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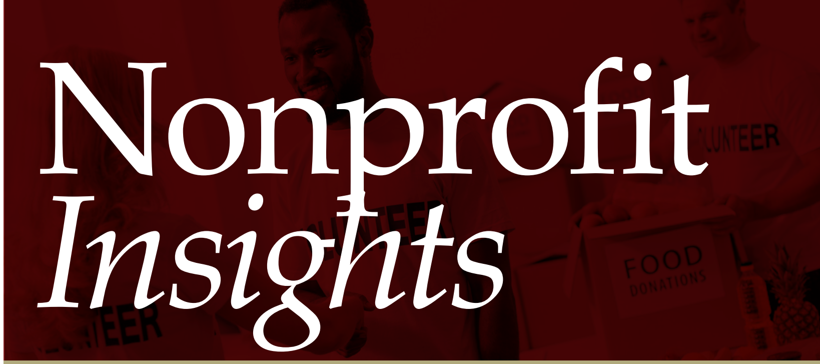

Nonprofit *Insights*

A Newsletter for Nonprofit Decision-Makers Summer 2024

Accounting Standards Update No. 2016-02
New Lease Accounting Standard in Effect

It has been more than two years since Accounting Standards Update No. 2016-02 (ASC 842) became effective for private companies and nonprofit organizations for fiscal years beginning after December 15, 2021. However, some nonprofits are still adjusting to this major accounting change in the treatment of leases.

The new lease accounting standard affects all organizations—including nonprofits—that lease real estate, vehicles, equipment, or other assets for more than one year. Previously, operating leases were considered "off" balance sheet, which meant they only had to be disclosed in the financial statement footnotes. This made it hard to identify future debts that could reflect significant financial liabilities.

Lease obligations longer than 12 months must now be reported on the balance sheet as a right-of-use (ROU) asset and lease liability. The intention is to improve transparency and provide a more accurate measure of the contractual obligations that underlie leases.

More Consistent Representation

With the new lease accounting standard, financial statement users benefit from a more consistent representation of lease obligations. It's now easier for users to understand the amount, timing, and uncertainty of cash flows related to leases.

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Internal Controls for Nonprofits

What Are Your Internal Control Objectives?

Many nonprofits recognize the importance of establishing strong internal controls. But it's just as important to know why certain internal controls are in place. In other words, what are the objectives of your internal controls and what are you trying to accomplish with them?

Following is a list of some of the most common internal controls and assertions at nonprofit organizations. Compare this list to your organization's internal controls and your objectives for implementing each one.

Revenue Controls

Completeness Assertion: Are there procedures in place to ensure that all revenue earned has been recorded?

Cutoff Assertion: What has management done to ensure that all revenue earned has been recorded in the correct period?

Occurrence Assertion: What procedures has management put in place to ensure all recorded revenue transactions actually occurred?

Accuracy/Valuation Assertions: What has management done to ensure the correct amount of revenue was recorded? In other words, are there procedures in place to prevent overbilling or underbilling?

Rights and Obligations Assertion: Are there procedures in place to prevent sales in excess of credit limits (or to customers who are on a credit hold)?

Accounts Receivable (A/R) Controls

Accuracy Assertion: What procedures has management put in place to ensure that all checks received have been applied to A/R and posted to the correct customer accounts and invoices?

Existence Assertion: What has management done to ensure that fictitious invoices haven't been created and that credits issued have been authorized?

Completeness Assertion: Are there procedures in place to prevent the creation of fictitious invoices and ensure all issued credits have been authorized?

Valuation Assertion: What has management done to ensure that the estimate for the allowance for credit losses appears reasonable?

Cash Receipts Controls

Completeness Assertion: Are there procedures in place to ensure that all cash and checks received by the organization have been deposited into the bank and recorded in the accounting software and none have been skimmed for personal gain?

Accuracy/Classification Assertions: What procedures has management put in place to ensure that all cash and checks received have been entered correctly into the accounting software?

Payroll Controls

Accuracy Assertion: Are there procedures in place to ensure only current and active employees get paid, and that these employees are paid the correct amount?

Existence/Accuracy/Cutoff Assertions: What has management done to ensure that accrued payroll and bonuses have been correctly recorded at the period end?

Purchasing Controls

Occurrence Assertion: What procedures has management put in place to ensure all purchases have been authorized and all products and/or services have been received?

Accuracy/Classification Assertions: Are there procedures in place to ensure all vendor invoices are entered accurately in the accounting system?

Accuracy Assertion: Are there procedures in place to prevent duplicate vendor invoices from being entered into the accounting system?

Cash Disbursement Controls

Accuracy/Rights and Obligations Assertions: What has management done to ensure that only valid vendors are paid?

Accuracy Assertion: What procedures has management put in place to ensure the proper amounts are paid to each vendor?

Existence/Occurrence Assertions: Are there procedures in place to prevent unauthorized disbursements?

Month/Period-End Close Controls

Accuracy and Existence/Occurrence Assertions: What has management done to prevent unauthorized journal entries from being posted in the accounting system, or to detect them if they are posted?

