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Spotlight on the AICPA's New Auditor Reporting SAS

On May 8, 2019, the AICPA issued SAS 134, *Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements*, a suite of auditor reporting standards. This suite of auditor reporting standards is the result of the AICPA's ongoing Auditor's Report project. SAS 134 supersedes and replaces AU-C 700, *Forming an Opinion and Reporting on Financial Statements*; AU-C 705, *Modifications to the Opinion in the Independent Auditor's Report*; and AU-C 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*. SAS 134 also adds AU-C 701, *Communicating Key Audit Matters in the Independent Auditor's Report*, and amends the following existing standards: AU-C 200, 210, 220, 230, 240, 260, 300, 315, 320, 330, 450, 510, 540, 570, 600, and 910.

Effective Date

SAS 134 is effective for audits of financial statements for periods ending on or after December 15, 2020, with no early adoption.

Practical Consideration:

The professional standards section of the AICPA materials in Checkpoint (**checkpoint.riag.com**) now reflect the replaced standards under SAS 134 for AU-C 700, AU-C 705, and AU-C 706. For extant guidance, see AU-C 700A, AU-C 705A, and AU-C 706A in Checkpoint.

Treatment in *PPC's Guide to Audits of Nonprofit Organizations*

Due to the delayed effective date of the new auditor reporting requirements, the 2020 edition of *PPC's Guide to Audits of Nonprofit Organizations* (NPO) will provide guidance for both pre- and post-SAS 134 requirements.

Changes to the Standard Auditor's Report

The following changes are made to the

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standard auditor's report (AU-C 700) (Revised)—

- Requires the first section of the auditor's report to have the heading "Opinion" and to include the auditor's opinion on the financial statements, followed directly by the "Basis for Opinion" section (unless a different order is prescribed by law or regulation).
- Requires the "Basis for Opinion" section to include an affirmative statement about the auditor's independence and fulfillment of the other ethical responsibilities in accordance with relevant ethical requirements.
- Adds an option to communicate Key Audit Matters.
- Expands the description of management's responsibilities for the financial statements. It requires a section with the heading "Responsibilities of Management for the Financial Statements" that, in addition to the description of management's responsibilities now included in auditor's reports, also is required to state management's responsibility for assessing the entity's ability to continue as a going concern and whether use of the going concern basis of accounting is appropriate.
- Expands the description of the auditor's responsibilities for the audit and of key features of an audit. It requires a section with the heading "Auditor's Responsibilities for the Audit of the Financial Statements" that, in addition to the description of the auditor's responsibilities and the audit now included in auditor's reports, also is required to state that (1) the auditor's objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement whether due to fraud or error and to issue a report that includes the auditor's opinion, (2) reasonable assurance is a high level of assurance, but not absolute assurance, and isn't a guarantee that an audit will detect a material misstatement when it exists, (3) the risk of not detecting a material misstatement resulting from fraud is higher than one resulting from error, (4) misstatements can arise from fraud or error and are considered material if they could reasonably be expected to influence the economic decisions users make based on the financial statements, (5) the auditor exercises professional judgment and maintains professional skepticism throughout the audit, and (6) the auditor's responsibilities include concluding on the entity's ability to continue as a going concern.
- Requires the section of the auditor's report that describes the auditor's responsibilities to state that the auditor is required to communicate with those charged with governance about, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control matters identified.
- Requires, when applicable, the auditor's report to include a separate section when the auditor concludes there is substantial doubt about the entity's ability to continue as a going concern.

Modifications to the Report

AU-C 705 (Revised) makes changes to the form and content of the auditor's report when the auditor's opinion is modified. These changes are to conform to the changes in AU-C 700 (Revised). The criteria for when modification to the auditor's opinion is required and the type of modification required are unchanged by the AU-C 705 revisions. AU-C 705 (Revised) now clarifies that along with emphasis-of-matter and other-matter paragraphs, communication of KAMs doesn't constitute a report modification.

Emphasis-of-matter and Other-matter Paragraphs

AU-C 706 (Revised) was primarily modified to clarify the relationship between matters included in emphasis-of-matter paragraphs and communicating key audit matters in the auditor's report. AU-C 706 (Revised) now clarifies that an emphasis-of-matter paragraph isn't a substitute for describing key audit matters in the auditor's report when AU-C 701 applies. The revised guidance also now requires that, when key audit matters are included in the auditor's report, the heading of any emphasis-of-matter sections should include the term "Emphasis of Matter." AU-C 706 (Revised) otherwise leaves existing guidance on other-matter paragraphs essentially unchanged.

Going Concern

The ASB also revised certain provisions of AU-C 570 with respect to disclosure in the auditor's report when the auditor concludes there is substantial doubt about the entity's ability to continue as a going concern (after considering relevant conditions and events and management's plans). The revisions require the auditor's conclusion about substantial doubt to be expressed in a separate section in the auditor's report, rather than in an emphasis-of-matter paragraph. In addition, the revisions make certain changes to the form and content of the separate section.

