Nonprofit Accounting and Compliance Update

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Today’s Instructor

Tom Sneeringer

Partner

RSM US LLP

Gaithersburg, MD

+1.301.296.3642

Tom.Sneeringer@rsmus.com

Agenda

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ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*	10
ASU 2023-01, *Leases (Topic 842): Common Control Arrangements* (and other ASC 842 post-adoption matters)	10
ASU 2023-08, *Intangibles-Goodwill and Other – Crypto Assets (Subtopic 350-60): Accounting for and Disclosure of Crypto Assets*	5
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Objectives

- By the end of this presentation, participants will be able to:
  - Identify recent US accounting standards impacting not-for-profit organizations and how they might impact your organization.
  - Identify emerging changes and issues pertaining to compliance requirements of Uniform Guidance.

ASU 2016-13: Current Expected Credit Losses (CECL)

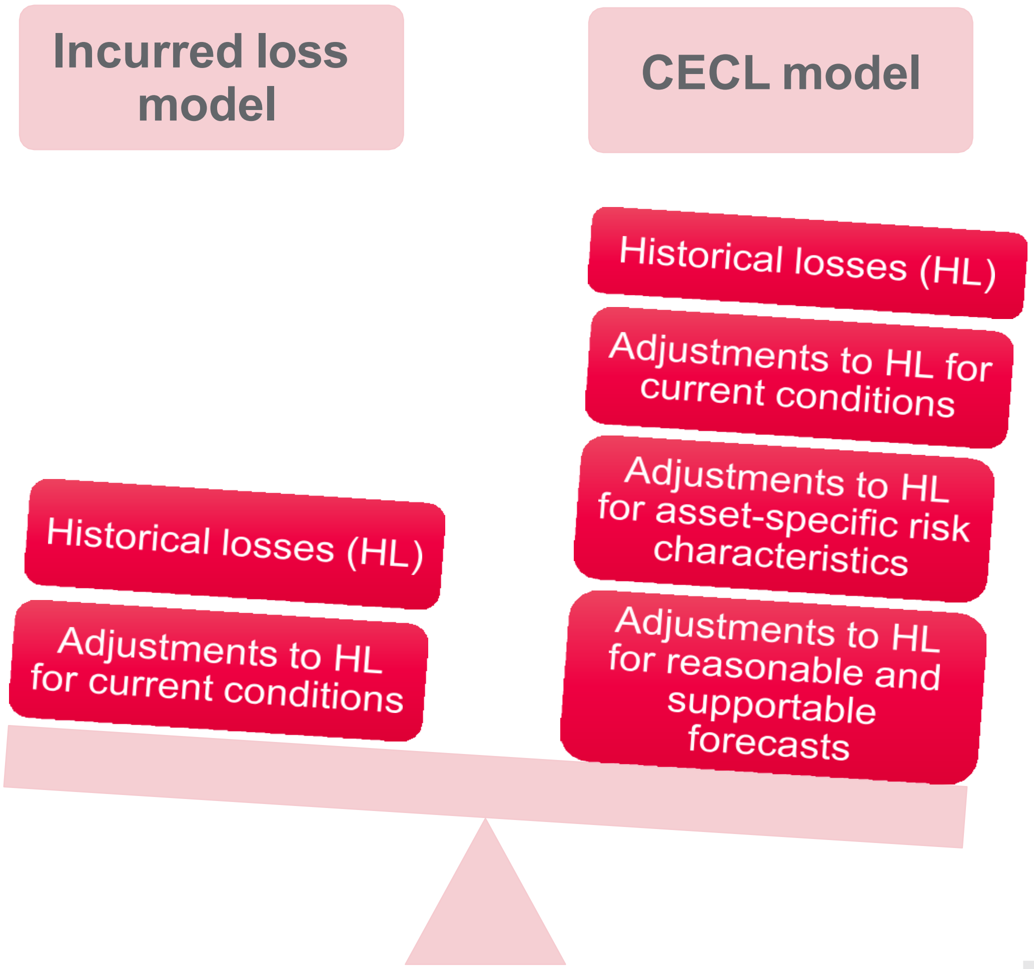
RSM

ASU 2016-13

- Effective for years beginning after December 15, 2022 (i.e., CY 2023 or FY 2024)
- Public business enterprises (not nonprofits) have already adopted this ASU

