expenses involve the direct conduct or direct supervision of the strategic and tactical activities involved in generating investment return. The following are some examples of internal costs that may, or may not, be considered direct internal investment expenses:

- *Chief investment officer's (CIO's) compensation.* Potentially all of this expense could be considered direct internal investment expense if all the CIO's duties are focused on generating investment return.
- *Chief financial officer's (CFO's) compensation.* Potentially part of this expense could be considered direct internal investment expense to the extent the CFO's duties include activities focused on generating investment return.
- *CIO's travel expenses to visit fund managers.* Potentially all of this expense could be considered direct internal investment expense.
- *Compensation of the accountant performing endowment allocations.* None of the expense would be considered direct internal investment expense because endowment allocations are not a part of generating investment return.

**.270** NFPs will continue to have the option to report investment income in multiple, appropriately labeled lines in the statement of activities. For example, some NFPs segregate investment return and report the income from different portfolios on separate lines, in different net asset classes, or as operating versus nonoperating.

**.271** ASU No. 2016-14 removes the requirements for NFPs to disclose investment expenses and the components of investment return. Accordingly, NFPs may remove those disclosures from their footnotes.

### *Expense Presentation*

**.272** Upon implementation of the new standard, the financial statements of an NFP should disclose all of the following information related to expenses:

- Total fundraising expenses.
- Total program expenses and information about why total program expenses disclosed in the notes do not articulate with the statement of activities. This disclosure is only required if the components of total program expenses are not evident from the details

provided on the face of the statement of activities (for example, if cost of sales is not identified as either program or supporting services).

- The relationship between functional classification and natural classification for all expenses (except investment expenses) in an analysis that disaggregates functional expense classifications by their natural expense classifications.
- The amount of income tax expense and the nature of the activities that generated the taxes, which is only required if the NFP incurs income tax expense.
- A description of the methods used to allocate costs among program and support functions.

**.273** ASU No. 2016-14 provides the following example of a footnote that presents expenses by both their nature and their function and describes the methods used to allocate costs among program and support functions.

Note F

The following table presents expenses by both their nature and their function for fiscal year 20X1.

	<i>Program Activities</i>			<i>Supporting Activities</i>				<i>Total Expenses</i>
	<i>A</i>	<i>B</i>	<i>C</i>	<i>Programs Subtotal</i>	<i>Management and General</i>	<i>Fund-Raising</i>	<i>Supporting Subtotal</i>	
Salaries and benefits	\$7,400	\$3,900	\$1,725	\$13,025	\$1,130	\$960	\$2,090	\$15,115
Grants to other organizations	2,075	750	1,925	4,750	—	—	—	4,750
Supplies and travel	890	1,013	499	2,402	213	540	753	3,155
Services and professional fees	160	1,490	600	2,250	200	390	590	2,840
Office and occupancy	1,160	600	450	2,210	218	100	318	2,528
Depreciation	1,440	800	570	2,810	250	140	390	3,200
Interest	171	96	68	335	27	20	47	382
<b>Total expenses</b>	<b>\$13,296</b>	<b>\$8,649</b>	<b>\$5,837</b>	<b>\$27,782</b>	<b>\$2,038</b>	<b>\$2,150</b>	<b>\$4,188</b>	<b>\$31,970</b>

The financial statements report certain categories of expenses that are attributable to more than one program or supporting function. Therefore, these expenses require allocation on a reasonable basis that is consistently applied. The expenses that are allocated include depreciation, interest, and office and occupancy, which are allocated on a square-footage basis, as well as salaries and benefits, which are allocated on the basis of estimates of time and effort.

### *Functional Classification of Expenses*

**.274** To help donors, creditors, and others in assessing an NFP's service efforts, including the costs of its services and how it uses resources, a statement of activities or notes to financial statements is required to provide information about expenses reported by their functional expense classification, such as major classes of program services and supporting activities.

**.275** Activities that represent direct conduct or direct supervision of program or other supporting activities require allocation from management and general activities. Additionally, certain costs benefit more than one function and, therefore, should be allocated. For example, information technology generally can be identified as benefiting various functions, such as management and general (for example, accounting and financial reporting and human resources), fundraising, and program delivery. Therefore, information technology costs generally would be allocated among the functions receiving direct benefit.

**.276** Program services are the activities that result in goods and services being distributed to beneficiaries, customers, or members that fulfill the purposes or mission for which the NFP exists. Those services are the major purpose for and the major output of the NFP and often relate to several major programs. For example, a large university may have programs for student instruction, research, and patient care, among others. Similarly, a health and welfare entity may have programs for health or family services, research, disaster relief, and public education, among others. A federated fundraising entity's programs may include making contributions to NFPs supported by the federated fundraising entity.

**.277** Information about an NFP's major programs (or segments) can be enhanced by reporting the interrelationships of program expenses and program revenues. For example, a university might report expenses for its instruction and other academic services with related revenues from student tuition and expenses for its housing and food services with related revenues from room and board fees. Related nonmonetary information about program inputs, outputs, and results also is helpful, for example, information about applications, acceptances, admissions, enrollment, occupancy rates, and degrees granted. Generally, reporting that kind of information is feasible only in supplementary information or management explanations or by other methods of financial reporting.

**.278** Supporting activities are all activities of an NFP other than program services. Generally, supporting activities include management and general activities, fundraising activities, and member development activities.

**.279** Management and general activities include the following:

- Oversight
- Business management
- General recordkeeping and payroll
- Budgeting
- Financing, including unallocated interest costs
- Soliciting funds other than contributions and membership dues
- Administering government, foundation, and similar customer-sponsored contracts, including billing and collecting fees and grant and contract financial reporting
- Disseminating information to inform the public of the NFP's stewardship of contributed funds
- Making announcements concerning appointments
- Producing and disseminating the annual report
- Employee benefits management and oversight (human resources)
- All other management and administration, except for direct conduct of program services, fundraising activities, or membership development activities

**.280** Fundraising activities include the following:

- Publicizing and conducting fundraising campaigns
- Maintaining donor mailing lists
- Conducting special fundraising events
- Preparing and distributing fundraising manuals, instructions, and other materials
- Conducting other activities involved with soliciting contributions from individuals, foundations, government agencies, and others

**.281** Membership development activities include membership relations activities and soliciting for prospective members and membership dues.

**.282** The costs of oversight and management usually include the salaries and expenses of the governing board, the chief executive officer of the NFP, and the supporting staff. If such staff spend a portion of their time directly conducting or supervising program services or categories of other supporting services, however, their salaries and expenses should be allocated among those functions.

**.283** The following are examples of direct conduct and direct supervision of program and support activities that should be allocated to the program or support function or functions that receive a benefit.

**.284** The broad responsibilities of a CEO generally include administrative and programmatic oversight. At NFP A, the CEO spends a portion of time directly overseeing the research program. Additionally, a portion of time is spent with current and potential donors on fundraising cultivation activities. A portion of the CEO's compensation and benefits and other expenses would be allocated to the research program and to the fundraising function representing the portion of time spent on those activities because they reflect direct conduct or direct supervision of those functions. If the remainder of the CEO's time is spent indirectly supervising the other areas of NFP A, including the administrative areas, those activities would not constitute direct conduct or direct supervision, and the ratable portion of compensation and benefit amounts would remain in management and general activities.

**.285** The CFO at NFP B has primary responsibility for (a) accounting and reporting, (b) short-term budgeting and long-term financial planning, (c) cash management, and (d) direct oversight of NFP B's endowment. A portion of the CFO's compensation and benefits and other expenses would be allocated to management and general activities for the accounting and reporting, short-term budgeting and long-term financial planning, and cash management functions because they benefit the overall organization. A portion also would be allocated to investment expenses for management of the endowment's investment strategy and would be netted against investment return. However, any portion of time spent supervising the accounting for investments or other fiduciary oversight would not be allocated to investment expenses because that time is related to an accounting and general management activity that benefits the overall organization and should be allocated to management and general activities.

**.286** The human resources department at NFP C generally is involved in the benefits administration for all personnel of NFP C. The human resources department's related costs would not be allocated to any specific program.



Rather, those costs would remain a component of management and general activities because benefits administration is a supporting activity for the entire entity.

**.287** NFP D receives federal grants and employs an accountant who is responsible for grant accounting and reporting. In some cases, under the terms of the grant agreement, a fiscal report that details expenses incurred and charged against the grant is required to be filed. The fiscal report is not part of the direct conduct or direct supervision of the grant but, rather, is an accounting function. Therefore, the grant accountant's compensation and benefits would not be allocated to the programmatic area. However, a scientific report prepared by a principal investigator who is responsible for the research activity would be indicative of direct conduct or direct supervision, or both, of the grant activity, and the principal investigator's compensation and benefits would be allocated to the grant.

### *Implementation Considerations*

**.288** When creating a plan to implement the changes required by ASU No. 2016-14, the following are some key considerations that should help facilitate an efficient and effective process.

- *Preparer and auditor collaboration.* The collaboration process among preparers and auditors should commence as early as possible. Detailed discussions regarding the requirements, their applicability, and how to best comply, present, and communicate the required information in the financial statements and disclosures would be the primary objectives of these discussions.
- *Use of examples.* During the implementation process, reference to existing examples should prove helpful. These examples can help establish a baseline that then can be refined and tailored to the unique aspects of the organization. Several examples can be found in ASU No. 2016-14. More examples are available in the AICPA Financial Reporting Center at [www.aicpa.org/frc](http://www.aicpa.org/frc). Additionally, the AICPA Not-for-Profit Section has materials available to section members.
- *Engage those charged with governance.* Discussion with board committees responsible for financial reporting oversight prior to final implementation should also be considered. Potential best practices in implementation may include drafting disclosures in advance of the audit and presenting them for committee approval. This proactive engagement with the committee should help avoid last-minute disruptions or changes if members of the board hold strong opinions relative to the updated presentation.

### *Key Considerations for Certain Requirements*

**.289** *Classification and Disclosure of Underwater Endowments.* As previously mentioned, ASU No. 2016-14 requires the classification of underwater endowments within net assets with donor restrictions. This represents a change in presentation because previously underwater endowments would have been classified in unrestricted net assets and, thus, mapped to net assets without donor restrictions under the new requirements. Preparers and practitioners should be particularly sensitive to this change because it changes NFP accounting, not just presentation or disclosure. In addition, the ASU states "In the

period that the amendments are first applied, an NFP should disclose the nature of any reclassifications or restatements and their effects, if any, on changes in the net asset classes for each period presented." Therefore, to the extent any underwater endowments exist at the time of transition, information relative to these reclassifications will need to be disclosed.

**.290** *Analysis of Expenses by Function and Nature.* For NFPs that do not already present a statement of functional expenses, this may require significant contemplation prior to implementation. An NFP needs to consider a variety of issues, including the following:

- The level of detail to include in the financial statements
- The preferred location of the information in the financial statements considering potential pros and cons
- The ability to extract the desired data efficiently from the accounting system in order to prepare the required information

**.291** Though these are some considerations that may be beneficial, ultimately, a proactive, collaborative approach between preparers and auditors might be the most significant component to promoting a smooth transition and avoiding unwanted surprises at the end of the audit process during the year of implementation.

### *Comparative Financial Statements*

**.292** Though the majority of the requirements in the ASU should be applied retrospectively when presenting comparative financial statements, FASB ASC 958-10-65-1 explains that the NFP would have the option to omit the following for any periods presented before the period of adoption:

- Analysis of expenses by both functional classification and natural classification as required by paragraph 15 of FASB ASC 958-720-45 (the separate presentation of expenses by functional classification and expenses by natural classification is still required). NFPs that previously were required to present a statement of functional expenses do not have the option to omit this analysis; however, they may present the comparative period information in any of the formats permitted by paragraph 15 of FASB ASC 958-720-45, consistent with the presentation in the period of adoption.
- Disclosures about liquidity and availability of resources as required by paragraph 7(c) of FASB ASC 958-210-45 and paragraph 1A of FASB ASC 958-210-50.

### *Recognition of Breakage for Certain Prepaid Stored-Value Products*

**.293** FASB issued ASU No. 2016-04, *Liabilities—Extinguishments of Liabilities (Subtopic 405-20): Recognition of Breakage for Certain Prepaid Stored-Value Products*, in March 2016 to address current and potential future diversity in practice related to the derecognition of a prepaid stored-value product liability.

**.294** A common example of a prepaid stored-value product is a gift card issued by an NFP that may be redeemed at a later date by the holder to purchase goods or services. When an NFP sells a prepaid stored-value product, such as a gift card, to a third party, the NFP recognizes a liability for its obligation to provide the product holder with the ability to purchase goods and services.

When the product holder redeems the prepaid stored-value product, the NFP's liability (or a portion of that liability) to the product holder is extinguished. Currently, some entities view this liability as a financial liability and other entities view it as a nonfinancial liability. This ASU clarifies that the liability should be viewed as a financial liability and not a nonfinancial liability.

**.295** In some cases, a prepaid stored-value product may go unused wholly or partially. FASB has indicated there currently is diversity in the methodology used to recognize the portion of the dollar value of prepaid stored-value products that ultimately are never redeemed, which is referred to as *breakage*.

