2022 WICPA NOT-FOR-PROFIT ACCOUNTING CONFERENCE

YOUR SOURCE FOR KEY UPDATES & INSIGHTS ON TIMELY ISSUES

TUESDAY, SEPT. 20

BROOKFIELD CONFERENCE CENTER
& WICPA CPE LIVESTREAM

MATERIALS AT A GLANCE

The following materials are from the morning sessions of the 2022 WICPA Not-For-Profit Accounting Conference held on Tuesday, Sept. 20, including:

- Accounting & Auditing Update
- Excel: Fast Track Data Cleanup
- Private Foundation & Donor Advised Funds Legislation

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Wednesday, Oct. 26
Glacier Canyon Lodge, Wisconsin Dells

Tax Conference
Thursday, Nov. 3 - Friday, Nov. 4
Brookfield Conference Center, Brookfield

Accounting & Auditing Conference
Wednesday, Nov. 16
Brookfield Conference Center, Brookfield

Accounting Technology Conference
Thursday, Dec. 8
Brookfield Conference Center, Brookfield

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AWARDS

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- ★ Woman to Watch
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Submit your nomination at **wicpa.org/awards** by Nov. 10, 2022.

Recipients will be announced in January and honored at the Member Recognition Banquet & Annual Business Meeting on May 5, 2023.

8:10 – 9:40 a.m.

Accounting & Auditing Update

Ashley Johnson, CPA, *Director, Sikich LLP*

Ray Krouse, CPA, *Partner, Sikich LLP*

LEASE AND A&A UPDATE

SEPTEMBER 20, 2022

SIKICH.COM

9/20/2022

TODAY'S **PRESENTERS**

ASHLEY JOHNSON, CPA
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LEASES - ASC 842

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THE **AGENDA**

- Overview and Key Concepts
- Classification
- Measurement
- Presentation and Disclosure
- Policy Elections
- Subsequent Accounting Considerations
- Related Party Leases
- Considerations at Transition
- Contributed and Below Market Leases
- Examples using ASC 842 Lessee Ledger
- Resources

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FASB ASC 842 **OVERVIEW**

- Who
  - Entities issuing financial statements in accordance with US GAAP
- What
  - Recognize liabilities and related assets for contracts that are, or contain, a lease of identified property, plant, or equipment
- Why
  - Increase comparability and transparency among entities
  - Significantly reduce off-balance-sheet risk
  - More reflective of true substance of leasing transactions
- When
  - NFP that has issued or is a conduit debt obligor for securities that are traded, listed, or quoted on an exchange or an over-the-counter market
    - FYs beginning after 12/15/2018
    - If financial statements not issued as of 6/3/2020, delayed to FYs beginning after 12/31/2019
  - All other entities – fiscal years beginning after 12/15/2021

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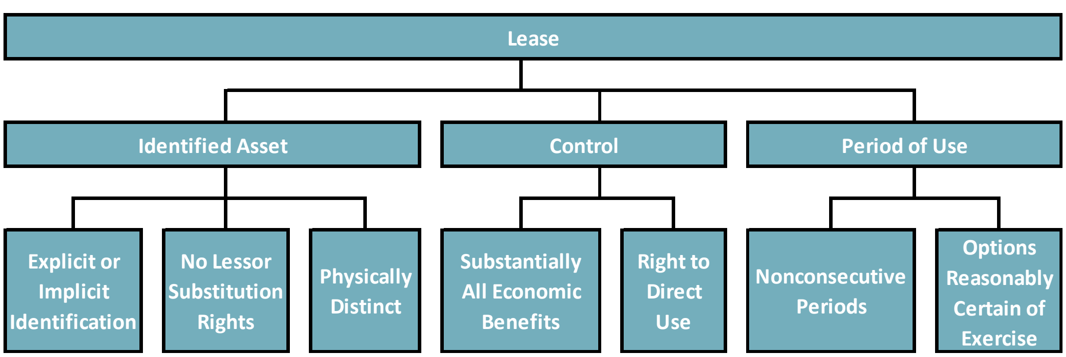
WHAT'S IN A LEASE?