Key Changes

- Legacy GAAP = incurred loss method
  - Recognize credit losses when probable and estimable
- New guidance = CECL
  - Recognize expected credit losses at the time of origination/purchase of the financial asset
  - Establish allowance for recognized financial assets
  - Changes in the allowance (plus and minus) are recorded immediately through the allowance for credit losses



ASC 326-20: Scope

In Scope (ASC 326-20-15-2)

- Financial assets measured at amortized cost including:
  - Receivables and contract assets (ASC 606/610)
  - Held-to-maturity (HTM) debt securities
  - Cash equivalents (short-term securities)
  - Alternative investments, if recorded at amortized cost
  - Loans
  - Reinsurance recoverable
- Net investments in leases
- Off-balance-sheet credit exposures

Out of Scope (ASC 326-20-15-3)

- Financial assets measured at fair value through net income
- Equity securities
- Available-for-sale (AFS) debt securities
- Loans held for sale
- Loans and receivables between entities under common control
- Contributions (pledges) receivable for a NFP entity
- Government grants reported under the contribution guidance
- Loans held for sale
- Operating lease receivables
- Entities following GASB

Estimating Expected Credit Losses

(ASC 326-20-30-7 to 30-9)

Information related to past events + Information related to current conditions + Information related to reasonable and supportable forecasts about future conditions = Inputs in estimating expected credit losses

Not considered in estimating the allowance under legacy guidance

Typical Process for Estimating Losses

Start with historical loss rates on assets w/similar risk characteristics → Adjust historical loss rates for current and forecasted conditions

- Should be reflective of contractual term, with consideration given to prepayments and extensions/renewals that are not unconditionally cancellable
- Should consider all components of amortized cost basis, including unamortized premiums or discounts
- Could be based on relevant internal data, external data or a combination
- Historical loss rates should be consistent with the asset types used in the collective assessment
- Does not need to be most recent historical period

Audit Considerations – Historical Loss Rates

- Obtain an understanding of management's process for determining and calculating the historical loss rate
  - Relevance of data being evaluated to asset pool
  - Evaluate the period(s) used and compare to asset pool's contractual term
  - Assess contractual terms to ensure completeness of inputs/assumptions
- Consider the reliability of historical data
  - Controls and substantive procedures
  - Considerations of ITGC's - what systems are being used?
    - Potential use of new systems
    - Broader range of data

Typical Process for Estimating Credit Losses

Continued

Start with historical loss rates on assets w/similar risk characteristics → **Adjust historical loss rates for current and forecasted conditions**

- Consider factors relevant to the collectibility of the assets and how those factors compare in the current and forecasted period to the historical loss rate period. For example:
  - Are the customers'/obligors' financial condition, business prospects and ability to pay
- better or worse than the historical period?
  - Are economic conditions (e.g., unemployment) better or worse?
  - Are the level of delinquencies higher or lower?
  - Is there more or less collateral coverage?
  - Have there been any changes to credit terms?
- Adjust historical losses +/- for differences to arrive at best estimate of expected losses
- Consider expected recoveries of amounts previously written off and expected to be written off

Audit Considerations

Current Conditions

Gain an understanding of management's process, evaluate controls and assess reasonableness of the following:
Significant credit risk factors identified (loss drivers)
Internal/external information • Availability – obtain without undue cost and effort • Relevancy – relates to significant credit risk factors • Reliability – is complete and accurate
Adjustments for current conditions • Directional consistency • Magnitude • Probability weighted scenarios
Reassess each period

Audit Considerations

Reasonable and Supportable Forecasts

Gain an understanding of management's process, evaluate controls and assess reasonableness of the following:
Economic indicators identified
Internal/external information • Availability – obtain without undue cost and effort • Relevancy – relates to significant credit risk factors • Reliability – is complete and accurate
Adjustments for current conditions • Methodology • Directional consistency • Magnitude
Length of forecast period
Reassess each period

ASC 320: Estimation Methodologies

No one method required and multiple methods may be used.

- Aging Analysis
- Loss rate Methods (Snapshot, Vintage, Remaining Maturity)
- Probability of Default Method
- Discounted Cash Flow Method

Goal is to identify the method or combination of methods that best estimates expected credit losses based on the nature of the pools/segments, the relevant loss drivers and other factors.