**.296** FASB ASC 606, *Revenue from Contracts with Customers*, includes authoritative breakage guidance. However, financial liabilities are excluded from the scope of Topic 606. This ASU provides a narrow-scope exception to that exclusion to require that breakage for liabilities associated with prepaid stored-value products be accounted for consistent with the breakage guidance in Topic 606.

**.297** The effective date of the amendments in this ASU aligns with the effective date of the amendments in FASB ASC 606. Accordingly, for NFPs that are considered public entities, this ASU is effective for fiscal years beginning after December 15, 2017. All other NFPs should apply the amendments in this ASU for financial statements issued for fiscal years beginning after December 15, 2018. Earlier application is permitted, including adoption in an interim period.

### ***FASB's Recognition and Measurement of Financial Assets and Financial Liabilities***

**.298** In January 2016, FASB issued ASU No. 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. This ASU affects NFPs by (a) eliminating the requirement for not-for-profit entities to disclose certain information about the fair value of financial instruments not recorded at fair value and (b) simplifying the impairment assessment of an equity security that does not have a readily determinable fair value.

#### ***Disclosures Related to the Fair Value of Financial Instruments Not Recorded at Fair Value***

**.299** Prior to ASU No. 2016-01, FASB ASC 825-10-50 generally required public entities or nonpublic entities with over \$100 million in assets to make certain disclosures related to the fair value of financial instruments not recorded at fair value on the statement of financial position.

**.300** The required disclosures affected NFPs with publicly traded debt as well as organizations with over \$100 million in assets. The disclosures typically related to the fair value of contributions receivable, customer accounts receivable, accounts payable, notes payable, and debt. These disclosures included the following:

- a. The fair value of the financial instruments for which it is practical to estimate that value
- b. The method(s) and significant assumptions used to estimate the fair value of financial instruments (excluding the quantitative disclosures about significant unobservable inputs used in the fair

value measurements categorized within level 3 of the fair value hierarchy)

- c. A description of the changes in method(s) and significant assumptions used to estimate the fair value of financial instruments, if any, during the period
- d. The level of the fair value hierarchy within which the fair value measurements are categorized in their entirety (level 1, 2, or 3)

**.301** ASU No. 2016-01 changed the applicability of the disclosure from *publicly traded company* to the newly defined *public business entity*, which was added to the Master Glossary. The definition of *public business entity* states that neither an NFP nor an employee benefit plan is considered to be a business entity for the purposes of that definition. ASU No. 2016-01 clarifies that the fair value disclosures for financial instruments are only required for public business entities (PBEs).

**.302** Given the change in definition, all NFPs, including NFPs with publicly traded conduit debt, NFPs with more than \$100 million in assets and NFPs with derivatives, were immediately, upon issuance of ASU No. 2016-01, no longer required to provide fair value disclosures of financial instruments that are measured and carried at cost or amortized cost, which was previously required by FASB ASC 825-10-50. The most significant change is that NFPs are no longer required to provide disclosure about the fair value of their long-term debt. This change goes in tandem with the move toward FASB's efforts to simplify and streamline disclosures in response to feedback from the financial statement user community. Additionally, many have challenged the difficulty in estimating fair value of long-term debt for entities that have always borrowed at a discount or at favorable terms with related parties or governmental agencies.

**.303** There is no change to the disclosure requirements for assets and liabilities measured and reported at fair value as a result of this ASU. NFPs are still required to provide a table that identifies the levels for their financial instruments that are measured and carried at fair value in their financial statements as well as the disclosures in FASB ASC 820-10-50 that accompany that table.

### *Measuring an Equity Security Without a Readily Determinable Fair Value*

**.304** ASU No. 2016-01 simplifies the impairment assessment of equity investments without readily determinable fair values by introducing a two-step process for identifying impairment of such investments. The first step requires a qualitative assessment to identify if impairment exists. This qualitative assessment must be performed at each reporting period. When the qualitative assessment indicates that an impairment exists, the entity is required to perform step two, which is to compare the fair value to the amount recorded. If the fair value is less than the cost, the investment must be marked down to fair value. This replaces guidance in FASB ASC 320-10-35, which required an assessment of the fair value compared to cost each reporting period.

### *Effective Date*

**.305** Although ASU No. 2016-01 is effective for NFPs for fiscal years beginning after December 15, 2018, and can be implemented early only for fiscal years beginning after December 15, 2017, the ASU permits NFPs and all other

entities that are not PBEs to elect not to disclose the fair value of financial instruments that are measured and carried at cost or amortized cost in all financial statements that have not yet been issued or made available for issuance as of January 5, 2016.

## The Net Asset Value Practical Expedient and Readily Determinable Fair Value

**.306** In November 2017, the AICPA issued Technical Questions and Answers (Q&A) section 2220.28, "Definition of *Readily Determinable Fair Value* and Its Interaction With the NAV Practical Expedient,"<sup>3</sup> and updated Q&A section 2220.18, "Applicability of Practical Expedient." Both address fair-value-related financial reporting issues that affect NFPs.

**.307** Q&A section 2220.18 addresses the question of which investments are permitted, as a practical expedient, to be measured at fair value on the basis of net asset value (NAV). The updates released in November 2018 were intended to provide additional insight regarding the complete line of thinking regarding when an investment qualifies for use of the practical expedient, rather than to change the nature of the guidance previously provided. The updated Q&A now includes the relevant detailed guidance from FASB ASC 820-10-15-4 indicating that the practical expedient in FASB ASC 820-10-35-59 should apply only to an investment that meets both of the following criteria as of the reporting entity's measurement date:

- a. The investment does not have a readily determinable fair value (RDFV).
- b. The investment is in an investment company within the scope of Topic 946 or is an investment in a real estate fund for which it is industry practice to measure investment assets at fair value on a recurring basis and to issue financial statements that are consistent with the measurement principles in Topic 946.

**.308** In addition, Q&A section 2220.18 now refers the reader to Q&A section 2220.28. Q&A section 2220.28 is important relative to Q&A section 2220.18 and its application because it addresses what RDFV is and how it interacts with the NAV practical expedient.

**.309** Q&A section 2220.28 includes the FASB Master Glossary definition of *readily determinable fair value*, which is as follows:

An equity security has a readily determinable fair value if it meets any of the following conditions:

- a. The fair value of an equity security is readily determinable if sales prices or bid-and-asked quotations are currently available on a securities exchange registered with the U.S. Securities and Exchange Commission (SEC) or in the over-the-counter market, provided that those prices or quotations for the over-the-counter market are publicly reported by the National Association of Securities Dealers Automated Quotations systems or by OTC Markets Group Inc. Restricted stock meets that definition if the restriction terminates within one year.

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<sup>3</sup> All Q&A sections can be found in *Technical Questions and Answers*.

- b. The fair value of an equity security traded only in a foreign market is readily determinable if that foreign market is of a breadth and scope comparable to one of the U.S. markets referred to above.
- c. The fair value of an equity security that is an investment in a mutual fund or in a structure similar to a mutual fund (that is, a limited partnership or a venture capital entity) is readily determinable if the fair value per share (unit) is determined and published and is the basis for current transactions.

**.310** The preceding definition reflects the amendments made by ASU No. 2015-10, *Technical Corrections and Improvements*, to condition (c). Whether an equity security has an RDFV in accordance with condition (c) is a facts-and-circumstances determination and requires judgment. Following these amendments, stakeholders questioned whether certain investments (such as common collective trusts and pooled separate accounts) meet condition (c) and, therefore, would be considered to have an RDFV.

**.311** FASB discussed questions raised regarding condition (c) and could not identify a pervasive measurement issue based on outreach conducted with stakeholders. Although FASB acknowledged that the interpretation of the Master Glossary definition of RDFV could have implications on which set of disclosures may be used for certain investments, some board members concluded that users of the financial statements would not be misled when provided either set of disclosures. Therefore, FASB encourages entities to provide the disclosures that are consistent with the conclusions previously reached on the measurement of the investment.

## **Clarification of Key Terms in the Definition of Public Business Entity**

**.312** NFPs with conduit bonds that meet certain characteristics are subject to the same effective dates and expanded disclosure requirements that certain FASB standards impose on PBEs. However, careful attention should be paid to FASB's terminology because not all conduit bonds fit the characteristics that subject NFPs to these requirements. This section discusses the information available to help NFPs determine whether they are subject to the requirements of PBEs.

### **Background**

**.313** In 2013, FASB amended the Master Glossary of FASB ASC to include one definition of a PBE for future use in accounting standards. NFPs are specifically scoped out of the definition of a PBE in the Master Glossary. However, certain NFPs are subject to the same requirements imposed on PBEs by certain FASB standards. In addition, these NFPs are differentiated using terms similar to those used in criterion (d) of the FASB Master Glossary definition of a PBE: "a business entity that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market."

**.314** Several FASB standards subject an NFP that has "issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market" to the same accelerated effective dates and expanded disclosure requirements imposed on PBEs. This includes the new

revenue (ASU No. 2014-09, *Revenue from Contracts with Customers*) and leases (ASU No. 2016-02, *Leases (Topic 824)*) standards. The proposed ASU, *Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made*, also includes a similar differentiation in its proposed effective dates. Similar terminology is also used in the multiple Master Glossary definitions of *public entity*, which FASB used to differentiate effective dates and disclosure requirements in certain standards issued prior to the use of the PBE definition. For example, certain pension disclosures are required for NFPs only if the NFP is deemed to be a public entity.

### **Q&As Clarify Terms in the Definition of Public Business Entity**

**.315** As a practical matter, understanding the key terms is important for NFPs to determine whether they may take advantage of the delayed effective dates and scaled disclosures available to NFPs that are not considered "public." Therefore, the AICPA recently issued several Q&As, which clarified certain terms included in the definition of *public business entity*.

**.316** The Q&As were specifically intended to address questions regarding the definition of a PBE and, therefore, were not intended to serve as guidance to NFPs. However, some of the Q&As may assist NFPs in understanding the key terms FASB uses to differentiate NFPs. The most relevant of the Q&As are summarized in the text that follows, along with a summary of the guidance available to NFPs in the AICPA Audit and Accounting Guides.

### **Guidance Available to NFPs**

**.317** The AICPA Audit and Accounting Guide *Not-for-Profit Entities* (NFP audit guide) and the AICPA Audit and Accounting Guide *Health Care Entities* (health care audit guide), provide guidance relative to the determination about whether conduit bonds trade in public markets. The guidance provided in each of these audit guides relative to consideration of public markets is consistent.

**.318** Specifically, paragraph 10.19 in the NFP audit guide states the following:

The FASB ASC glossary has multiple definitions for the term public entity. Generally, these are entities that have debt or equity securities that trade in public markets. When applying accounting standards that refer to public entities, careful attention should be paid to the requirements to determine which definition applies and whether the definition includes conduit bond obligors within its scope. If within its scope, it is also necessary to determine whether the obligor's securities trade in public markets (for example, over-the-counter markets). As discussed in paragraph 10.24, if conduit bonds have been issued on behalf of an NFP in a competitive or negotiated offering, they are deemed to trade in public markets; bonds issued in a private placement would not be deemed to trade in public markets for as long as the bonds are privately held.

**.319** Further, the guidance in paragraph 10.24 in the NFP audit guide states the following:

Municipal bonds are issued through negotiated sales, competitive bids, or private placements. In a negotiated sale, the issuer or obligor negotiates a price with one or more underwriters. In a competitive bid sale, the securities are sold to one or more underwriters who submitted the best acceptable bid(s). The underwriters then resell the

securities to the general investing public. Municipal bonds issued in negotiated sales or competitive bids are deemed to be traded in public markets; thus, conduit borrowers under those arrangements are considered public entities for purposes of providing certain disclosures under accounting standards (see the discussion in paragraphs 10.18–.20). In addition, when underwriters sell municipal securities to the general investing public, the SEC imposes certain requirements on the underwriters, who in turn require the obligors to file certain disclosure documents. An overview of SEC considerations related to municipal bonds is provided in appendix A, "Municipal Securities Regulation," of this chapter and in paragraphs 15.57–.60. In a private placement, the securities generally are sold directly to qualified investors (for example, an institutional investor), rather than through an offering to the general investing public. Municipal bonds issued in private placements are not deemed to trade in public markets because the investors typically are subject to restrictions on resale.

**.320** Similar guidance is available in paragraphs 7.07 and 7.12 of the health care audit guide.

### **Clarification Provided in Q&As That Is Relevant to NFPs**

#### *Use of the Term Security and Types of Securities (Q&A Sections 7100.01 and 7100.02)*

**.321** Q&A section 7100.01, "Use of the Term *Security* in the Definition of a Public Business Entity," provides guidance on how entities should evaluate whether their financing instruments are securities. The definition of *security* in the PBE definition is now linked to the definition of a security in FASB ASC 320, *Investments—Debt and Equity Securities*.

