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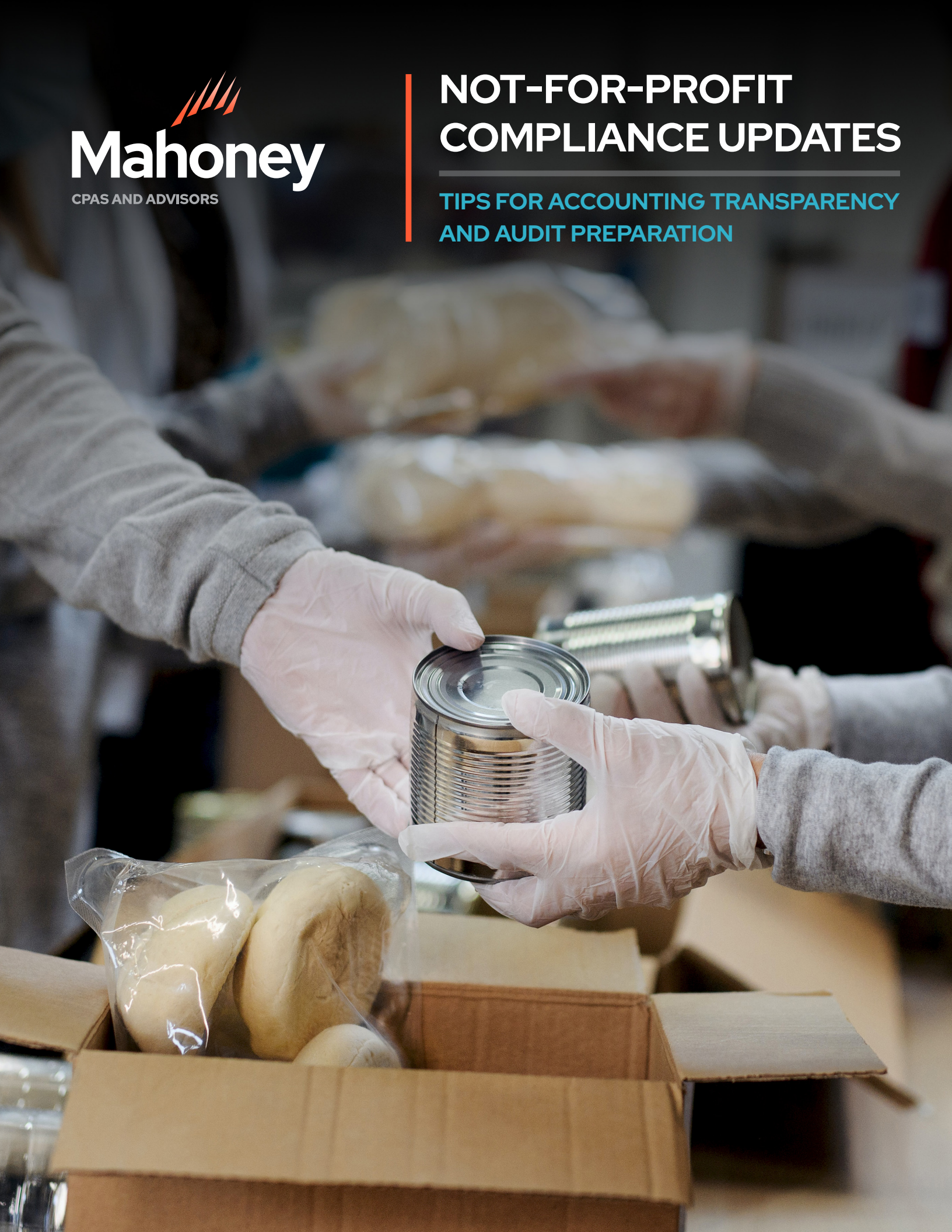
CPAS AND ADVISORS

NOT-FOR-PROFIT COMPLIANCE UPDATES

TIPS FOR ACCOUNTING TRANSPARENCY AND AUDIT PREPARATION



Introduction

As you navigate changes to accounting and audit standards in your not-for-profit organization, the CPAs and Advisors at Mahoney can work closely with your leadership, finance committees and boards. On the accounting side, we advise you on updating accounting processes and procedures (and technology) to manage multiple programs and/or entities. On the audit side, recommended reporting and disclosures can be added to your financial statements to support transparency.

Standards amendments and updates are always happening. It's an interesting time to be a CPA and a not-for-profit finance leader!

This guide is a summary of current and upcoming changes applicable to not-for-profit organizations. It is designed to give you context for asking additional questions when working with your public accountant or audit team.
Let us know if we can be of help in any way.

About Mahoney

Established in 1989, Mahoney CPAs and Advisors is a full-service CPA firm. We provide a uniquely personal level of service in auditing, accounting, tax preparation and consulting for the real estate industry, not-for-profit organizations and closely held small businesses.

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Section 1: Accounting Process and Procedural Updates

Current Expected Credit Loss (CECL) – ASU 2016-13

FASB has issued an amendment to its guidance on the impairment of financial instruments, *ASU 2016-13 – Financial Instruments- Credit Losses (Topic 326) Measurement of Credit Losses on Financial Instruments.* Although the guidance has a larger impact on banks, not-for-profits may be impacted based on applicable financial instruments or assets. Leaders and their advisors will need to evaluate which, if any, financial instruments or other assets are subject to the CECL model and evaluate any changes to existing credit impairment models and internal controls.