- A contract is or contains a lease if the contract conveys the **right to control** the use of **identified property, plant, or equipment** (an identified asset) for a **period of time**



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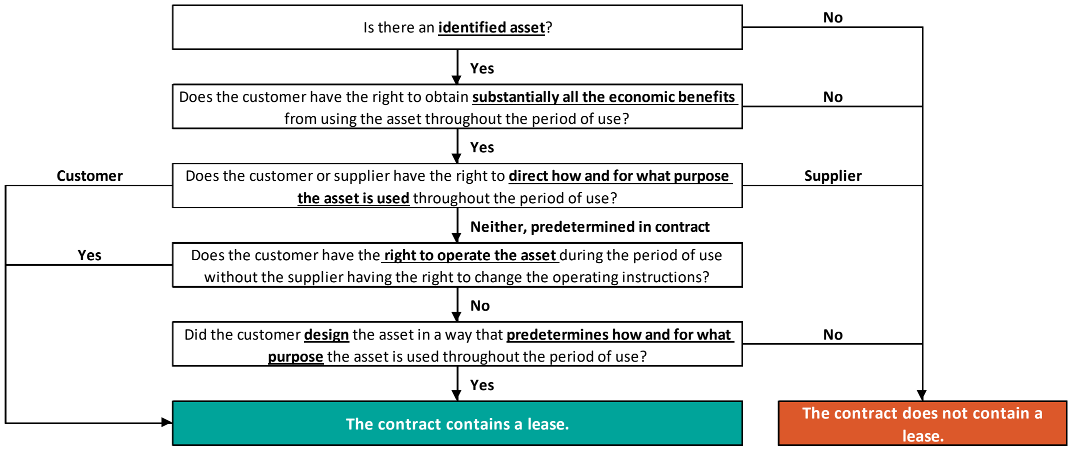
DOES A CONTRACT CONTAIN A LEASE?



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EMBEDDED LEASES

- Agreements may require lease accounting pursuant to ASC 842 even if they are not called “leases,” or contain the word “lease.” Leases may be contained in other arrangements.
- Evaluate contracts pursuant to the ASC 842 definition of a lease (identified asset, right to control and period of time).
- Types of contracts to consider:

Purchase agreements for consumables that include ‘free’ use of vendor provided equipment	Advertising/promotion that grants exclusive rights to signage/billboards
Arrangements that bundle a service and a device	Data center or other outsourced IT service arrangements

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EMBEDDED LEASES - EXAMPLES

01	Advertising	It is possible the use of an asset, such as a billboard or other space, could be included in an advertising agreement and meet the definition of a lease.
02	Information technology	It is possible that servers, copiers, telephones or other assets could be embedded in these contracts and fall under the scope of the new lease standard.
03	Inventory management	Contracts with third parties may contain provisions regarding the usage of a warehouse or other space that could meet the definition of a lease.
04	Food service and facilities management	Rentals of assets such as water coolers, soft drink dispensers, refrigerators and other food and facilities-related equipment may be embedded in contracts for these arrangements.
05	Transportation	In scenarios where organizations use third-parties to ship goods or materials, it is possible that these agreements could incorporate the use of an asset (rail-car, semi-truck, etc.).

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IT SERVICES ILLUSTRATION

- NFP enters into contract with Outsourced IT for managed IT services for 3 years.
- Outsourced IT provides servers and networking equipment according to contract specifications.
- Outsource IT provides all maintenance and support. Outsourced IT can substitute the equipment for repair/maintenance only.
- NFP determines where equipment is installed, what data is stored, and how the network is used.

- What if it were cloud-computing?
  - Is the sever hardware shared with other customers or dedicated to NFP solely?

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COMPONENTS OF A CONTRACT

- Payments associated with leases may be accounted for differently
  1. **Lease components** – provide right to the use of an underlying asset
     - Examples: Rent/lease payments
     - Part of ROU assets and lease liabilities under ASC 842
  2. **Non-lease components** – transfer a good/service related to use of the underlying asset
     - Examples: CAM charges, security services, provide an operator (e.g., a pilot), etc.
     - Accounted for under other guidance
  3. **Non components** (other payments not considered "components") – not a good or service separate from right to use underlying asset
     - Examples: Property taxes and insurance
     - Allocated to lease and non-lease components, and accounted for with those payments
- As a policy election, an entity may **elect** to combine lease and non-lease components and account for them as a single component
  - This will result in higher ROU assets and lease liabilities

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COMBINING COMPONENTS – "ASSOCIATED WITH"

- Lessee may account for each separate lease component and the nonlease components associated with that lease component as a single lease component.
- What does "associated with" mean?
  - How dependent is the lessee's ability to use the lease component on the nonlease component(s)?
  - Can the lease component only function or be used with purchased nonlease components, such as:
    - Consumable
    - Operator/personnel
  - Could the nonlease components be used with a different asset (e.g. purchased from another supplier)?
  - Could the lessee direct the lessor to perform the contracted services on a different asset?
- Combine nonlease components with lease components only when the costs of both would be recognized in a similar manner (e.g. both are recognized in cost of goods sold, both are SG&A, etc)

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ILLUSTRATION OF COMPONENTS – STANDARD ACCOUNTING (SEPARATE)

Property taxes in this example are paid based on estimates, but trued up to actuals as they become known by the lessor. Accordingly, these property taxes are variable in nature, and not based on an index or rate. As such, they are excluded from contract consideration.