**.322** Q&A section 7100.02, "Types of Securities Included in the Definition of a *Public Business Entity*," also clarifies that securities may be in the form of equity or debt instruments. For NFPs, the financing instruments are generally in the form of debt instruments or obligations of the NFP (for example, municipal bonds), which meet the definition of a security.

#### *Use of the Terms Conduit Bond Obligor and Over-the-Counter (Q&A Sections 7100.03 and 7100.04)*

**.323** A conduit bond obligor is an entity that is obligated for the repayment of conduit debt securities. As defined in the FASB ASC Master Glossary, *conduit debt securities* are municipal securities issued by state or local governments, agencies, or instrumentalities on behalf of a third party (for example, an NFP).

**.324** Paragraph BC16 of ASU No. 2013-12, *Definition of a Public Business Entity—An Addition to the Master Glossary*, states that an over-the-counter (OTC) market includes an interdealer quotation or trading system for securities that are not listed on an exchange. Q&A section 7100.03, "Use of the Term *Over-the-Counter Market* in the Definition of a *Public Business Entity*," also states that markets that are not generally accessible by the public or that do not publish such data points are not OTC markets for the purpose of the PBE definition (that is, public OTC markets). This would also hold true for the determination of whether the NFP is considered public.



**.325** Q&A section 7100.04, "Use of the Term *Conduit Bond Obligor* in the Definition of a *Public Business Entity*," also states that municipal bonds issued in public offerings (when an underwriter purchases municipal securities from an issuer for reoffering to the public) trade thereafter in the public OTC market. However, municipal securities issued in private placements generally are sold directly to qualified investors (for example, institutional investors); they are not deemed to trade in public OTC markets because the markets in which they are available are limited to only certain investors. The investors are also typically subject to restrictions on resale.

**.326** This guidance is consistent with the guidance in the previously mentioned audit guides relative to determining whether conduit bonds trade in public markets. The determination of whether the conduit debt is considered to trade in public markets is not based on who purchases the debt securities initially or who holds the debt securities currently but, rather, who has the ability to purchase the securities. Because the general public has the ability to purchase the debt securities, conduit debt issued through a negotiated sale or competitive bid would be considered to trade in a public market. This is consistent with Q&A section 7100.03, which states that public OTC markets are "accessible by the public to execute trades."

**.327** Private placements can be analogized to Rule 144A securities. As stated in Q&A section 7100.14, "Private Resales (Rule 144 and Rule 144A) and the Definition of a Public Business Entity," Rule 144A securities "can only be sold to qualified institutional buyers unless the securities become registered with the SEC. That is, if not registered, such securities are not traded, listed, or quoted on an exchange or an OTC market." Because private placement securities are traded similarly to Rule 144A securities, they would not be securities that are traded, listed, or quoted on an exchange or an OTC market.

**.328** Therefore, although the Q&As were prepared specifically to clarify guidance about the definition of a PBE (which excludes all NFP entities), the determination of a public OTC market, as discussed in the Q&As, is consistent with the guidance in the previously mentioned audit guides.

### **MSRB EMMA Data (Q&A Section 7100.05)**

**.329** Q&A section 7100.05, "FINRA TRACE and MSRB EMMA Data and a Public Business Entity," clarifies that the Municipal Securities Rulemaking Board's Electronic Municipal Market Access (EMMA) is not, itself, an OTC market. EMMA is the official SEC-designated repository for disclosure documents related to public offerings of municipal securities. EMMA provides historical trade prices, credit ratings, and other information related to those securities but does not allow execution of trades. NFPs that have issued conduit bonds that trade in public markets are required to provide continuing disclosures (including financial statements) on EMMA.

### **Key Takeaway**

**.330** Each financing instrument should be assessed against the criteria. If the NFP is a conduit bond obligor of municipal securities, the NFP should determine whether these securities are traded in the public OTC market. If so, the NFP would be subject to the accelerated effective dates or expanded disclosures, or both, imposed on PBEs in the new revenue and lease standards,

the upcoming contribution standard (as proposed), and other standards with similar requirements.

## Expiration of the Perkins Loan Program

**.331** The Federal Perkins Loan Program (program), which provides low-interest loans to graduate and undergraduate students with exceptional financial need, expired September 30, 2017. Under the program, a portion of the funding is provided by the institution in addition to that provided by the federal government. The required match was based on the government's requirements at the time the loan advance was made.

**.332** In 2015, the program was in danger of expiring but was extended for two years. Under the terms of the 2015 Extension Act, schools could make new Perkins loans to graduate students through September 30, 2016. However, if an institution made a disbursement of a Perkins loan to a graduate student before October 1, 2016, the student could still receive any subsequent disbursements of that loan. For undergraduate students, new loans could be made through September 30, 2017. For loans made to eligible undergraduates before October 1, 2017, for the 2017–18 award year, subsequent disbursements of those loans are permitted through June 30, 2018. No disbursements are permitted after June 30, 2018 under any circumstances.

**.333** On October 6, 2017, the U.S. Department of Education (ED) issued a "Dear Colleague Letter" (read the letter at <https://ifap.ed.gov/dpcletters/GEN1710.html>), which provides information on the wind-down of the Federal Perkins Loan Program. The letter states that schools will need to return ED's share of the institutions' Perkins Loan Revolving Fund. Because institutions may make subsequent disbursements to eligible borrowers through June 30, 2018, ED will begin collecting its share following the submission of a school's 2019–2020 Fiscal Operations and Application to Participate, which is due October 1, 2018.

**.334** Institutions may choose to assign Perkins loans to ED or continue to service the loans themselves. However, when loans are assigned, ED keeps all monies collected and does not reimburse the institutional share. If, on the other hand, an institution continues operating the program and remits excess cash annually, the institution can keep its share and repurpose the funds. Institutions may choose to assign the balance of their Perkins loans to ED at any time.

**.335** Although there is a chance that the program could be reinstated—either as an extension bill or during reauthorization of the Higher Education Act—institutions should begin planning for its unwinding now.

## Leases

**.336** On February 25, 2016, FASB issued ASU No. 2016-02. FASB ASC 842, *Leases*, will be effective for NFPs that have issued or are conduit bond obligors for securities that are traded, listed, or quoted on an exchange or an OTC market) for fiscal years and interim periods within those fiscal years, beginning after December 15, 2018. For all other NFPs, FASB ASC 842 will be effective for fiscal years beginning after December 15, 2019, and for interim

periods within fiscal years beginning after December 15, 2020. Early application is permitted for all organizations.

### **Key Requirements**

**.337** Except for leases that have a term of 12 or fewer months, all leases, including operating leases, will be recognized on the statement of financial position. This will be accomplished by recording both a right of use (ROU) asset and lease liability. Executory costs should also be considered in this analysis and recorded based on the specifics of the lease terms or donor agreement.

**.338** The definition of *initial direct costs* has narrowed under the new standard to include only incremental costs incurred because of executing the lease. Origination costs that were historically capitalized under existing guidance, including costs to negotiate and arrange a lease, will be expensed when incurred.

**.339** The new standard requires expanded quantitative and qualitative disclosures by both lessees and lessors. Examples are provided in FASB's authoritative guidance.

**.340** Although the new definition of a lease is similar to that under current GAAP, some arrangements that currently contain a lease will no longer meet the criteria under the new definition. A new requirement to determine whether the customer has the right to direct the use of the identified asset will entail significant judgment.

**.341** Lease accounting will continue to require significant judgments by management, including when organizations establish estimates related to the lease term, lease payments, and discount rates. The discount rate will be the rate implicit in the lease. However, lessees will be permitted, as an accounting policy election, to use a risk-free discount rate to determine the present value of the lease payments. Like the current standard, the term of the lease will include the non-cancellable lease term plus renewal periods that are reasonably certain of exercise by the lessee or within the control of the lessor.

**.342** If property, plant, or equipment is explicitly or implicitly identified and its use is controlled by the customer in a contract, an embedded lease exists. The assessment of whether a service arrangement contains an embedded lease may be more critical under the new standard, as most leases will be recorded on the balance sheet (and service arrangements would not be reflected on the balance sheet). Under existing lease guidance, the accounting for service arrangements and operating leases is similar.

**.343** In certain circumstances, under the new standard, the lessee will be required to remeasure the lease payments. Re-measurement of the lease payment may be triggered by a reassessment of the lease term (should conditions change from the initial measurement), even if there is not a lease modification.

**.344** Fixed payments by the lessee to cover lessor costs related to ownership of the underlying asset, such as property taxes or insurance (also referred to as *executory costs*), that do not represent payments for a good or service will be considered lease payments and reflected in the measurement of ROU assets and lease liabilities by lessees. Under current GAAP, payments for executory costs, including those to reimburse lessors for costs related to the underlying asset, are excluded from minimum lease payments and, therefore, from lease accounting.

**.345** Variable payments that do not depend on an index or rate, such as property taxes and insurance reimbursements and rental payments based on the use of the underlying asset, will be excluded from fixed payments in the measurement of lease assets and lease liabilities.

**.346** Lessor accounting remains largely unchanged but has still been updated to align with certain changes to the lessee model. Leveraged lease accounting has been eliminated, although existing arrangements will be grandfathered.

**.347** When collectibility of lease payments is uncertain (for example, if the lessee's ability and intention to pay is in doubt, and it is uncertain whether the lessor will collect the lease payments and any amount necessary to satisfy the residual value guarantee provided by the lessee), lessors may now have to recognize some lease payments as liabilities, which is a change to existing guidance. Other leases that have significant variable payments will no longer be classified as operating leases solely due to the extent of variable payments. This may result in a negative implicit rate for the lease or loss recognition at lease commencement.

**.348** Fewer build-to-suit lease activities will be subject to sale-leaseback accounting requirements under the new standard. This is due to the process for determining when a lessee controls an underlying asset before lease commencement and will result in fewer transactions where the lessee is considered the owner of an asset for accounting purposes during the construction period than under current GAAP. Changes made to sale-leaseback guidance also make it easier for lessees to remove real estate assets recognized during the construction period from their balance sheets. The transition provisions of the new standard will permit many entities to de-recognize build-to-suit assets and liabilities that have remained on the balance sheet after the end of the construction period under current GAAP.

### *Lessee Accounting for Donated Rent and Below-Market Leases*

**.349** Unconditional promises to give the use of long-lived assets (such as a building or other facilities) for a specified number of periods in which the donor retains legal title may be similar to leases but have no lease payments. Under the new ASU, a *lease* is defined as a contract, or part of a contract, that conveys the right to control the use of identified property and equipment for a period of time in exchange for consideration. As a result, such promises are not within the scope of the ASU on leases. In other instances, NFPs may receive below-market leases (that is, a lease agreement may call for lease payments at amounts below the fair rental value of the property). When calculating ROU assets and lease liabilities, organizations should not include the fair rental value of donated use of facilities that is in excess of the stated lease payments. Consideration, as defined in the new standard, should only include cash or other assets exchanged in the transaction (that is, the lease payments). Therefore, only the portion of the lease requiring the payment of consideration will be accounted for under the new ASU for leases. The below-market portion (donated rent) would be recorded as a contribution and recognized in accordance with FASB ASC 958-605, rather than in accordance with FASB ASC 842.

**.350** Under FASB ASC 958-605-55-23 and FASB ASC 958-605-25-2, an NFP that receives a contribution of the use of property or facilities, in which the donor retains legal title to the assets, should record the fair value of the use

as contribution revenue in the period in which the contribution is received and expense in the period the property or facilities are used. Under FASB ASC 958-605-55-24, if the contributed assets are being provided for a specified number of periods, the unconditional promise is recorded as revenue and as a contribution receivable for the difference between fair rental value of the property and the stated amount of the lease payments (if any). The revenue would be donor-restricted due to time and the restriction released as the contributed assets are used each period. The contribution receivable may be described in the financial statements based on the item whose use is being contributed, such as a building, rather than as contributions receivable, as discussed in FASB ASC 958-605-55-24.

### **Implementation Considerations**

**.351** The leases standard, as issued, can be summarized as moving operating lease obligations from the footnotes to the statement of financial position. Bringing operating leases onto the entity's statement of financial position could make a significant difference in the numbers an organization is reporting. Many lessees will be able to meet the new reporting and disclosure requirements using existing systems and processes.

**.352** Although initial implementation will require some level of effort, the ongoing costs of providing the information are expected to be consistent with the costs of complying with existing GAAP, according to FASB.

**.353** As entities implement the new requirements, FASB will continue to address stakeholder concerns. Readers are encouraged to monitor [fasb.org](http://fasb.org) for updates. Also refer to the "On the Horizon" section of this alert for a discussion of a recently proposed ASU related to the new leases standard.

### **Recent Pronouncements**

**.354** AICPA auditing and attestation standards are applicable only to audits and attestation engagements of non-issuers. The PCAOB establishes auditing and attestation standards for audits of issuers. For information on pronouncements issued subsequent to the writing of this alert, please refer to the AICPA website at [aicpa.org](http://aicpa.org), the FASB website at [www.fasb.org](http://www.fasb.org), and the PCAOB website at [www.pcaob.org](http://www.pcaob.org). Also look for announcements of newly issued accounting standards in the *CPA Letter Daily* and the *Journal of Accountancy*.