The revised standard clarifies that if the auditor expresses a qualified or adverse opinion because of inadequate disclosure of going concern uncertainties, the auditor's "Basis for Qualified (Adverse) Opinion" section of the report is required to state either that substantial doubt exists or that substantial doubt has been alleviated, as appropriate, and that the financial statements fail to adequately disclose those matters.

Auditor Communications

In addition, SAS 134 includes amendments to AU-C 260 to require, among other things, the auditor to communicate with those charged with governance about (1) significant risks identified by the auditor and (2) circumstances that affect the form and content of the auditor's report.

Other Recently Issued SASs

In addition to SAS 134, the AICPA recently issued SAS 135, *Omnibus Statement on Auditing Standards—2019*, which amends 13 sections of the SASs, and SAS 137, *The Auditor's Responsibilities Relating to Other* Information Included in Annual Reports, which supersedes AU-C 720, *Other Information in Documents Containing Audited Financial Statements*. The November 2019 and December 2019 issues of this newsletter discuss SAS 135 and the December 2019 issue discusses SAS 137.

FASB's NAC Activity

The FASB's Not-for-Profit Advisory Committee (NAC) works with the FASB to provide input on how accounting standards impact the nonprofit sector. The NAC typically meets twice a year, first as a committee and then in a joint meeting with the FASB. NAC met most recently on September 16 and 17, 2019. Here are the highlights from that meeting.

Practical Consideration:

Information about the NAC and its activities is available on the FASB website at **www.fasb.org**.

Implementation and Effective Dates of Major ASUs

The FASB staff provided an update on the Exposure Draft that was issued in September 2019 for the deferral of the effective dates of several major accounting standards [the Exposure Draft was discussed in the October 2019 issue of *The PPC Nonprofit Update* and subsequently issued as ASU 2019-10, *Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842)*] and sought feedback from NAC on implementation and other issues.

When asked about how nonprofit entities handle interim reporting when implementing new standards, the NAC indicated that most nonprofit entities wait until year end to implement new standards depending on the sophistication of an entity's systems and capacity limitations. The NAC supported using the same effective date for all nonprofit organizations.

The FASB staff also sought input on implementation issues for ASU 2018-08, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*; ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*; FASB ASC 606, *Revenue from Contracts with Customers*; FASB ASC 842, *Leases*; and FASB ASC 326, *Financial Instruments—Credit Losses*. The discussion on ASU 2018-08 included changing grant agreements to enhance the clarity of wording when determining whether a barrier exists in an agreement and understanding right of return clauses in grant agreements; determining exchange versus nonexchange transactions; and increasing amounts of deferred revenue. For ASU 2016-14, the discussion focused on the disclosures on the availability of financial assets, some confusion on the transition guidance regarding the analysis of expenses by function and nature, and terminology to use in place of "net assets without donor restrictions" when the entity does not have donors (the FASB staff suggested using "net assets" with an explanation provided in the notes).

Gifts-in-kind (Including Donated Pharmaceuticals)

The FASB staff also provided an update on the project for reporting of certain gifts-in-kind (GIKs) by nonprofit entities. The NAC members split into three breakout groups to provide feedback about the usefulness, operationality, and potential cost of potential disclosures and presentation requirements. NAC was in overall agreement with the current scope of the project, which is GIKs of nonfinancial assets, and that the project's scope should not be narrowed. The transparency of GIKs and donated volunteer services were discussed.

The NAC also discussed potential quantitative and qualitative disclosure requirements for GIKs of nonfinancial assets using some best practice examples and indicated that requiring such additional disclosures would provide useful information for users. The NAC felt that most nonprofit organizations would be able to supply the information, depending on the requirements. However, the NAC expressed some concern that the additional requirements could be too burdensome on smaller nonprofit entities that are often more heavily reliant on GIKs than larger nonprofit entities. The additional administrative requirements may take resources away from the smaller nonprofit entity's missions.

Other Items

The FASB staff and the NAC also discussed other FASB projects in process, including (1) reference rate reform, (2) accounting for certain identifiable intangible assets in a business combination and subsequent accounting for goodwill, (3) improving the accounting for asset acquisitions and business combinations, (4) balance sheet classification of debt, and (5) AICPA projects on digital assets and management's discussion and analysis. Other topics discussed included international nonprofit activities; and recent trends, concerns, and observations in the nonprofit sector.

Inflation-adjusted Amounts for 2020

The following inflation-adjusted amounts apply for 2020 [Rev. Proc. 2019-44 (2019-47 IRB 1093)].