The standard sets out to create a one-size-fits-all model for measuring expected credit losses on financial assets that have contractual cash flows. Once adopted, the new model will effectively replace several other standards under U.S. GAAP. FASB continues to seek comment on the new guidance and has issued multiple ASUs that amend ASU 2016-13. Therefore, this is an evolving standard that will require guidance from your CPA.

Some common not-for-profit financial assets that may be impacted under CECL include:

- Trade receivables and contract assets that result from revenue transactions or other income
- Loans/notes receivable
- Loans to officers and employees
- Financing receivables, including program-related investments

Assets not subject to the CECL include financial assets measured at fair value through net income as well as promises to give (pledges receivable) of not-for-profit entities. Loans and receivables between entities under common control are also not subject to the new standard.

Seek guidance from an advisor experienced with not-for-profit accounting to help you properly assess applicable financial assets with regard to CECL. The goal is to provide timely recognition of expected credit losses in your organization and to simplify accounting.

Leasing Standard

Not-for-profit organizations that must account for operating leases under the standard ASU 2016-02 *Leases,* or its optional transition method, ASU 2018-11, should already be well on their way to adopting this standard. Its fully effective date is for fiscal years beginning after December 15, 2021.

Lessors can adopt the practical expedient to account for all lease components as a single component if (1) the timing and pattern of transfer of the non-lease components are the same as the lease components, and (2) the lease component would be classified as an operating lease if accounted for separately.

If your organization has already applied ASU 2016-02, you may be eligible to adopt the new transition method — and ease reporting complexity going forward — by recognizing a cumulative effect adjustment to opening retained earnings in the period of adoption.

Applying the leasing standard is further complicated by:

- Entities that hold multiple operating leases
- Uncertainty of how to define a lease
- Requirements to calculate lease amortization in subsequent periods

When assessing compliance with the leasing standard, auditors will consider proper calculation of the opening lease accounting entry for all applicable leases as well as processes and controls in place to accurately record new or updated lease arrangements. If a third party has performed the lease accounting calculations and delivered the accounting entries and disclosures, then an auditor will request the third-party provider's System and Organization Controls report to assess accuracy of the information provided.

For entities that have real estate leases, the leasing standard may require data mining to account for existing leases, any amendments to those leases over the years as well as operating leases that may be embedded within real estate lease contracts.

The list of potential audit issues may be long following implementation of this standard. It often requires additional analysis, training and refinement until it becomes a naturally recurring accounting activity for many not-for-profits. Continue communications between the accounting department and those who manage lease agreements within your organization.

Section 2: Audit and Assurance Preparation

Single Audit Threshold

A not-for-profit organization with federal expenditures in excess of $750,000 is required by law to have a Single Audit performed, which includes an audit of financial statements and related federal awards. The Single Audit is conducted in accordance with the Uniform Guidance.

Although many not-for-profit organizations will never reach this threshold, there are occasions when a large federal loan or grant can require it. In addition, there are organizations anticipating future growth or the addition of an entity that is reliant on federal funding. Parent organizations or the finance committee may request a Single Audit. This is not required, but it can provide a baseline to management for future compliance.

If you believe your organization will be close to the threshold for a Single Audit, even for one year, speak with your advisor about preparation and the newest OMB updates that may affect your financial statements. It's important to remember that even funds passed through a state or local entity are still subject to a Single Audit if the original source of those funds was from a federal agency. There may be waivers or flexibility available through federal agencies to reduce your compliance burden.

Consolidated Financial Statement Issues

Consolidated financial statements are required by Generally Accepted Accounting Principles (GAAP) when one entity is deemed to have (1) a controlling interest over and ability to steer activities and (2) the obligation to absorb losses or the rights to receive benefits from other entities.

Transitioning to consolidated financial statements is not comfortable or quick for the executive leadership or accounting team, as it requires developing a new chart of accounts, processes and controls for the organization to produce consolidated financials accurately and seamlessly. This transition may also require switching accounting tools and providing staff training.

Consolidated financial statements have been criticized for a lack of transparency regarding the health, specific outcomes or success of multiple programs, including:

- Challenges identifying areas of poor performance within a specific program
- Skewing of financial ratios such as costs vs. revenue that are distinct to each program
- Lack of clarity about overhead costs allocated to each program

There are a variety of methods to demonstrate the outcomes of distinct programs within the same set of financial statements. The first step is for the organization to determine what matters most in their mission and core organization – tracking measurable outcomes that can be more easily disclosed and reported in the consolidated financial statements.

For example, P&Ls can be set up for specific programs to show expenses as well as the revenue outcomes of each. This approach will help your organization inform stakeholders and tell a more impactful story about mission fulfillment. If expenses are growing for an important program, separating that program into its own job class can support strategic analysis.

For further transparency, some organizations may choose to separate non-cash expenses from cash expenses. Non-cash expenses such as depreciation can make the organization appear to have higher expenses than it does. Likewise, the results of a capital campaign can be shared separately to avoid skewing revenue.

Your independent auditor can provide general recommendations for improved transparency as it relates to current audit standards and disclosures. When addressing the relative transparency of your consolidated financial statements, your executive team, accounting staff and any committee members involved with your assurance requirements should discuss areas of improvement that can help you to deliver a better financial narrative. **New approaches can be developed to help you track, gather and report data with more clarity, but it must happen throughout the year.**

Questions?

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