### **Recent Auditing and Attestation Pronouncements and Related Guidance**

**.355** The following table presents a list of recently issued auditing and attestation pronouncements and related guidance.

<b><i>Recent Auditing and Attestation Pronouncements and Related Guidance</i></b>	
Statement on Auditing Standards (SAS) No. 133, <i>Auditor Involvement with Exempt Offering Documents</i> Issue Date: July 2017	This SAS addresses the auditor's responsibilities with respect to offerings of securities exempt from registration under the Securities Act of 1933 and to franchise offerings. SAS No. 133 amends AU-C section 560, <i>Subsequent Events and Subsequently Discovered Facts</i> and AU-C section 925, <i>Filings with the U.S. Securities and Exchange Commission Under the Securities Act of 1933</i> .  It is effective for exempt offering documents with which the auditor is involved that are initially distributed, circulated, or submitted on or after June 15, 2018.
Attestation Interpretation No. 4, "Performing and Reporting on an Attestation Engagement Under Two Sets of Attestation Standards," of AT-C section 105, <i>Concepts Common to All Attestation Engagements</i> (May 2017) (Interpretive publication)	This interpretation addresses and provides examples of how the auditor might report when performing an attestation engagement under two sets of attestation standards.
Auditing Interpretation No. 4, "Reporting on Audits Conducted in Accordance With Auditing Standards Generally Accepted in the United States of America and the Standards of the PCAOB," to AU-C section 700, <i>Forming an Opinion and Reporting on Financial Statements: Auditing Interpretations of AU-C Section 700</i> (March 2018) (Interpretative publication)	This interpretation provides guidance on how an auditor complies with AU-C section 700 in the context of the revised reporting standards adopted by the PCAOB and approved by the SEC.

## Recent ASUs

**.356** The following table presents, by codification area, a list of recently issued ASUs, through the issuance of ASU No. 2018-03, *Technical Corrections and Improvements to Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. However, this table does not include ASUs that are SEC updates (such as ASU No. 2017-13, *Revenue Recognition (Topic 605)*, *Revenue from Contracts with Customers (Topic 606)*, *Leases (Topic 840)*, and *Leases (Topic 842): Amendments*

to SEC Paragraphs Pursuant to the Staff Announcement at the July 20, 2017 EITF Meeting and Rescission of Prior SEC Staff Announcements and Observer Comments [SEC Update]) or ASUs that are technical corrections to various topics. FASB ASC does include SEC content to improve its usefulness for public companies, but the content labeled as "SEC staff guidance" does not constitute rules or interpretations of the SEC nor does such guidance bear official SEC approval.

<b>Recent Accounting Standards Updates</b>	
<b>Presentation Area of FASB ASC</b>	
ASU No. 2017-11 (July 2017)	<i>Earnings Per Share (Topic 260); Distinguishing Liabilities from Equity (Topic 480); Derivatives and Hedging (Topic 815): (Part I) Accounting for Certain Financial Instruments with Down Round Features, (Part II) Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests with a Scope Exemption</i>
ASU No. 2018-02 (February 2018)	<i>Income Statement—Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income</i>
<b>Assets Area of FASB ASC</b>	
ASU No. 2017-08 (March 2017)	<i>Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities</i>
<b>Revenue Area of FASB ASC</b>	
ASU No. 2017-05 (February 2017)	<i>Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition and Accounting for Partial Sales of Nonfinancial Assets</i>
<b>Expenses Area of FASB ASC</b>	
ASU No. 2017-07 (March 2017)	<i>Compensation—Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost</i>
ASU No. 2017-09 (May 2017)	<i>Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting</i>

(continued)

<b>Recent Accounting Standards Updates—continued</b>	
<b>Broad Transactions Area of FASB ASC</b>	
ASU No. 2017-10 (May 2017)	<i>Service Concession Arrangements (Topic 853): Determining the Customer of the Operation Services (a consensus of the FASB Emerging Issues Task Force)</i>
ASU No. 2017-12 (August 2017)	<i>Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities</i>
ASU No. 2018-01 (January 2018)	<i>Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842</i>
ASU No. 2018-03 (February 2018)	<i>Technical Corrections and Improvements to Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities</i>
<b>Industry Area of FASB ASC</b>	
ASU No. 2017-06 (February 2017)	<i>Plan Accounting: Defined Benefit Pension Plans (Topic 960): Defined Contribution Pension Plans (Topic 962), Health and Welfare Benefit Plans (Topic 965): Employee Benefit Plan Master Trust Reporting (a consensus of the FASB Emerging Issues Task Force)</i>
ASU No. 2017-15 (December 2017)	<i>Codification Improvements to Topic 995, U.S. Steamship Entities: Elimination of Topic 995</i>

## Recently Issued Technical Questions and Answers

.357 AICPA nonauthoritative accounting and audit and attest technical questions and answers address a variety of practice issues encountered by practitioners. The following table presents a list of recently issued nonauthoritative audit, attest, and accounting technical questions and answers issued by the AICPA. Recently issued questions and answers can be accessed at [www.aicpa.org/interestareas/frc/pages/recentlyissuedtechnicalquestionsandanswers.aspx](http://www.aicpa.org/interestareas/frc/pages/recentlyissuedtechnicalquestionsandanswers.aspx).

<b>Recently Issued Technical Questions and Answers</b>	
<b>Long-Term Investments</b>	
Q&A section 2220.28 (November 2017)	Definition of <i>Readily Determinable Fair Value</i> and Its Interaction With the NAV Practical Expedient



<b><i>Recently Issued Technical Questions and Answers—continued</i></b>	
<b><i>Definition of a Public Business Entity</i></b>	
Q&A section 7100.01 (October 2017)	Use of the Term "Security" in the Definition of a Public Business Entity
Q&A section 7100.02 (October 2017)	Types of Securities Included in the Definition of a Public Business Entity
Q&A section 7100.03 (October 2017)	Use of the Term "Over-the-Counter Market" in the Definition of a Public Business Entity
Q&A section 7100.04 (October 2017)	Use of the Term "Conduit Bond Obligor" in the Definition of a Public Business Entity
Q&A section 7100.05 (October 2017)	FINRA, TRACE, and MSRB EMMA Data and a Public Business Entity
Q&A section 7100.06 (October 2017)	Use of the Phrase "Contractual Restriction on Transfer" in the Definition of a Public Business Entity
Q&A section 7100.07 (October 2017)	Use of the Terms "Prepare," "Publicly Available," "Financial Statements," and "Periodic Basis" in the Definition of a Public Business Entity
Q&A section 7100.08 (October 2017)	Application of the Definition of a Public Business Entity When Entities are Organized in Tiered Organizational Structures (Parent, Consolidated Subsidiaries, Nonconsolidated Entities, Guarantors, Equity Method Investees)
Q&A section 7100.09 (October 2017)	Financial Statements or Financial Information Filed With the SEC and Considerations for Effective Dates and the Definition of a Public Business Entity
Q&A section 7100.10 (October 2017)	Accounting Standard Update Effective Dates and the Definition of a Public Business Entity
Q&A section 7100.11 (October 2017)	Evaluating the Definition of Public Business Entity for Financial Institutions Subject to Section 36 of the Federal Deposit Insurance Act and Part 363 of the FDIC Rules and Regulations
Q&A section 7100.12 (October 2017)	Mutual Depository Institutions and the Definition of a Public Business Entity

*(continued)*

<b><i>Recently Issued Technical Questions and Answers—continued</i></b>	
Q&A section 7100.13 (October 2017)	Brokered Certificates of Deposit and the Definition of a Public Business Entity
Q&A section 7100.14 (October 2017)	Private Resales (Rule 144 and Rule 144A) and the Definition of a Public Business Entity
Q&A section 7100.15 (October 2017)	Insurance Companies and the Definition of Public Business Entity
Q&A section 7100.16 (October 2017)	Brokers, Dealers, and Futures Commission Merchants and the Definition of a Public Business Entity
<b>Other Reporting Issues</b>	
Q&A section 9160.31 (July 2017)	Following Accounting Standards as Promulgated by FASB by a State or Local Governmental Entity
Q&A section 9160.32 (July 2017)	Reporting on Accounting Standards as Promulgated by FASB by a State or Local Government
Q&A section 9160.33 (July 2017)	Engagement Acceptance When a State or Local Government Elects to Follow a Special Purpose Framework
Q&A section 9160.34 (July 2017)	Accounting Standards as Promulgated by FASB as a Special Purpose Framework
Q&A section 9160.35 (July 2017)	Reporting on Indian Tribe Financial Statements Prepared in Accordance With Accounting Standards as Promulgated by FASB
<b>Internal Control</b>	
Q&A section 8200.17 (April 2017)	Obtaining an Understanding of Business Processes Relevant to Financial Reporting and Communication
Q&A section 8200.18 (April 2017)	Obtaining an Understanding of Internal Control Relevant to the Audit
Q&A section 8200.19 (April 2017)	Obtaining an Understanding of the Controls Relevant to the Audit
Q&A section 8200.20 (April 2017)	Control Activities That Are Always Relevant to the Audit
Q&A section 8200.21 (April 2017)	Control Activities That May Be Relevant to the Audit

## Recent AICPA Independence and Ethics Developments

### Proposed Interpretations Responding to Non-Compliance With Laws and Regulations

**.358** The International Federation of Accountants' (IFAC's) International Ethics Standards Board for Accountants (IESBA) develops and maintains a global *Code of Ethics for Professional Accountants*.

**.359** In 2016, the IESBA issued a standard, "Responding to Non-Compliance with Laws and Regulations" (abbreviated as NOCLAR). This standard provides a framework to guide auditors and others in public practice and accountants in business on how best to act in the public interest when confronted with noncompliance or suspected noncompliance with laws or regulations. The standard became effective on July 15, 2017, and since its adoption, several member bodies have adopted or are in the process of considering adoption of the NOCLAR standard.

#### **Relevance of the IESBA Code**

**.360** The IESBA's *Code of Ethics for Professional Accountants* (IESBA code) serves as the foundation for codes of ethics developed and enforced by IESBA member bodies, such as the AICPA in the United States. As a member of IFAC, the AICPA's Professional Ethics Executive Committee (PEEC) ensures that its ethics standards meet the IESBA ethics requirements, which serve as a global benchmark. Thus, it is important to stay aware of changes to the IESBA code because the AICPA monitors those changes and considers whether they require similar changes to the AICPA Code of Professional Conduct (AICPA code).

#### **NOCLAR Highlights**

**.361** NOCLAR means "noncompliance with laws or regulations" committed by a client or employer, including a client or employer's governance body, management, and employees (including contracted employees).

**.362** NOCLAR is further narrowed as follows:

- The law or regulation directly effects material amounts and disclosures in a client or employer's financial statements.
- Compliance with the law or regulation is fundamental to the client or employer's business and operations or to avoid material penalties.

**.363** NOCLAR does not include the following:

- Clearly inconsequential matters
- Personal misconduct that is unrelated to the company's business
- Misconduct by persons not included in the scope of NOCLAR

**.364** Examples of laws and regulations that the standard addresses include those related to the following:

- Fraud, corruption, and bribery
- Money laundering, terrorist financing, and proceeds of crime
- Securities markets and trading

- Banking and other financial products and services
- Data protection
- Tax and pension liabilities and payments
- Environmental protection
- Public health and safety

### ***Proposed Ethics Interpretation***

**.365** PEEC proposed a new ethics interpretation requiring members to take certain actions when they encounter their client or employer's noncompliance with laws or regulations. The proposed rules are tailored to members in public practice and members in business (parts 1 and 2 of the AICPA code, respectively) and mirror the scope of a standard the IESBA adopted in 2016. However, the proposal also departs from the IESBA standard in significant ways (as noted by PEEC) to account for AICPA, state accountancy, and other rules and regulations that prohibit disclosure of confidential information, in many cases, without client or employer permission. In other words, the NOCLAR standard provides an additional exception to the confidentiality rules that would normally preclude such disclosure without consent of the client or employer.

### ***Main Provisions***

**.366** The proposed standard would apply when a member is delivering a professional service to a client or carrying out professional activities for a company and becomes aware of or suspects NOCLAR has occurred or is going to occur.

**.367** Once a member learns of a matter within the scope of the standard, he or she would consider or may be required to consider, and take, certain actions (if warranted), including (a) discussions with the client or employer's management, including when possible and appropriate, those charged with governance; (b) disclosure to the auditor, or other auditors within the member's firm or network, when relevant and permissible; (c) consideration of the client or employer's actions in response to the NOCLAR; and (d) based on the client or employer's response (or lack of response), withdrawal from the client or employer organization, when appropriate.

**.368** Members in public practice would be required, and members in business encouraged, to document the matter.

**.369** The major difference between the IESBA standard and the AICPA proposed standards is that due to U.S. confidentiality restrictions, the AICPA standards do not require the member to consider disclosing NOCLAR to a regulatory or similar body, or an outside auditor, unless law or regulation requires such disclosure.