Low-cost Articles

Charitable organizations normally can distribute low-cost articles in connection with a fundraising campaign without fear that the IRS will treat the activity as an unrelated business activity [IRC Sec. 513(h)(1)(A)]. A low-cost article is an item that costs the organization no more than $11.20 in 2020 (up from $11.10 in 2019).

Insubstantial Benefits

The deductible portion of a donor's contribution normally must be reduced by the value of anything received in return. However, an insubstantial benefit can be ignored, therefore allowing a full deduction, if the gift otherwise meets the requirements for claiming a contribution. The following alternative limitations are used to determine if benefits are insubstantial:

1. The fair market value of all benefits received is not more than the lesser of $112 for 2020 (up from $111 in 2019) or 2% of the contribution.
2. The contribution is at least $56 for 2020 (up from $55.50 in 2019), and the cost of the benefits received is no more than the low-cost article value of $11.20 for 2020 (up from $11.10 for 2019).
3. In connection with a fundraising campaign, the benefits are distributed free to potential donors who neither requested nor expressly consented to receiving them, and their cost is no more than the low-cost article value of $11.20 for 2020.

Lobbying Expenditures

If a Section 501(c)(4) social welfare organization, a Section 501(c)(5) agricultural or horticultural organization, or a Section 501(c)(6) organization has any lobbying expenditures, it normally must notify members of the portion of their dues that is nondeductible because of such expenses [IRC Sec. 6033(e)(1)(A); Rev. Proc. 98-19 (1998-1 CB 547)].

However, Section 501(c)(4) and (c)(5) entities are exempt from the notification requirements if (1) more than 90% of the annual dues comes from certain other tax-exempt entities, or (2) more than 90% of the dues comes from members who annually pay $119 or less for 2020 (up from $117 for 2019).

Agricultural or Horticultural Organization

The dues and similar income of an agricultural or horticultural organization are not subject to unrelated business income tax, regardless of the benefits or privileges to which the entity's members are entitled, if the annual dues do not exceed $171 for 2020 (up from $169 in 2019) [IRC Sec. 512(d)(1)].

Penalty Provisions

Some of the penalty provisions under IRC Sec. 6652 are adjusted for inflation. Those that apply to tax-exempt organizations or their managers are summarized as follows.

Failure to File Return under IRC Sec. 6033(a)(1). Exempt organizations can be assessed penalties for failure to file returns. The penalties listed (not all inclusive) are for returns required to be filed in 2021.

Scenario	Daily Penalty	Maximum Penalty
Organization with gross receipts of $1,084,000 or less	$20	Lesser of $10,500 or 5% of the organization's gross receipts for the year
Managers	$10	$5,000
Public inspection of annual returns	$20	$10,500
Public inspection of exemption applications	$20	No limit

For a tax-exempt entity with gross receipts over $1,084,000, the daily penalty is $105 with a maximum penalty of $54,000.

Failure to File Disclosure Required under IRC Sec. 6033(a)(2). The daily penalty is $105 with a maximum penalty of $54,000.

Failure to File Return under IRC Sec. 6043(b). Terminated exempt organizations and their managers can be penalized. This list is not all inclusive.

Scenario	Daily Penalty	Maximum Penalty
Organization	$10	$5,000
Managers	$10	$5,000

Other Penalty Provisions. There are several other penalty provisions (both taxpayer and preparer) that are adjusted annually for inflation, but they are not specific to tax-exempt organizations. See Rev. Proc. 2019-44 (2019-47 IRB 1093) for additional inflation adjusted amounts for various penalties.

New Year's To Do List

January is a good time for an exempt organization, whether calendar-year or fiscal-year, to address several matters that have tax and/or governance significance.

Maintaining a Who's Who List

It is essential for an exempt organization to maintain complete lists of relationships for persons connected with it. These lists can be critical for either tax or governance reasons.

Disqualified Persons (DPs). DPs who receive an economic benefit from a Section 501(c)(3) public charity, (c)(4), or (c)(29) organization in excess of the value of the consideration for such benefit are subject to an excise tax of 25% of the excess benefit received [IRC Sec. 4958(a)(1)]. Under certain circumstances, organization managers are subject to a 10% tax [IRC Sec. 4958(a)(2)].

A DP is anyone who was, at any time during the five-year period on the date of the excess benefit transaction, in a position to exercise substantial influence over the organization's affairs. To be a DP, it is not necessary that the person *actually exercise* substantial influence, only that the person be in a position to exercise substantial influence. Substantial influence is attributed automatically to certain people in positions of power in an organization. It can also be determined under the facts and circumstances. DPs also include members of that person's family and any entity (corporation, partnership, LLC, trust, or estate) in which the DP and family members have more than a 35% ownership interest [IRC Secs. 4958(f)(1) and (f)(3)].