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ILLUSTRATION OF COMPONENTS – ELECTION TO COMBINE COMPONENTS

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LEASE CLASSIFICATION

Lessee	Lease Criteria	Lessor
Finance lease	Any one of the following five criteria are met: 1. Lease **transfers ownership** by end of term 2. Lessee has **option to purchase** asset, and is **reasonably certain to exercise** it 3. Lease term is for a **major part of the remaining life** of the asset (if the commencement date falls at or near the end of the economic life of the underlying asset, this criteria shall not be used) 4. Present value of lease payments plus residual value guarantee by lessee is equal to or greater than **substantially all of the fair value** of the asset, or 5. The asset is **specialized** and is expected to have **no alternative future use to the lessor**.	Sales type lease
	None of the above criteria are met; **however,** both of these criteria are met: ▪ Present value of lease payments plus residual value guarantee (including third party guarantee) is equal to or greater than substantially all of the fair value of the asset, and ▪ It is probable that the lessor will collect lease payments and residual value guarantee.	Direct financing lease
Operating lease	None of the above criteria are met.	Operating lease

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LEASE PAYMENTS

LEASE CLASSIFICATION	LEASE LIABILITY MEASUREMENT
Lease payments include **all lease payments made <u>before commencement</u>**, and those not yet made, including:	Lease payments include **only those not yet made**, including:
▪ Fixed payments less lease incentives,	▪ Fixed payments less lease incentives,
▪ Variable lease payments that depend on an index or rate,	▪ Variable lease payments that depend on an index or rate,
▪ Exercise price of purchase option if lessee reasonably certain to exercise,	▪ Exercise price of purchase option if lessee reasonably certain to exercise,
▪ Payments for penalties to terminate lease if lease term reflects lessee exercising option to terminate,	▪ Payments for penalties to terminate lease if lease term reflects lessee exercising option to terminate,
▪ Fees paid by lessee to special-purpose entity for structuring the transaction,	▪ Fees paid by lessee to special-purpose entity for structuring the transaction,
▪ **<u>Entire potential amounts</u>** owed under residual value guarantees.	▪ **Amounts that are <u>probable</u>** of being owed under residual value guarantees.

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VARIABLE LEASE PAYMENTS

- When lease payments are variable based on index or rate
  - Payments are included in measurement of the lease liability based on the particular index or rate in place as of measurement
  - When the rate changes in the future:
    - If the variability is not resolved, do not remeasure the liability
      - For example, payments that adjust based on changes in CPI
    - If the variability is resolved and future payments become fixed, remeasure the liability
      - For example, payments that adjust based on changes in CPI, subject to a cap, and that cap is met; thus, payments are effectively fixed for remaining periods of the lease
- When lease payments are variable but NOT based on an index or rate
  - For example, payments that increase when and if certain sales targets are achieved by the lessee, or usage by the lessee, tuition rates, occupancy, etc.
  - These payments are **not** included in the initial measurement of the lease liability until or unless the contingency upon which they relate is resolved, and the remaining payments become fixed

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Q&A – PAYMENT INCREASES BASED ON CPI

- **Q:My lease payments increase each year based on the change in CPI. How do I determine the payment amount to use for future periods in the initial recognition and measurement of the lease?**
- **A:** <u>In the initial recognition and measurement of the lease you do not adjust for the potential change in CPI</u>. While the variability is based on a change in rate or index such as CPI, the amount of that rate or index at commencement is 0 because there is no change in the CPI at that date. Therefore, you would not include any amount for the change in CPI in the future payments for recognition and measurement; <u>you would use the initial period stated amount for the future periods as well</u>. In future periods, the change in lease payments due to the change in CPI would be reported as variable lease expense in that period.

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Q&A – RENEWALS AT FUTURE MARKET RENTS

- **Q: My lease contract contains renewal options with payment amounts established at future market rents. These amounts are variable, so do I include them in lease payments for measurement?**
- **A:** Yes, future payments dependent on future fair market rents are tied to economic factors. While the amount cannot be known until the renewal date, the payment is not avoidable (assuming the renewal option is exercised). While the payment amount could increase or decrease from the last scheduled payment, there will still be a required payment and it is reasonable to expect it will be consistent with scheduled payments. The amount for the last scheduled payment should be used for renewal periods reasonably certain to be exercised.