### ***Continued Discussion***

**.370** The AICPA received comments on its proposed rules, some critical of the expansion of responsibilities to non-auditors and members in business under the proposal, and others questioning why the AICPA did not propose a rule that conforms more closely to the IESBA rule and allows the member to disclose NOCLAR when warranted without client or employer consent. Due to the disparate comments received, PEEC will likely study the issues further.

Ultimately, the question is how to balance the accountant's duty of confidentiality with his or her duty to protect the public interest. For now, the debate continues.

## Conceptual Framework Implementation Tools and Resources

**.371** The AICPA Professional Ethics website provides tools and resources to assist members in implementing and complying with the AICPA Code of Professional Conduct. The following toolkits are especially useful:

- Conceptual Framework Toolkit for Independence. This toolkit assists members in the implementation of the Independence Conceptual Framework. It includes, among other things, a worksheet to aid members with applying the steps of the conceptual framework that could also be used to satisfy the documentation requirement found in paragraph .09 in the framework.
- Conceptual Framework Toolkit for Members in Public Practice. This toolkit assists members in the implementation of the Conceptual Framework for Members in Public Practice. It includes, among other things, a worksheet to aid members with applying the steps of the conceptual framework that could be used to document their assessment.
- Conceptual Framework Toolkit for Members in Business. This toolkit assists members in the implementation of the Conceptual Framework for Members in Business. It includes, among other things, a worksheet to aid members with applying the steps of the conceptual framework that could be used to document their assessment.

**.372** These and other helpful tools are available at [www.aicpa.org/interestareas/professionalethics/resources/pages/default.aspx](http://www.aicpa.org/interestareas/professionalethics/resources/pages/default.aspx).

## Definition of a *Client*

**.373** In July 2017, PEEC adopted revised definitions for the terms *client* and *attest client*. These revised definitions of *client* make it clear that there may be two separate clients on an engagement, an entity that engages the member and an entity that is subject to the member's services. The revised definition of *attest client* better reflects the notion of affiliates.

## New Independence Interpretation—Hosting Services

**.374** In June 2017, PEEC adopted a new independence interpretation, "Hosting Services" (ET sec. 1.295.143),<sup>4</sup> which appears under the "Independence Rule" (ET sec. 1.200.001) in the AICPA code and applies to members in public practice who provide attest services to a client.

**.375** Under the new rule, hosting services impair independence when a member takes responsibility for maintaining internal control over an attest client's data or records. Specifically, a member performs hosting services when he or she takes responsibility for the following:

- Being the sole host of a client's financial or nonfinancial information system

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<sup>4</sup> All ET sections can be found in *Professional Standards*.

- Custody or storage of the client's data, leaving the client's data incomplete and accessible only through the member
- Providing data or records security or back-up services for a client's electronic data or records

**.376** Because members may have access, take possession, or retain copies of client records for various reasons, the interpretation provides several examples of activities that do and do not result in a member providing hosting services.

### ***Hosting Services Defined***

**.377** The new interpretation provides three examples of situations that create hosting services, that is, if the attest client engages the member to be responsible for any of the following activities, independence is impaired:

- The member houses the client's website or other nonfinancial information system on the member's servers (whether the member owns or leases the servers).
- The member keeps the client's financial data or records (for example, general ledger, legal documents, amortization schedules) on the member's servers (whether leased or owned) or hardcopies of data or records in a physical location the member maintains.
- The member provides business continuity or disaster recovery services to the client for its data or records.

### ***Non-Hosting Services Defined***

**.378** Not all custody or control of a client's records results in hosting services because a member's access, use, custody, or control of the client's data may be appropriate and necessary when rendering professional services. The primary question is whether the member has accepted responsibility to maintain custody or control of the client's information. For example, a member may do the following without being considered a provider of hosting services:

- Have custody of the client's records to support a nonattest service. For example, the client provides payroll data to the member to support the member's preparation of a payroll tax return.
- Retain copies of work product, or data collected to support the member's work product, when providing a professional service for a client.
- Provide bookkeeping services using accounting software, such as QuickBooks, if the member and client separately maintain the software on their respective servers. Or, the client can contract with a third-party cloud-based software provider, such as Xero, and give the member permission to access the client's books via the software to perform the services.
- Exchange data, records, or the member's work product with the client electronically (for example, through a portal). Exchanges are related to performance of the member's professional services to the client or to deliver the member's work product to third parties at the client's request. To avoid hosting services when exchanging client data or records through a portal, the member should terminate the client's access to the data or records in the portal on a timely basis once the engagement is complete.

- License software to a client for the client's own use, provided the software performs an activity that the member could provide under the "Independence Rule" (ET sec. 1.200.001). For example, under the "Appraisal, Valuation, and Actuarial Services" interpretation (ET sec. 1.295.110), the member should not license business valuation software to the client that requires significant subjectivity and is material to the client because independence would be impaired. However, the member could license software that performs only tax-related valuations and appraisals because the member is permitted to perform those types of valuations under the "Independence Rule."
- Hold depreciation schedules the member prepared for the client; the member should supply the schedules and calculations to the client so the books and records are complete.
- Possess a client's original data or records to facilitate performance of a nonattest service, such as tax return preparation. The member should return the data or records at the completion of the engagement (or if the engagement is ongoing, on an annual basis).

**.379** Members are reminded to comply with requirements of other interpretations in the "Nonattest Services" subtopic (ET sec. 1.295). For example, all nonattest services are subject to certain general requirements, including documentation, and because elements akin to hosting may arise when a member performs tax, bookkeeping, or other nonattest services, members should comply with all applicable rules in that section of the AICPA code.

**.380** The interpretation will be effective September 1, 2018.

## Knowing Misrepresentations in the Preparation and Presentation of Information

**.381** In June 2017, PEEC adopted a revised version of this interpretation following review of a similar provision in the IESBA ethics code. This rule applies only to members in business and, as before, appears under the "Integrity and Objectivity Rule" (ET sec. 2.100.001).

**.382** The interpretation has traditionally applied to members preparing financial statements and records by barring them from knowingly and materially misrepresenting such information or directing others to do so.

**.383** The revised interpretation expands the current rule to include information beyond the financial statements that is distributed both within and outside the member's employing organization. Information is described as follows:

[F]inancial and nonfinancial information that may be made public or used for internal purposes such as the following:

- a. Operating and performance reports
- b. Decision support analyses
- c. Budgets and forecasts
- d. Information provided to the internal and external auditors
- e. Risk analyses
- f. General and special purpose financial statements
- g. Tax returns

- h.* Reports filed with regulators for legal and compliance purposes.

**.384** The interpretation also addresses information that is not subject to a reporting framework.

**.385** The "Integrity and Objectivity Rule" provides safeguards that the member should apply to resolve a matter when he or she becomes associated with misleading information as described previously.

**.386** A member who intends to rely on the work of others, either internal or external to the organization, is instructed to use professional judgment to determine steps to take to ensure that the requirements of the interpretations are met. For example, factors to consider in determining whether reliance on others is reasonable would include the reputation, expertise, objectivity, and resources available to the individual or organization and whether the other individual is subject to applicable professional and ethical standards. The member may have gained this information through prior association with others or by consulting others about the individual or the organization.

**.387** Under the revised interpretation, if a member suspects he or she may be associated with misleading information, the member should apply the following safeguards:

- Consult the employing organization's policies and procedures (for example, an ethics or whistleblowing policy) regarding how such matters should be addressed internally.
- Discuss concerns that the information is misleading with the member's supervisor or the appropriate levels of management within the member's employing organization or those charged with governance and request such individuals take appropriate action to resolve the matter.

**.388** Additional actions, including refusal to be associated with the misleading information, will be required if the member applies the preceding safeguards and the situation is not resolved because threats will be at an unacceptable level if the member remains associated with the misleading information. In addition, the member may decide to resign from the employing organization. Following is an excerpt from the interpretation.

If, after exhausting all feasible options, the member determines that appropriate action has not been taken and there is reason to believe that the information is still misleading, the member should refuse to be or to remain associated with the information. The member also should consider whether to continue a relationship with the employing organization.

Members are encouraged to thoroughly document the facts and circumstances, actions taken, and other relevant factors about the matter.

**.389** The interpretation became effective August 31, 2017.

## Pressure to Breach the Rules

**.390** In June 2017, PEEC adopted this new interpretation following review of a similar provision in the IESBA ethics code. The "Pressure to Breach the Rules" interpretation (ET sec. 2.170.010) applies only to members in business



and falls under the "Integrity and Objectivity Rule" (ET sec. 2.100.001). This interpretation provides guidance to members who come under pressure (whether explicit or implicit) from various parties when they perform professional services and provides several examples, factors to consider, and safeguards.

**.391** The interpretation addresses pressures that could result in a member taking actions that breach or cause others to breach the rules and guides the member on addressing threats (for example, undue influence threats) to compliance with the "Integrity and Objectivity Rule" when undertaking a professional service.

**.392** Pressure may be explicit or implicit and can come from different sources:

- Within the employing organization, for example, from a colleague or superior
- An external individual or organization, such as a vendor, customer, or lender
- The need to meet internal or external targets and expectations

**.393** A member should not allow pressure from others to result in a breach of the "Integrity and Objectivity Rule" and should also not place pressure on others that the member knows, or has reason to believe, would result in the other individuals breaching the rules of the AICPA code.

### **Examples**

**.394** Examples of pressure that could result in a breach of the "Integrity and Objectivity Rule" include the following:

- Pressure related to conflicts of interest, for example, pressure from a family member bidding to act as a vendor to the member's employing organization to select that vendor over another prospective vendor
- Pressure to influence the presentation of information, for example, the following:
  - Pressure to report misleading financial results to meet investor, analyst, or lender expectations
  - Pressure from elected officials to misrepresent programs or projects to voters
  - Pressure from colleagues to misstate income, expenditure, or rates of return to bias decision making on capital projects and acquisitions
  - Pressure from superiors to approve or process expenditures that are not legitimate business expenses
  - Pressure to suppress internal audit reports containing adverse findings
  - Pressure to act without sufficient competence or due care (for example, without sufficient skills or training or under unrealistic deadlines)
  - Pressure to manipulate performance indicators from superiors, colleagues, or others, such as those who may benefit from participation in compensation or incentive arrangements

- Pressure related to gifts or entertainment (for example, offering gifts or entertainment to inappropriately influence the judgment or decision-making process of an individual or organization or accept inappropriate gifts or entertainment from potential vendors in a bidding process)

**.395** In determining whether the pressure could result in a breach of the "Integrity and Objectivity Rule," the member may consider the following factors:

- The intent of the individual who is exerting the pressure and the nature and significance of the pressure.
- The application of relevant laws, regulations, and professional standards to the circumstances.
- The culture and leadership of the employing organization, including the extent to which it emphasizes the importance of ethical behavior and the expectation that employees will act in an ethical manner. For example, a corporate culture that tolerates unethical behavior may increase the likelihood that the pressure would result in a breach of the rules.
- Policies and procedures, if any, that the employing organization has established, such as ethics or human resources policies that address pressure.

**.396** In considering the preceding factors, members may wish to consult with the following:

- A colleague, superior, human resources personnel, internal compliance personnel, or another professional accountant
- Relevant professional or regulatory bodies or industry associations
- Legal counsel

**.397** If the member determines that the pressure would result in a breach of the "Integrity and Objectivity Rule," the member might consider safeguards, including the following:

- Discuss the matter with the individual who is exerting the pressure to seek to resolve it.
- Discuss the matter with the member's supervisor if the supervisor is not the individual exerting the pressure.
- Escalate the matter within the employing organization, for example, with higher levels of management, internal or external auditors, or those charged with governance, including independent directors and, when appropriate, explaining any consequential risks to the organization.
- Request restructuring or segregating certain responsibilities and duties so that the member is no longer involved with the individual or entity exerting the pressure, when doing so would eliminate the pressure to breach the "Integrity and Objectivity Rule." For example, if a member is pressured in relation to a conflict of interest, the pressure to breach the rule may be eliminated if the member avoids being associated with the matter creating the conflict.

- Disclose the matter in accordance with the employing organization's policies, including ethics and whistleblowing policies, using an established mechanism, such as a confidential ethics hotline.
- Consult with legal counsel.

**.398** When the member determines that the pressure to breach the "Integrity and Objectivity Rule" has not been eliminated, the member should do the following:

- Decline to undertake or discontinue the professional activity that would result in a breach of the rule.
- Consider whether to continue a relationship with the employing organization.

**.399** The member is also encouraged to document the facts, communications, courses of action considered, the parties with whom these matters were discussed, and how the matter was addressed.

## AICPA NFP Initiatives

**.400** The mission of each NFP may be unique, but NFPs share many common concerns about financial reporting, tax, audit, and governance. To meet the increasing needs in this fast-growing sector, the AICPA offers the following initiatives that provide news, education, training, and resources to individuals who are CPAs and non-CPA professionals serving NFPs:

- Not-for-Profit Section
- Not-for-Profit Certificate Program

## Not-for-Profit Member Section

**.401** In May 2015, the AICPA launched a membership section for practitioners and others who serve or work for the nation's growing NFP sector. The AICPA's Not-for-Profit Section (NFP Section) provides support and resources in the areas of audit, financial accounting, governance, and tax for members and other finance professionals.