Prevent Audit Surprises

Plan to meet with your management team to discuss your internal control objectives before your next audit. Fine-tuning your internal controls will help the audit process run more smoothly and prevent unexpected surprises in the management letter.

Call our office if you have questions about internal controls for your nonprofit organization.

Accounting Standards Update No. 2016-02

New Lease Accounting...

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All operating leases must now be recorded as an asset and a liability on the balance sheet. The ROU asset must be amortized over the life of the lease while an offsetting liability for the present value of the lease payments must be recorded. This represents the obligation to pay the lease.

According to the right-to-use concept, an operating or finance lease contract gives the lessee the right to control the use of an asset for a certain time period. This right creates an asset that must be reflected on the balance sheet, along with a corresponding recognized liability.

Note that short-term leases of 12 months or less and leases for intangible assets (such as computer software) are not subject to the new lease accounting standard.

Important Points

Here are a few things to keep in mind as you continue adjusting to the new lease accounting standard:

- The standard creates a new lease definition: “A contract or part of a contract that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration.”
- The standard also creates a new lease term: the noncancellable period during which a lessee has the right to use an underlying asset. This term should be based on the period during which the contract is enforceable.
- Because operating leases now create a lease liability and ROU asset on the balance sheet, it’s important to review all service agreements and contracts to see if they contain an embedded lease. If so, the lease must be accounted for using the new standard.

Impact of the New Standards

ASC 842 is significantly impacting organizations with long-term leases. For starters, the additional debt and leverage added to the balance sheet is affecting lenders’ financial ratios and metrics. This could affect debt covenants so it’s important to talk to lenders about the potential impact.

Also, because off-balance-sheet financing under U.S. GAAP was one of the main benefits of leasing, the curtailment of this type of accounting structure is altering the lease vs. buy decision for organizations. In some instances, asset purchases could be more attractive than they were in the past.

Eliminate Confusion

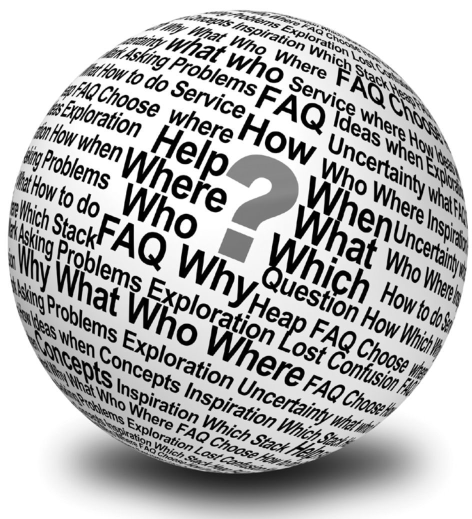
It’s important to educate lenders, board members, donors, and other stakeholders who use your financial statements about how ASC 842 has changed the representation of leases on your statements. This will help eliminate any confusion or unpleasant surprises.

Contact our office if you have questions about the new lease accounting standard.

Helping Not-for-Profit Organizations Further Their Mission

If you are interested in working with a CPA firm that understands your issues, delivers valuable insight, and can answer the questions to help your organization achieve its goals, contact us.

- Audits, Reviews and Compilations
- Form 990 Tax Return Preparation
- Agreed Upon Procedures
- General Consulting
- Exemption Applications
- Exempt Status Issues
- Restricted Net Asset Accounting
- Fraud Risk Assessment
- Charitable Solicitation License Filing
- Board Development
- UBIT Planning



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we hear you.

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Add Gilliam Bell Moser LLP to your RFP list today!

Beware of Employee Retention Tax Credit Scams

The Employee Retention Tax Credit (ERTC) was devised during the pandemic to provide financial relief to businesses and nonprofit organizations that continued paying employees while shut down due to COVID-19 or that had a significant decline in gross receipts during the pandemic.

Even though we are more than two years past the end of the ERTC eligibility period, aggressive promoters are trying to convince organizations that they can still file for the credit, even if they aren't eligible. According to the IRS, these promoters are "wildly misrepresenting and exaggerating who can qualify for the credits." The IRS is scrutinizing ERTC claims more closely because of these aggressive promoters.

The ERTC is a legitimate tax credit that qualifying organizations can claim by filing an amended Form 941. However, there are specific eligibility criteria for claiming the credit. The organization must have:

- Sustained a full or partial suspension of operations due to orders from a government authority because of COVID-19 during 2020 or the first three quarters of 2021
- Experienced a significant decline in gross receipts during 2020 or the first three quarters of 2021
- Qualified as a recovery startup business for the third or fourth quarter of 2021

Unscrupulous promoters are lying about eligibility requirements, leaving out key details or making broad arguments suggesting that all employers are eligible for the credit. Their aggressive marketing tactics have appeared online, in TV and radio commercials, and in direct mail in the form of letters made to look like official IRS correspondence.

Any organization that claims the ERTC improperly must repay the money, possibly with penalties and interest. According to the IRS, the best way to protect your organization is to work with a trusted tax professional and not rely on the advice of an unsolicited third-party promoter.

Give us a call if you have questions about claiming the ERTC.