Zero Expected Losses

- There is a presumption that financial assets have a loss amount associated with them under the expected losses model because even remote risk is considered
- May reach conclusion expected credit loss of zero is justified based on practical expedient or historical loss information adjusted for current conditions and reasonable and supportable forecasts
- Instances where zero loss may be acceptable
  - Collateral dependent practical expedient
  - Cash or CD secured loans
  - Government grants that are exchange
- Need to continually re-evaluate if circumstances change
- **Should maintain documentation supporting zero expected losses**

Key aspects of ASC 326-20

Interaction with ASC 606

- Upon recognizing a receivable, recognize an allowance through credit loss expense (ASC 606-10-45-4)
- ASC 326-20 also applies to contract assets (ASC 606-10-45-3)

Receivable	Contract Asset
Right to consideration that is unconditional (e.g., only the passage of time is required before payment of that consideration due)	Right to consideration that is conditioned on something other than the passage of time (e.g., future performance)

ASU 2023-01
Leases
Common Control Arrangements

ASU 2023-01

- ASU 2023-01 – Leases (Topic 842): Common Control Arrangements
  - Effective for years beginning after December 15, 2023 (i.e. CY 2024 or FY 2025), early adoption permitted
  - The ASU is meant to correct practical issues that were created by ASC 842, which originally did not recognize the unique relationships/nature of transactions from entities under common control. Prior to the ASU, entities under common control would account for their leases as if they were unrelated parties, including determination of lease term for purposes of amortizing leasehold improvements
  - The ASU addresses two issues:
    - Issue 1: Terms and conditions to be considered
    - Issue 2: Accounting for leasehold improvements

ASU 2023-01

- Practical expedient offered
  - Entities under common control can still determine if a lease exists (under ASC 842 criteria) and account for the lease as it would for an unrelated party
  - Alternatively, entities under common control that are private companies or nonprofits without conduit bond debt, can use WRITTEN terms and conditions in order to determine if a lease exists and the classification of that lease
  - The practical expedient can be applied on an arrangement-by-arrangement basis
  - If adopting the practical expedient, entities must document the terms and conditions in writing at that time if not previous reduced to writing. Otherwise, the use of the practical expedient cannot be used

ASU 2023-01

- Accounting for Leasehold Improvement
  - ASC 842 generally requires leasehold improvements to be amortized over the shorter of the lease term or estimated useful lives of the improvements
  - The new rules for LHI under common control arrangements would:
    - Amortize by the lessee over the useful life of the leasehold improvements to the common control group (but also look at lease limitation to the common control group if a lease is with an entity outside of the common control group)
      - Example, NFP X and NFP Y are brother/sister entities (controlled by same parent). NFP X has a 20 year lease with an outside entity. NFP X entered into a 5-year lease agreement with NFP Y either based on a legally enforceable lease agreement or written terms and conditions. NFP Y made leasehold improvements to the space. In this case, NFP Y should amortize those improvements over the shorter on the estimated useful life of the improvements or the remaining term that NFP X has with the unrelated party (NOT 5 years!!!)

ASU 2023-01

- The new rules for LHI under common control arrangements would (Continued):
  - Accounted for as a transfer between entities under common control through an adjustment to equity (or net assets for a nonprofit entity) if and when the lessee no longer controls the use of the underlying asset
  - The leasehold improvements are still subject to impairment guidance under ASC 360

ASC 842

- How did we all do with the ASC 842 adoption last year?
- Any insights to share?
- Any remaining questions/issues?

ASU 2023-08
Crypto Assets

Pending Accounting Standards (analysis)

- ASU 2023-08 – Intangibles-Goodwill and Other – Crypto Assets (Subtopic 350-60): Accounting for and Disclosure of Crypto Assets
  - Effective for years beginning after December 15, 2024 with early adoption permitted
  - Main impact is for organizations that plan to hold crypto currency (e.g. Bitcoin) vs. organizations that sell any donation received of crypto currency immediately
  - If criteria is met, the asset on the balance sheet would be adjust to current value and presented separately
  - The method prior to this ASU called for cost basis less impairments through out the year (without recovery)

Pending Accounting Standards (analysis)