**.402** Responding to member calls for added NFP resources, the NFP Section strengthens the AICPA's commitment to serving the public interest. In addition to providing tools and training throughout the NFP sector, the NFP Section offers those who have management or governance responsibilities with respect to an NFP, including those who serve as board members or volunteers, the opportunity to join the AICPA as a non-CPA associate. All current AICPA members, including associate and non-CPA associates, are eligible to join the NFP Section.

**.403** More than half of Americans (57 percent) who took part in a recent survey said they would be more likely to contribute to an NFP entity whose employees receive regular updates about financial management issues and trends. Those responses provide ample evidence of the importance of staff and consultant competencies to support non-profit organizations. The survey results provide incentive for accountants and others who work in or with the nation's NFP sector to both join the NFP Section and enroll in the Not-for-Profit Certificate Program.

**.404** The NFP Section's mission is to deliver information, tools, and resources to NFP professionals that facilitate timely compliance with standards

and regulations, promote the excellence of its members as leaders in the NFP sector, and serve as a connector for peer-to-peer learning and information sharing.

**.405** Benefits of NFP Section membership include the following:

- *Timely communications covering breaking news.* Receive e-alerts and join our interactive webcasts to be among the first to know when standard setters and regulatory agencies issue new guidance that will affect NFPs—and learn how to anticipate the impact of such changes and take appropriate action.
- *Tools and resources.* On our dedicated website, you will find wide-ranging information that is vital to your role in serving NFPs. Just a few examples of what you will find in our resource library include
  - articles that offer a deeper dive into topics like ASU No. 2016-14 implementation, risk management, communication with audit committees, allocation of functional expenses, and Form 990 red flags;
  - sample financial statements and note disclosures;
  - board governance and accounting policy examples;
  - streamlined tools, such as Form 990 worksheets, internal control checklists, example management letter comments, and reference charts; and
  - working paper templates in Microsoft Excel.
- *Affordable access to live and on-demand CPE-eligible courses on a variety of topics.* Members receive exclusive discounts on high-quality courses covering topics such as NFP accounting, auditing, tax compliance, and board governance. Included in the membership price, is one, two-hour CPE-eligible webcast in the last month of each calendar quarter.
- *Opportunities within our community for peer-to-peer learning and information-sharing, both online and in-person.* Get connected through our interactive, members-only discussion boards. Attend our exclusive pre-conference workshops and networking events. Join our community to collaborate and share your experience and insights.
- *Special discounts on NFP products and resources.* NFP Section members receive discounts on the AICPA National Not-for-Profit Industry Conference, NFP publications (including AICPA Audit and Accounting Guide *Not-for-Profit Entities* and AICPA Audit Risk Alert *Not-for-Profit Industry Developments*), and the Not-for-Profit Certificate Program.

**.406** Visit [www.aicpa.org/nfp](http://www.aicpa.org/nfp) for more information or to join.

## Not-for-Profit Certificate Program

**.407** The AICPA offers a two-part certificate program for NFP professionals. The program is available to anyone with an interest in learning more about financial management of NFPs.

### ***Not-for-Profit Certificate I***

**.408** Part I of the Not-for-Profit Certificate Program is specially designed to help accountants and others gain a basic understanding of NFP entities and build the knowledge needed to support them in the pursuit of their missions. Certificate I provides a foundation in NFP accounting, tax compliance, governance, and assurance. This online program is available on demand and offers 40 hours of CPE-eligible credit that is divided among 24 courses, delivered in 3 topical tracks.

**.409** Participants learn about GAAP reporting standards that apply to NFPs, including financial statement presentation and disclosure requirements, state and federal filing requirements for tax-exempt organizations, best practices in board governance, financial oversight, internal controls, fraud and other risks, and audit planning considerations. Courses are available for purchase individually or as a package. All 24 courses must be completed to receive the certificate; however, there may be individual courses from which staff and volunteers can benefit. Learn more at [www.aicpastore.com](http://www.aicpastore.com).

### ***Not-for-Profit Certificate II***

**.410** Part II of the Not-for-Profit Certificate Program offers 30 hours of CPE-eligible credit across 17 courses that build on the core principles presented in Part I of the program; however, Part I is not a prerequisite for Part II. This online, video-based program is presented by leading NFP-industry experts and is intended to teach participants how to apply their skills in a real-world setting. Participants learn how to prepare financial statements, complete the IRS Form 990, build complex budgets, perform risk assessments, guide the strategic planning process, and work with an NFP's governing board. Learning exercises, targeted case studies, and detail-rich interpretations are interspersed throughout the video presentations. Courses are available for purchase individually or as a package and are accessible on demand. All 17 courses must be completed to receive the certificate; however, there may be individual courses from which staff and volunteers can benefit. Learn more at [www.aicpastore.com](http://www.aicpastore.com).

## **On the Horizon**

**.411** Auditors should keep abreast of auditing and accounting developments and upcoming guidance that may affect their engagements. The following sections present brief information about some ongoing projects that have particular significance to NFPs or that may result in significant changes. Remember that research projects and exposure drafts are nonauthoritative and cannot be used as a basis for changing the application of existing standards.

**.412** Information on, and copies of, outstanding research projects and exposure drafts may be obtained from the various standard-setters' websites. These websites contain in-depth information about proposed standards and other projects in the pipeline. Many more accounting and auditing projects exist in addition to those discussed here. Readers should refer to documents provided by the various standard-setting bodies for further information.

## **Auditing Pipeline**

### ***Proposed Changes to the Auditor's Report***

**.413** In November 2017, the ASB issued a set of exposure drafts aimed at enhancing the relevance and usefulness of the auditor's report. The proposed

SASs were developed in consideration of the following issues identified by the PCAOB and the International Auditing and Assurance Standards Board:

- Although users value the "pass/fail" nature of the auditor's opinion, they would like the auditor's report to provide greater transparency into the audit.
- Users would like the auditor's report to include more information about areas with higher assessed risks of material misstatement, areas that involve significant judgement by management and the auditor, and areas that relate to significant events or transactions.
- To address the long-standing "expectations gap," users and other stakeholders would like the auditor's report to expand the descriptions of the auditor's responsibilities in financial statement auditing and management's responsibilities in financial statement preparation.

.414 The following are the exposure drafts released in November 2017 and a summary of their key proposed changes.

*Proposed Statements on Auditing Standards: Auditor Reporting and Proposed Amendments—Addressing Disclosures in the Audit of Financial Statements*

.415 *Proposed SAS Forming an Opinion and Reporting on Financial Statements (AU-C Section 700)*. The following summarizes what the ASB believes are the most significant changes in the proposed SAS from extant AU-C section 700:

- Requires the "Opinion" section to be presented first in the auditor's report, followed by the "Basis for Opinion" section
- Requires the "Basis for Opinion" section of the auditor's report to include an affirmative statement about the auditor's independence and fulfillment of the auditor's other ethical responsibilities
- Requires the auditor to report substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time, if such a conclusion is reached, in a section of the auditor's report under the heading, "Substantial Doubt About the Entity's Ability to Continue as a Going Concern," instead of an emphasis-of-matter paragraph, in accordance with proposed amendments to AU-C section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*
- Provides a framework for auditors of nonissuers to communicate key audit matters (KAMs). Although noncommunication of KAMs would not be required for audits of nonissuers, if the terms of the audit engagement include reporting KAMs, the auditor would be required to communicate KAMs in accordance with proposed SAS *Communicating Key Audit Matters in the Independent Auditor's Report* (proposed new AU-C section 701).
- Requires the auditor to report on "other information" (if any) in a section so titled, in accordance with proposed SAS *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*
- Expands the description of the responsibilities of management for the preparation and fair presentation of the financial statements and includes a requirement to identify those responsible for the

oversight of the financial reporting process when those responsible for such oversight differ from those responsible for the preparation of the financial statements

- Expands the description of the responsibilities of the auditor and key features of an audit

**.416** *Proposed SAS Communicating Key Audit Matters in the Independent Auditor's Report (Proposed New AU-C Section 701)*. As discussed earlier, proposed SAS *Forming an Opinion and Reporting on Financial Statements* would not require the communication of KAMs for audits of nonissuers but, if done as part of the terms of the audit engagement, the auditor would be required to communicate KAMs in accordance with proposed SAS *Communicating Key Audit Matters in the Independent Auditor's Report* (proposed new AU-C section 701), which closely converges with ISA 701, *Communicating Key Audit Matters in the Independent Auditor's Report*.

**.417** *Proposed SAS Modifications to the Opinion in the Independent Auditor's Report (AU-C Section 705)*. The proposed SAS *Modifications to the Opinion in the Independent Auditor's Report* is intended to converge with ISA 705 (Revised), *Modifications to the Opinion in the Independent Auditor's Report*. The principal changes to extant AU-C Section 705 relate to the form and content of the auditor's report when the opinion is modified consistent with the requirements in proposed SAS *Forming an Opinion and Reporting on Financial Statements*.

**.418** *Proposed SAS Emphasis-of-Matter and Other-Matter Paragraphs in the Independent Auditor's Report (AU-C Section 706)*. The proposed SAS *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report* is intended to converge with ISA 706 (Revised), *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*. The principal changes to extant AU-C Section 706 relate to clarifying the relationship between emphasis-of-matter paragraphs and the communication of KAMs in the auditor's report. When proposed SAS *Communicating Key Audit Matters in the Independent Auditor's Report* applies, the use of an emphasis-of-matter paragraph is not a substitute for a description of individual KAMs. Proposed SAS *Emphasis-of-Matter and Other-Matter Paragraphs in the Independent Auditor's Report* also requires the auditor to use an appropriate heading for an emphasis-of-matter paragraph that includes the term "Emphasis of Matter." The auditor would be able to add additional context to the heading to further describe the nature of the matter (for example, "Emphasis of Matter—Subsequent Event").

**.419** *AU-C Section 570, Going Concern*. The proposed amendments to AU-C section 570 (SAS No. 132) modify the requirements relating to auditor reporting on going concern to be consistent with the corresponding requirements in ISA 570 (Revised). When SAS No. 132 was issued in February 2017, it was contemplated that the reporting requirements would be assessed and potentially revised in connection with the ASB's auditor reporting project. The underlying auditor performance requirements relating to going concern are not changing. If, after considering identified conditions or events 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 would include a separate section in the auditor's report under the heading "Substantial Doubt About the Entity's Ability to Continue as a Going Concern"

instead of an emphasis-of-matter paragraph. The content of this separate section would be similar to that included in the emphasis-of-matter paragraph.

**.420** *AU-C Section 260, Communications With Those Charged With Governance.* If the proposed amendments are issued as final, the most significant change to extant AU-C section 260 would be a requirement for the auditor to communicate with those charged with governance about the significant risks identified by the auditor. This communication would be part of the required communication of an overview of the planned scope and timing of the audit.

**.421** The proposed amendments to AU-C section 260 would also add a requirement for the auditor to communicate with those charged with governance about circumstances that affect the form and content of the auditor's report, if any.

**.422** *AU-C Section 210, Terms of Engagement.* The proposed amendments to AU-C section 210 modify the application material relating to the form and content of the engagement letter and the example audit engagement letter to be consistent with the changes to the elements of the auditor's report in proposed SAS *Forming an Opinion and Reporting on Financial Statements*, as described in the section "Significant Changes From Existing Standards."

**.423** A new application material paragraph is being added to provide guidance when management (and, as applicable, those charged with governance) has requested that the auditor communicate KAMs in the auditor's report and to provide guidance regarding the acknowledgment of this in the engagement letter.

**.424** *Proposed Amendments Addressing Disclosures in the Audit of Financial Statements.* The amendments proposed to address disclosures in an audit of financial statements are intended to focus the auditor's attention on disclosures earlier in the process of auditing financial statements. The ASB is proposing amendments to specific AU-C sections, rather than a separate SAS on disclosures, to encourage a holistic and integrated approach to auditing disclosures throughout the financial statement audit. The proposed SAS includes a table of the proposed amendments addressing disclosures.

**.425** *Effective Date.* The proposed SASs and related proposed amendments would be effective no earlier than for audits of financial statements for periods ending on or after June 15, 2019, depending on when the proposed standards and amendments are finalized. Because the proposed standards and amendments are interrelated, all of them would be required to be adopted concurrently. It is anticipated that early implementation will not be permitted.

### *Proposed Statement on Auditing Standards: The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*

**.426** The following summarizes what the ASB believes would be the most significant changes to extant AU-C section 720 if the proposed standard is issued.

**.427** *Clarification of Documents Within Scope.* The proposed standard clarifies the scope of documents that the auditor is required to subject to the procedures. The ASB believes that in practice, extant AU-C section 720 is often



applied more broadly than intended. Therefore, the proposed SAS amends the title from *Other Information in Documents Containing Audited Financial Statements* to *The Auditor's Responsibilities Regarding Other Information Included in Annual Reports*. It also defines the term *annual report*.