DETERMINING THE DISCOUNT RATE

- Rate implicit in the lease
  - Required to be used by lessors
  - Used by lessees when readily determinable
    - *Unless the lease is with a related party, it's highly unlikely that a lessee would have knowledge of all the above elements to determine the rate implicit in the lease*
  - The rate of interest at which:

PV of lease payments + PV of the residual value of the asset = Fair value of the asset − Related investment tax credits + Deferred initial direct costs

- Incremental Borrowing Rate (IBR)
  - The rate of interest that a lessee would have to pay to borrow on a collateralized basis, over a similar term, an amount equal to the lease payments, in a similar economic environment
- Risk-Free Rate (RFR)
  - The theoretical rate of return of an investment with zero risk *(U.S. Treasury bond rates)*
  - Nonpublic business entity accounting policy election, by class of underlying asset

ROU ASSETS

- ROU asset is computed as:

Initial measurement of lease liability + Lease payments made at or before commencement − Lease incentives received at or before commencement + Initial direct costs

- Initial direct costs
  - Incremental costs that would not have been incurred had the lease not been executed
  - Specifically, costs related to activities that occurred before obtaining the lease are not capitalizable as IDC's
  - Examples of IDC's include legal fees resulting from the execution of a lease, commissions to employees acting as selling agents and certain payments to existing tenants to move out

STATEMENT OF FINANCIAL POSITION

FINANCE LEASE	OPERATING LEASE
Statement of Financial Position	
Record ROU asset and lease liability at commencement ▪ ROU asset will be presented as long term ▪ Lease liability will be presented in current and non-current portions	
Amortize ROU asset, typically on a straight-line basis over: ▪ Lease term, or ▪ Remaining economic life of underlying asset when transfer or title or purchase option reasonably certain to be exercised	Amortize ROU asset by an amount representing straight-line lease expense less accretion of interest on the lease liability (amortization increases over lease term)
Test ROU asset for impairment (ASC 360)	
Increase liability for accretion of interest and reduce liability for amounts paid	
Adjust ROU asset and lease liability for effects of modifications and remeasurements, as applicable	

STATEMENT OF ACTIVITIES

FINANCE LEASE	OPERATING LEASE
Statement of Activities	
Expense will decrease over lease term ▪ Amortization is recognized on a straight-line basis ▪ Interest accretion is reduced as the liability declines	Expense will remain the same (straight-line) over the lease term ▪ ROU amortization increases to result in combined straight-line expense ▪ Interest accretion is reduced as the liability declines
Present two expense line items: ▪ Amortization expense ▪ Interest expense *Do not have to be separately presented; should be consistent with how entity presents other interest and amortization*	Present a single expense line item: ▪ Operating lease expense ▪ Referred to as "single lease cost"
Recognize variable lease expense	
Recognize impacts of impairments, remeasurements, and modifications, as applicable	

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FINANCE VS OPERATING LEASE ILLUSTRATION

	Finance and Operating Lease		Finance Lease				Operating Lease				Difference Finance vs. Operating	
	Payments	Lease Liability	Straightline Amortization Expense	Interest Expense	Total Expense	ROU Asset	ROU Reduction "Plug"	Interest Accretion	Single Lease Cost (Straightline)	ROU Asset	Total Expense	ROU
0		**392,017**				**392,017**				392,017		-
1	50,000	362,094	39,202	20,076	59,278	352,815	29,924	20,076	50,000	362,094	9,278	(9,278)
2	50,000	330,413	39,202	18,320	57,522	313,614	31,680	18,320	50,000	330,413	7,522	(16,800)
3	50,000	296,874	39,202	16,460	55,662	274,412	33,540	16,460	50,000	296,874	5,662	(22,462)
4	50,000	261,365	39,202	14,491	53,693	235,210	35,509	14,491	50,000	261,365	3,693	(26,155)
5	50,000	223,772	39,202	12,407	51,609	196,009	37,593	12,407	50,000	223,772	1,609	(27,764)
6	50,000	183,973	39,202	10,200	49,402	156,807	39,800	10,200	50,000	183,973	(598)	(27,166)
7	50,000	141,837	39,202	7,864	47,066	117,605	42,136	7,864	50,000	141,837	(2,934)	(24,232)
8	50,000	97,228	39,202	5,391	44,593	78,403	44,609	5,391	50,000	97,228	(5,407)	(18,824)
9	50,000	50,000	39,202	2,772	41,974	39,202	47,228	2,772	50,000	50,000	(8,026)	(10,798)
10	50,000	0	39,202	-	39,202	-	50,000	-	50,000	0	(10,798)	0
	500,000		392,017	107,983					500,000		0	