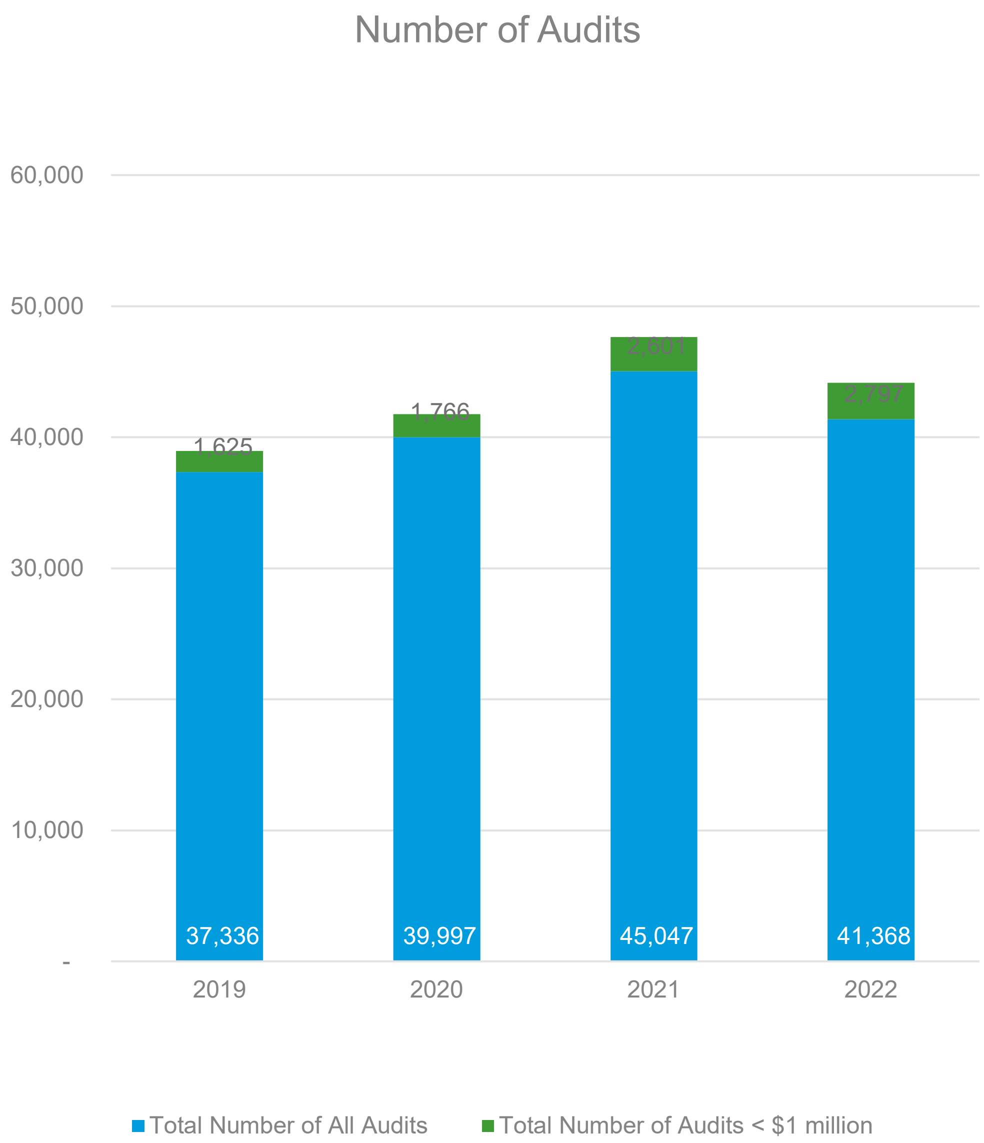
- Crypto assets must meet each of the following criteria in order to apply the provisions of the ASU:
  - Meet the definition of intangible assets as defined by the ASC
  - Do not provide the asset holder with enforceable rights to or claims on underlying goods, services, or other assets
  - Are created or reside on a distributed ledger based on blockchain or similar technology
  - Are secured through cryptography
  - Are fungible
  - Are not created or issued by the reporting entity or its related parties

Pending Accounting Standards (analysis)

- Other provisions
  - Change in value reported in the statement of activities by nonprofit entities
  - Cash flow implications – specific presentation of cash receipts arising from crypto assets that are received as noncash contribution and are converted nearly immediately into cash
  - Other disclosures, as applicable