**.428** *Determination of Which Documents Constitute the Annual Report.* The proposed standard includes a requirement for the auditor to determine, through discussion with management, and obtain management's written acknowledgment regarding which document or documents make up the annual report and the entity's planned manner and timing of the issuance of such document or documents. This requirement is intended to ensure that both the auditor and management understand the documents that are considered to constitute the entity's annual report and, therefore, are subject to the auditor's required procedures.

**.429** *Reading the Other Information.* In accordance with the proposed SAS, the objectives of the auditor, having read the other information, include the following:

- a. Consider whether there is a material inconsistency between the other information and the financial statements
- b. Consider whether there is a material inconsistency between the other information and the auditor's knowledge obtained in the audit
- c. Respond appropriately when the auditor identifies that such material inconsistencies appear to exist or when the auditor otherwise becomes aware that other information appears to be materially misstated

**.430** The proposed SAS expands and clarifies the auditor's responsibilities with respect to other information. Further, in accordance with the definition in the proposed SAS, "a misstatement of the other information exists when the other information is incorrectly stated or otherwise misleading (including because it omits or obscures information necessary for a proper understanding of a matter disclosed in the other information)." The term *misstatement of the other information* is intended to be broader than, but to encompass, the defined terms *inconsistency* and *misstatement of fact* from extant AU-C section 720.

**.431** Extant AU-C section 720 does not require the auditor to consider whether the other information omits or obscures information necessary for a proper understanding of a matter. To provide guidance to auditors with respect to this point, the proposed SAS includes the following application paragraphs:

**A12.** When a particular matter is disclosed in the other information, the other information may omit information that is necessary for a proper understanding of that matter or, in light of the circumstances, to keep the other information from being misleading. The auditor is not responsible for searching for omitted information or for the completeness of the other information.

**A13.** Other information may be undermined by the inclusion of information that is not relevant or that obscures a proper understanding of the matters disclosed.

**.432** *Knowledge of Component Auditors When Group Auditor Decides to Make Reference to a Component Auditor in the Auditor's Report on Group Financial Statements.* The proposed SAS addresses the implications when a group

auditor decides to make reference to a component auditor in the auditor's report on group financial statements by including the following application guidance.

**.433** In the case of a group audit, though the group auditor is required to read the entirety of the other information if, in accordance with paragraph .24 of AU-C section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*, the group auditor decides to make reference to a component auditor in the auditor's report on the group financial statements, the group auditor's knowledge does not extend beyond that obtained by the group auditor during the audit of the group financial statements.

**.434 Reporting.** The proposed SAS requires that the auditor's report include a separate section with the heading "Other Information," or other appropriate heading, when, at the date of the auditor's report, the auditor has obtained some or all of the other information. The intent is to bring transparency of the auditor's work with respect to other information.

**.435** The appendix of the proposed SAS includes four examples of "other information" sections to be included in auditors' reports relating to other information included in the annual report.

**.436** If issued as final, the proposed SAS will be effective for audits of financial statements for periods beginning on or after June 15, 2019. This effective date is provisional but will not be earlier than June 15, 2019. Early implementation is not permitted.

### *Proposed Statement on Auditing Standards: Omnibus Statement on Auditing Standards—2018*

**.437** The ASB reviewed three PCAOB auditing standards (Auditing Standard [AS] 1301, *Communication With Audit Committees*; AS 2701, *Supplementary Information*; and AS 2410, *Related Parties* [AICPA, PCAOB Standards and Related Rules]) and, for each requirement in a PCAOB auditing standard that the ASB believes does not have an equivalent in GAAS, considered whether an amendment to GAAS was appropriate.

- The proposed SAS amends the following sections of SAS No. 122, *Statements on Auditing Standards: Clarification and Recodification*: Section 210, *Terms of Engagement* (AU-C sec. 210), as proposed to be amended by the exposure draft *Proposed Statements on Auditing Standards: Auditor Reporting and Proposed Amendments—Addressing Disclosures in the Audit of Financial Statements*
- Section 240, *Consideration of Fraud in a Financial Statement Audit, as amended* (AU-C sec. 240)
- Section 260, *The Auditor's Communication With Those Charged With Governance* (AU-C sec. 260), as proposed to be amended by the exposure draft *Proposed Statements on Auditing Standards: Auditor Reporting and Proposed Amendments—Addressing Disclosures in the Audit of Financial Statements*
- Section 265, *Communicating Internal Control Related Matters Identified in an Audit* (AU-C sec. 265)
- Section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement, as amended* (AU-C

sec. 315), as proposed to be amended by the exposure draft *Proposed Statements on Auditing Standards: Auditor Reporting and Proposed Amendments—Addressing Disclosures in the Audit of Financial Statements*

- Section 330, *Performing Audit Procedures in Responses to Assessed Risks and Evaluating the Audit Evidence Obtained* (AU-C sec. 330)
- Section 510, *Opening Balances—Initial Audit Engagements, Including Reaudit Engagements* (AU-C sec. 510)
- Section 550, *Related Parties, as amended* (AU-C sec. 550)
- Section 560, *Subsequent Events and Subsequently Discovered Facts* (AU-C sec. 560)
- Section 580, *Written Representations* (AU-C sec. 550)
- Section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors), as amended* (AU-C sec. 600)
- Section 930, *Interim Financial Information* (AU-C sec. 930)
- Amends SAS No. 130, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements* (AU-C sec. 940)

**.438** If issued as final, the proposed SAS will be effective for audits of financial statements for periods ending on or after June 15, 2019. This date is provisional but will not be earlier than June 15, 2019.

**.439** Proposed SASs can be found at [www.aicpa.org/research/exposure-drafts/accountingandauditing.html](http://www.aicpa.org/research/exposure-drafts/accountingandauditing.html). Comments for those released in November 2017 are requested by May 15, 2018.

## Accounting Pipeline

**.440** FASB has a variety of research and standard-setting projects currently underway. The description and status of each project is available at [www.fasb.org](http://www.fasb.org). Some of these projects that are of special interest to NFPs are discussed in the following paragraphs.

### *Financial Statements of Not-for-Profit Entities—Phase 2*

**.441** At the FASB meeting on October 28, 2015, FASB staff members recommended a plan for next steps that would allow progress toward the NFP financial statement project objectives to continue. The plan involved dividing the various topics addressed in the April 2015 proposed ASU *Not-for-Profit Entities (Topic 958) and Health Care Entities (Topic 954): Presentation of Financial Statements of Not-for-Profit Entities* into two different work streams. The first work stream resulted in the issuance of ASU No. 2016-14. The second work stream (Phase 2) contains those items that FASB staff felt would require extensive re-deliberations over a longer term.

**.442** The second work stream is expected to involve reconsideration of other proposed changes that are likely to require more time to resolve because they involve consideration of alternatives suggested by stakeholders that the board did not previously consider or are related to similar issues being addressed in other projects. Those proposals include the following:

- Addressing all other elements of the proposed ASU with regard to the required operating measures, including the following:
  - Whether to require intermediate measure(s)
  - Whether and how to define such measure(s) and what items should or should not be included in the measure(s)
  - Alternative disaggregation approaches suggested by stakeholders
- Reclassification of certain items between the categories on the statement of cash flows to align that statement with the operating measures to be required
- Consideration of segment reporting for use by NFP health care entities as an option to meet the required disclosure of expenses by function and natural classification

.443 At its September 20, 2017 meeting, FASB decided to revise the scope of the Financial Statements of Not-for-Profit Entities—Phase 2 research project by removing an alternative that would have required an NFP health care entity to apply FASB ASC 280, *Segment Reporting*. The board also decided to combine its for-profit and not-for-profit research projects on structuring the income statement (or statement of activities). Specific considerations include presentation of expenses by nature and function and a required operating measure.

.444 At the time of publication, there was no indication about when or if this research will be concluded, and the project would move on to the standard-setting phase. As information is available, it can be found at [www.fasb.org](http://www.fasb.org).

### ***Leases—Targeted Improvements***

.445 In January 2018, FASB issued the proposed ASU *Leases (Topic 842) Targeted Improvements* to address preparer concerns with two specific aspects of the new leases standard discussed earlier in this alert (ASU No. 2016-02): comparative reporting at adoption and separating components of a contract.

.446 As entities have started to implement the new lease requirements, some are incurring unanticipated costs and complexities associated with the modified retrospective transition method, particularly the comparative period reporting requirements. FASB is proposing an alternative that allows recognition of a cumulative effect adjustment to the opening balance of retained earnings in the period of adoption. Although this additional transition method would change when an entity would be required to initially apply the transition requirements of the new lease standard, it would not change how those requirements apply.

.447 Additionally, the amendments in this proposed ASU would address stakeholders' concerns about the requirement for lessors to separate components of a contract by providing lessors with a practical expedient, by class of underlying assets, to not separate non-lease components from the related lease components, similar to that provided for lessees. However, the lessor practical expedient would be limited to circumstances in which both (a) the timing and pattern of revenue recognition are the same for the non-lease component(s) and related lease components, and (b) the combined single lease component would be classified as an operating lease.

.448 The comment period ended in February 2018. More information is available at [www.fasb.org](http://www.fasb.org).

## Resource Central

.449 The following are various resources that practitioners engaged in the NFP industry may find beneficial.

### Publications

.450 Practitioners may find the following publications useful. Choose the best format for you—online, e-book, or print.

- Audit and Accounting Guide *Not-for-Profit Entities* (2018) (product no. AAGNFP18P [paperback], ARANFP18E [e-book], or WNP-XX [online with the associated Audit Risk Alert])
- Audit Guide Government Auditing Standards *and Single Audits* (2018) (product no. AAGGAS18P [paperback], AAGGAS18E [e-book], or WRF-XX [online with the associated Audit Risk Alert])
- Audit and Accounting Guide *Health Care Entities* (2017) (product no. AAGHCO17P [paperback], AAGHCO17E [e-book], or WHC-XX [online with the associated Audit Risk Alert])
- Audit and Accounting Guide *Employee Benefit Plans* (2018) (product no. AAGEBP18P [paperback], AAGEBP18E [e-book], or WEB-XX [online])
- Audit Guide *Analytical Procedures* (2017) (product no. AUDANP17HI [paperback], AAGANP17E [e-book], or WAN-XX [online])
- Audit Guide *Assessing and Responding to Audit Risk in a Financial Statement Audit* (2016) (product no. AAGARR16P [paperback], AAGARR16E [e-book], or WRA-XX [online])
- Guide *Preparation, Compilation, and Review Engagements* (2017) (product no. AAGCRV17P [paperback], AAGCRV17E [e-book], or WRC-XX [online])
- Audit Guide *Audit Sampling* (2017) (product no. AAGSAM17P [paperback], AAGSAM17E [e-book], or WAS-XX [online])
- Alert *Developments in Preparation, Compilation, and Review Engagements—2017/18* (product no. ARACRV17P [paperback], ARACRV17E [e-book], or ARACRVO [online])
- Audit Risk Alert *General Accounting and Auditing Developments—2017/18* (product no. ARAGEN17P [paperback], ARAGEN17E [e-book], or WGE-XX [online])
- Audit Risk Alert *Employee Benefit Plans Industry Developments—2018* (product no. ARAEBP18P [paperback] or ARAEBP18E [e-book])
- *Not-for-Profit Entities: Checklists and Illustrative Financial Statements* (2017) (product no. ACKNFP17P [paperback] or WNP-CL [online])
- *U.S. GAAP Financial Statements—Best Practices in Presentation and Disclosure* (2017) (product no. ATTATT17P [paperback] or ABPPDO [online])
- *Not-for-Profit Entities—Best Practices in Presentation and Disclosure* (2016) (product no. ATTNPO16P [paperback], ATTNPO16E [e-book], or WNT-XX [online])

- *Audit and Accounting Manual* (2017) (product no. AAMAAM17P [paperback] or WAM-XX [online])

## Continuing Professional Education

.451 The AICPA offers a number of continuing professional education (CPE) courses that are valuable to CPAs working with and for NFPs, including the following:

- *Not-for-Profit Certificate Program—Certificate I*. This comprehensive on-demand learning experience covers the core concepts of accounting and financial reporting, tax compliance, governance, and assurance. This 40-hour interactive CPE program contains real-world examples, case studies, animations, and videos that create a flexible, dynamic learning experience. Whether you are a public accounting firm seeking to grow your nonprofit niche or an NFP seeking to establish your commitment to excellence, the certificate program offers a convenient and accessible way to get the foundational NFP financial training that is crucial to your success (product no. 165160).
- *Not-for-Profit Certificate Program—Certificate II*. This video-based CPE program, presented by leading industry experts, builds on the core principles presented in Not-for-Profit Certificate I to deepen your knowledge of how to apply complex financial concepts in a variety of NFP settings. After completing this course, you will be able to successfully prepare financial statements, complete Form 990, build complex budgets, and guide the strategic planning process. You'll also learn how to perform risk assessments, proactively respond to tax compliance issues, measure performance, and work with an organization's governing board to achieve mission success. Plus, experts provide practice tips to help you tailor your methods to address the challenges of nonprofits of all sizes (product no. 165400).
- *Not-for-Profit Accounting and Auditing Update (2017 edition)* (product no. 746133 [text], 152102 [CPE On-Demand], or 182085 [video and manual]). Covering all the latest auditing and accounting developments affecting NFPs, this course will give you a complete understanding of changes in the NFP environment.
- *Frequent Frauds Found in Governments and Not-for-Profits* (product no. 746431 [text]). Through an informative case study approach, this course illustrates common frauds that make headlines and damage the reputations of governments and NFPs.