Family members are a person's spouse, siblings (whether by whole or half-blood) and their spouses, ancestors, direct descendants through great-grandchildren, and spouses of these descendants [IRC Sec. 4958(f)(4)]. Ownership of an entity includes constructive ownership (i.e., the indirect holdings of family members are considered) [IRC Sec. 4958(f)(3)(B)].

The list of DPs for an organization that sponsors donor advised funds (DAFs) also includes anyone who provides investment advice regarding fund assets. In addition, if the organization is a supported organization under IRC Sec. 509(a)(3), the DPs of the supporting organization are also DPs for the supported organization.

Note: The previous discussion is not a complete definition of a DP but is intended to indicate the complexity of identifying DPs.

Conflict of Interest Persons. Persons who should be identified for conflict of interest purposes are basically the same as those who are DPs, as described previously, except that family members include both adopted and natural children.

Related Organizations. Individuals are not the only persons of concern to an exempt organization. Transactions with related organizations require risk management to identify excess benefit transactions, and also to recognize potential unrelated business income and nonexempt activities. Therefore, an organization must identify all related organizations to ensure that all applicable transactions are properly documented and all required disclosures are made on Form 990.

Related organizations (in addition to a parent or subsidiary) include the following:

1. Brother/Sister—an organization controlled by the same person or persons who control the filing organization.
2. Supporting/Supported—an organization that is (or claims to be), at any time during the organization's tax year, (a) a supporting organization of the filing organization, or (b) a supported organization.

Control can be established either through influencing the governing board or through ownership. Control may be either direct or indirect (e.g., the filing organization controls Entity A, which in turn controls Entity B; therefore, the filing organization is deemed to control Entity B).

Donor Advised Funds. A distribution for a DAF that results in "more than an incidental benefit" to certain persons can trigger an excise tax on the recipient and, in certain instances, the fund manager [IRC Sec. 4967(a)]. Persons who cannot benefit include a donor or any person designated by the donor who has advisory privileges, family members of these persons, and entities in which the preceding persons have more than a 35% interest. In this instance, the definition of family members is the same as the definition for DP purposes.

Keeping the List. Maintaining an accurate cumulative list is the best way to minimize the likelihood of undesirable tax consequences. Therefore, an organization that has not updated its list in the last six months should do so.

Practical Consideration:

The greatest challenge in maintaining current lists of relationships is identifying changes in the identity of family members and their businesses and investments. Ideally, the organization should communicate at regular intervals (no less frequently than annually) with key persons to update the appropriate list.

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Conflict of Interest Oversight

Business transactions of exempt organizations pose potential conflicts of interest when persons responsible for protecting the organization's financial interest stand to benefit personally from dealing with it. Some conflicts of interest are not automatically illegal or unethical. However, independent members of the organization's governing body should be made aware of a potential conflict of interest and evaluate the benefits and risks of conducting business with the related party.

Although there is no statutory requirement that an organization adopt a written conflict of interest policy (CIP), the IRS believes that a policy is required for prudent governance.

Observations: Form 990, Part VI, requests information about an organization's CIP. Information requested includes whether the organization has a CIP and, if so, how it is monitored and enforced if a conflict arises. A policy must be adopted before the end of the filing year for the organization to affirmatively state that it has a CIP. If a CIP is adopted *after* the close of the year but *before* Form 990 is filed, answer "No" to the question in Part VI about the existence of a CIP. However, disclose the post-year-end policy adoption in Schedule O of Form 990.

Organizations that have a CIP should monitor compliance by all persons who are covered by it. Monitoring procedures can vary, but typically include having each person affirm in writing that he or she is unaware of having engaged in an impermissible transaction other than those, if any, disclosed previously for prospective transactions. A sample Conflict of Interest Disclosure Statement and Annual Conflict of Interest Information Form are included in *PPC's Nonprofit Tax and Governance Guide: Helping Organizations Comply*.

Observation: The IRS may view having an unmonitored or unenforced CIP as worse than having no CIP.

Practical Consideration:

An organization that has not yet adopted a CIP should consider doing so. The larger the organization, the greater the need for a written policy and monitoring procedures.

Tax Brief

IRS COMPLIANCE INITIATIVES FOR FISCAL YEAR 2020. The tax-exempt sector (TE/GE) of the IRS has indicated in the IRS Fiscal Year 2020 Program Letter that they are currently focusing on the following compliance initiatives: (1) the unrelated business income (UBI) of tax-exempt hospitals, (2) investment and non-member income of Section 501(c)(7) organizations, (3) charitable contributions reported by Section 4947(a)(1) organizations, (4) previous for-profit organizations that converted to Section 501(c)(3) status, and (5) organizations showing private benefit and private inurement to individuals or private entities. For the complete TE/GE Program Letter, see **www.irs.gov/pub/irs-pdf/p5313.pdf**.