Proposed Changes to Uniform Guidance (2 CFR 200)

Uniform Guidance – Proposed Changes



Increase threshold from $750,000 to $1,000,000

Audit Threshold Increase Impact – By the Numbers

Number of Audit Impact Stats

Year	Total Number of All Audits	Total Number of Audits < $1 million	% of Total
2019	37,336	1,625	4%
2020	39,997	1,766	4%
2021	45,047	2,601	6%
2022	41,368	2,797	7%

Expenditure Impact Stats

Year	Total of All Federal Expenditures	Total Federal Expenditures of Audits < $1 million	% of Total
2019	$ 1,317,061,831,168	$ 1,404,267,892	0.11%
2020	$ 1,633,393,327,211	$ 1,520,825,231	0.09%
2021	$ 2,300,372,959,691	$ 2,246,972,065	0.10%
2022	$ 1,724,188,090,237	$ 2,427,174,123	0.14%

Other Thresholds in Subpart F Remain the Same

- Type A/B threshold remains at $750K
- The auditor is still only required to perform risk assessments on Type B programs that exceed 25% of the Type A threshold
- Percentage of Coverage percentages remain at 20% and 40%
- Questioned cost reporting threshold remains at $25K
- Percentage of loans in a program for it to be considered a loan program remains 50%

SEFA Impact

Expands what has to be reported on the auditee’s SEFA for audits covering multiple recipients (such as departments, agencies, IHEs, and other organizational units).

In these situations, the recipient of the federal award will need to be identified.

Questioned Costs Definition Revised

- Questioned cost has the meaning given in paragraphs (1) through (3).

(1) Questioned cost means an amount, expended or received from a Federal award, that in the auditor's judgment: (i) Is noncompliant or suspected noncompliant with Federal statutes, regulations, or the terms and conditions of the Federal award; (ii) At the time of the audit, lacked adequate documentation to support compliance; or (iii) Appeared unreasonable and did not reflect the actions a prudent person would take in the circumstances.

(2) The questioned cost amount under (1)(ii) is calculated as if the portion of a transaction that lacked adequate documentation were confirmed noncompliant.

(3) There is no questioned cost solely because of: (i) Deficiencies in internal control; or (ii) Noncompliance with reporting requirements if this noncompliance does not affect the amount expended or received from the Federal award.

Known and Likely Questioned Costs Definitions Revised

- ***Known questioned cost*** means a questioned cost specifically identified by the auditor. Known questioned costs are a subset of likely questioned costs.

- ***Likely questioned cost*** means the auditor's best estimate of total questioned costs, not just the known questioned costs.

- Likely questioned costs are developed by extrapolating from audit evidence obtained, for example, by projecting known questioned costs identified in an audit sample to the entire population from which the sample was drawn.

- In evaluating the effect of questioned costs on the opinion on compliance, the auditor considers the likely questioned costs, not just the known questioned costs.

De Minimis Cost Rate Option

- Increase de minimis indirect cost rate from 10% to 15% (based on modified total direct costs)

Recent Clarification to SEFA Reporting

- Advances to subrecipients – SEFA reporting begins at the date and amount of the advance

Tax Matters

Watch list: 2024 Tax items of interest to Exempt Organizations

Employee retention credit

Donor advised funds proposed regulations

New compliance strategies

- Tax-exempt hospitals compliance with community benefit standard & section 501(r)
- NIL collectives and tax-exempt status (GLAM 2023-004)

President's budget

- Private foundation use of DAFs
- Private foundation compensation of family members

Election year issues

- Lobbying and political campaign activity

Additional Resources

- Visit RSM's email and subscriptions preference center in order to subscribe to our newsletters and other thought leadership.
- The **Muse** newsletter is a must-read for nonprofit professionals!

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- ☐ Technology helping my business
- ☐ Managing my audit needs
- ☐ Capitalizing on business opportunities
- ☐ Outsourcing or co-sourcing resources for my business
- ☐ Tax planning and preparation issues for my business
- ☐ Managing my personal wealth
- ☐ Managing M&A transactions
- ☐ Family Office

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RSM US LLP

30 South Wacker Dr
STE 3300
Chicago, IL 60606

T 312.634.3400
rsmus.com