.452 Visit [www.aicpastore.com](http://www.aicpastore.com) for a complete list of CPE courses.

### Online CPE

.453 CPEExpress is the AICPA's flagship online learning product. Divided into 1-credit and 2-credit courses that are available 24 hours a day, 7 days a week, CPEExpress offers hundreds of hours of learning in a wide variety of topics. Subscriptions are available at [www.aicpastore.com/FraudDetectionandPrevention/aicpa-cpexpress/PRDOVR-PC-BYF-XX/PC-BYF-XX.js](http://www.aicpastore.com/FraudDetectionandPrevention/aicpa-cpexpress/PRDOVR-PC-BYF-XX/PC-BYF-XX.js) (product no. BYT-XX). Some topics of special interest to NFPs include the following:

- Introduction to Not-for-Profit Entities: Accounting, Tax, and Compliance Essentials

- Not-for-Profit Auditing: Unique Auditing for a Unique Entity
- Fraud in Exempt Organizations: The Governmental and Not-for-Profit Environments
- Not-for-Profit Accounting: Financial Reporting

.454 To register or learn more, visit [www.aicpastore.com](http://www.aicpastore.com).

## Webcasts

.455 Stay plugged in to what is happening and earn CPE credit right from your desktop. AICPA webcasts are high-quality CPE programs that bring you the latest topics from the profession's leading experts. Broadcast live, the programs allow you to interact with the presenters and join in the discussion. If you cannot make the live event, each webcast is archived and available for viewing. For additional details on available webcasts, please visit [www.aicpastore.com/AST/AICPA\\_CPA2BiZ\\_Nav/Responsive\\_Top\\_Nav/Webcasts.jsp](http://www.aicpastore.com/AST/AICPA_CPA2BiZ_Nav/Responsive_Top_Nav/Webcasts.jsp).

.456 Get year-round unrestricted access to more than 500 webcasts featuring top experts, regulators, agency representatives, and more with the AICPA Annual Webcast Pass. With the Annual Webcast Pass, you can be confident you're getting the most relevant, convenient, and valuable professional guidance and career development available (product no. VSAPXX12).

## Member Service Center

.457 To order AICPA products, receive information about AICPA activities, and get help with your membership questions, call the Member Service Center at 1.888.777.7077.

## Hotlines

### *Accounting and Auditing Technical Hotline*

.458 Do you have a complex technical question about GAAP, other comprehensive bases of accounting, or other technical matters? If so, use the AICPA's Accounting and Auditing Technical Hotline. AICPA staff will research your question and call you back with the answer. The hotline is available from 9 a.m. to 8 p.m. ET on weekdays. You can reach the Technical Hotline at 1.877.242.7212 or online at [www.aicpa.org/research/technicalhotline.html](http://www.aicpa.org/research/technicalhotline.html). Members can submit questions by completing a technical inquiry form found on the same website.

### *Ethics Hotline*

.459 In addition to the Technical Hotline, the AICPA also offers an Ethics Hotline. Members of the AICPA's Professional Ethics Team answer inquiries concerning independence and other behavioral issues related to the application of the AICPA Code of Professional Conduct. You can reach the Ethics Hotline at 1.888.777.7077 or by email at [ethics@aicpa.org](mailto:ethics@aicpa.org).

## AICPA Online Professional Library: Accounting and Auditing Literature

.460 The AICPA has created your core accounting and auditing library online. The Online Professional Library is now customizable to suit your preferences or your firm's needs. You can also sign up for access to the entire

library. Get access—anytime, anywhere—to FASB ASC, the AICPA's latest *Professional Standards, Technical Questions and Answers*, Audit and Accounting Guides, Audit Risk Alerts, *Accounting Trends & Techniques*, and more. One option is the *AICPA Audit and Accounting Guides and Audit Risk Alert Set with FASB Accounting Standards Codification* that contains all guides, alerts, the Audit Risk Assessment Tool, and FASB ASC in the Online Professional Library (product no. WFA-XX [online]). To subscribe to this essential online service for accounting professionals, visit [www.aicpastore.com](http://www.aicpastore.com).

## Industry Conference

**.461** The AICPA offers its annual NFP industry conference in June in Washington, DC. The National Not-for-Profit Industry Conference is a comprehensive forum that deals with the challenges facing NFP practitioners and financial executives today. It's where you'll find out the latest information on the effect of tax, management, auditing, and accounting issues pertaining to NFPs. You'll also receive training in operational strategies that are crucial to the well-being of an NFP. For additional information about the conference, call 1.888.777.7077 or visit [www.aicpastore.com](http://www.aicpastore.com).

**.462** In October, the AICPA offers its Government and Not-for-Profit Training Program in Las Vegas, Nevada. This conference has been designed to help you with both awareness and comprehension of the latest regulatory changes. With guidance on compliance, ethics, and governance issues specific to governmental and NFP entities, you'll be prepared to meet the rigors of today's standards with newfound clarity. The sessions offered will enable increased interaction and the exchange of ideas among the participants and will seek to provide clarification on the tough subjects. For additional information about the conference, call 1.888.777.7077 or visit [www.aicpastore.com](http://www.aicpastore.com).

## AICPA Government Audit Quality Center

**.463** The Government Audit Quality Center (GAQC) is a voluntary membership center for CPA firms and state audit organizations designed to improve the quality and value of governmental audits. Governmental audits are performed under *Government Auditing Standards* and are audits and attestation engagements of federal, state, or local governments, NFPs, and certain for-profit organizations, such as housing projects and colleges and universities that participate in governmental programs or receive governmental financial assistance. The GAQC keeps its members informed about the latest developments and provides them with tools and information to help them better manage their audit practice. CPA firms and state audit organizations that join the GAQC demonstrate their commitment to audit quality by agreeing to adhere to certain membership requirements.

**.464** The GAQC has been in existence since September 2004. Since its launch, center membership has grown to 2,075 firms from 50 states, the District of Columbia, Puerto Rico, and 32 state audit organizations. The CPA firm portion of the GAQC membership accounts for more than 90 percent of the total federal expenditures covered in single audits performed by CPA firms in the Federal Audit Clearinghouse database (<https://harvester.census.gov/facweb/>) for the year 2014 (the latest year with complete submission data).

**.465** The GAQC's focus is to promote the highest quality audits and save members time by providing a centralized place to find information that they



need when they need it, to maximize quality, and to practice success. Center resources include the following:

- Email alerts with the latest audit and regulatory developments and their effect on your audits
- Exclusive online webcasts and webinars on compliance auditing and timely topics relevant to governmental and NFP financial statement audits (optional CPE is available for a fee, and events are archived online)
- Dedicated GAQC website at [www.aicpa.org/gaqc](http://www.aicpa.org/gaqc) with resources, community, events, products, and a complete listing of GAQC member firms in each state
- Savings on professional liability insurance

**.466** For more information about the GAQC, visit [www.aicpa.org/gaqc](http://www.aicpa.org/gaqc).

### **AICPA Industry Expert Panel—Not-for-Profit Entities**

**.467** For information about the activities of the AICPA Not-for-Profit Entities Expert Panel, visit the panel's website at [www.aicpa.org/InterestAreas/FRC/IndustryInsights/Pages/Expert\\_Panel\\_Not\\_for\\_Profit\\_Entities.aspx](http://www.aicpa.org/InterestAreas/FRC/IndustryInsights/Pages/Expert_Panel_Not_for_Profit_Entities.aspx).

### **AICPA.org Not-for-Profit Interest Area**

**.468** The Not-for-Profit Interest Area of [aicpa.org](http://aicpa.org) is a centralized resource to support NFPs and AICPA NFP Section members. It contains tools, resources, articles, and information that are useful to those who work with or for NFPs. There is a variety of content in the areas of accounting and financial reporting, tax compliance, assurance, and governance. Though some content is accessible only by NFP Section members, other content is available for use by the public. Access the website at [www.aicpa.org/nfp](http://www.aicpa.org/nfp).

### **Industry Websites**

**.469** The internet covers a vast amount of information that may be valuable to auditors of NFPs, including current industry trends and developments. Some of the more relevant sites for auditors with NFP clients include those shown in the appendix of this alert.

**.470** The NFP industry practices of some of the larger CPA firms also may contain industry-specific auditing and accounting information that is helpful to auditors.

## Appendix—Additional Internet Resources

Here are some useful websites that may provide valuable information to accountants:

<b>Website Name</b>	<b>Content</b>	<b>Website</b>
AICPA	Summaries of recent auditing and other professional standards, as well as other AICPA activities	aicpa.org www.aicpastore.com www.ifrs.com
AICPA Accounting and Review Services Committee	Summaries of review and compilation standards and interpretations	www.aicpa.org/research/standards/compilationreview/arsc.html
AICPA Financial Reporting Executive Committee	Summaries of recently issued guides, white papers, and technical questions and answers containing financial, accounting, and reporting recommendations, among other things	www.aicpa.org/interestareas/frc/accountingfinancialreporting/pages/finrec.aspx
AICPA Not-for-Profit Interest Area and Member Section	Tools, resources, and information for those who work with and for NFPs	www.aicpa.org/nfp
Better Business Bureau	Information about not-for-profit entities	www.give.org
Board Source	Resources to help strengthen NFPs' boards of directors	www.boardsource.org
<i>The Chronicle of Higher Education</i>	Articles that discuss issues faced by higher education institutions and links to other sites	www.chronicle.com
<i>The Chronicle of Philanthropy</i>	Articles from <i>The Chronicle of Philanthropy</i> newspaper and links to other sites	www.philanthropy.com

<b>Website Name</b>	<b>Content</b>	<b>Website</b>
CPAnet	Links to other websites of interest to CPAs	<a href="http://www.cpanet.com">www.cpanet.com</a>
Economy.com	Source for analyses, data, forecasts, and information on the U.S. and world economies	<a href="http://www.economy.com">www.economy.com</a>
The Federal Reserve Board	Source of key interest rates	<a href="http://www.federalreserve.gov">www.federalreserve.gov</a>
Financial Accounting Standards Board (FASB)	Summaries of recent accounting pronouncements and other FASB activities	<a href="http://www.fasb.org">www.fasb.org</a>
Government Accountability Office	Policy and guidance materials and reports on federal agency major rules	<a href="http://www.gao.gov">www.gao.gov</a>
Governmental Accounting Standards Board (GASB)	Summaries of recent accounting pronouncements and other GASB activities	<a href="http://www.gasb.org">www.gasb.org</a>
Guidestar	Information, news, and resources for NFPs and donors	<a href="http://www.guidestar.org">www.guidestar.org</a>
Independent Sector	A forum to encourage giving, volunteering, NFP initiatives, and citizen action	<a href="http://www.independentsector.org">www.independentsector.org</a>
Information for Tax-Exempt Organizations (an IRS site)	A Treasury Department site providing information and answers to frequently asked questions regarding tax-exempt entities	<a href="http://www.irs.gov/charities-non-profits">www.irs.gov/charities-non-profits</a>
International Financial Reporting Standards (IFRS) Foundation	Summaries of International Financial Reporting Standards and International Accounting Standards	<a href="http://www.ifrs.org">www.ifrs.org</a>
International Auditing and Assurance Standards Board	Summaries of International Standards on Auditing	<a href="http://www.iaasb.org">www.iaasb.org</a>

(continued)

<b>Website Name</b>	<b>Content</b>	<b>Website</b>
International Federation of Accountants	Information on standards-setting activities in the international arena	<a href="http://www.ifac.org">www.ifac.org</a>
National Association of College and University Business Officers	Provides information geared to colleges and universities, including accounting tutorials on specific situations encountered in higher education accounting	<a href="http://www.nacubo.org">www.nacubo.org</a>
National Center for Charitable Statistics	Provides statistics on revenue and expenses of NFPs	<a href="http://www.nccs.urban.org">www.nccs.urban.org</a>
Nonprofit Risk Management Center	Provides information to help NFPs control their risks	<a href="http://www.nonprofitrisk.org">www.nonprofitrisk.org</a>
The NonProfit Times Online	Articles from the <i>NonProfit Times</i> newspaper and links to other sites	<a href="http://www.nptimes.com">www.nptimes.com</a>
Office of Management and Budget (OMB)	OMB information and literature, including cost circulars	<a href="http://www.whitehouse.gov/omb">www.whitehouse.gov/omb</a>
USA.gov	Portal through which all government agencies can be accessed	<a href="http://www.usa.gov">www.usa.gov</a>