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STATEMENT OF CASH FLOWS

FINANCE LEASE	OPERATING LEASE
Statement of Cash Flows	
Payments of principal = Financing Activities	Lease payments* = Operating Activities
Payments of interest = Operating Activities	
Variable payments = Operating Activities	
Short-term lease payments = Operating Activities	
Impairment = Non-cash Activities	
Effects of remeasurement or modification = Non-cash Activities	
	*Payments associated with the cost of bringing another asset to the condition/location for intended use that are capitalized as part of the asset = Investing Activities

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PRESENTATION AND DISCLOSURE

- A lessee shall either (a) present in the balance sheet or (b) disclose in the notes to the financial statements:
  - Finance lease ROU assets and operating lease ROU assets separately from each other, and from other assets
  - Finance lease liabilities and operating lease liabilities separate from each other, and from other liabilities
- If disclosed in the notes to the financial statements, the lessee should disclose which line items in the balance sheet includes the ROU assets and lease liabilities
- In either case, lessees are <u>prohibited</u> from presenting:
  - Finance lease ROU assets in the same line item as operating ROU assets
  - Finance lease liabilities in the same line item as operating lease liabilities
- ROU assets and lease liabilities should be classified as current and noncurrent
  - ROU assets are generally classified as noncurrent in accordance with ASC 210

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PRESENTATION ILLUSTRATION

Separate Presentation *Acceptable*		Presentation with Other Assets and Liabilities and Disclosed Separately *Acceptable*		Combined Presentation *Not Acceptable*	
Balance Sheet Period Ended December 31, 20X1		Balance Sheet Period Ended December 31, 20X1		Balance Sheet Period Ended December 31, 20X1	
ROU assets – operating leases	25,000	ROU assets – operating leases	25,000	ROU assets	25,900
ROU assets – finance leases	900	Property, plant and equipment	2,000	Property, plant and equipment	1,100
Property, plant and equipment	1,100				
Operating lease liabilities	25,150	Operating lease liabilities	25,150	Lease liabilities	26,000
Finance lease liabilities	850	Other liabilities	1,850	Other liabilities	1,000
Other liabilities	1,000	Disclosure			
		For the period ended December 31, 20X1, right-of-use assets from finance leases of $900 are included as part of property, plant and equipment.			
		For the period ended December 31, 20X1, lease liabilities from finance leases of $850 are included as part of other liabilities.			

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QUALITATIVE DISCLOSURES

- General description of leases
- Basis and terms and conditions on which variable payments are determined
- Existence and terms and conditions of options to extend or terminate lease
  - Should include narrative disclosure of options that are recognized in lease ROUs and liabilities as well as those that are not
- Existence and terms and conditions of residual value guarantees
- Restrictions or covenants imposed by leases
- All the above information for subleases
- Information about leases that have not commenced but create significant rights and obligations
- Significant assumptions or judgments made in applying requirements of ASC 842 including:
  - Determination of whether a contract contains a lease
  - Allocation of consideration between lease and non-lease components
  - Determination of the discount rates for the leases
- Policy elections (short-term leases, not separating lease and nonlease components)
- Related party disclosures in accordance with ASC 850, when applicable
- Transition disclosures in accordance with ASC 250, when applicable

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QUANTITATIVE DISCLOSURES

	Year Ending December 31, 20X2	20X1
Lease cost		
Finance lease cost:	$XXX	$XXX
Amortization of right-of-use assets	XXX	XXX
Interest on lease liabilities	XXX	XXX
Operating lease cost	XXX	XXX
Short-term lease cost	XXX	XXX
Variable lease cost	XXX	XXX
Sublease income	(XXX)	(XXX)
Total lease cost	$XXX	$XXX

* If the short-term lease expense for the period does not reasonably reflect the lessee's short-term lease commitments, the lessee shall disclose that fact and the amount of its short-term lease commitments.

	Year Ending December 31, 20X2	20X1
Other information		
(Gains) and losses on sale and leaseback transactions, net	$(XXX)	$XXX
Cash paid for amounts included in the measurement of lease liabilities	XXX	XXX
Operating cash flows from finance leases	XXX	XXX
Operating cash flows from operating leases	XXX	XXX
Financing cash flows from finance leases	XXX	XXX
Right-of-use assets obtained in exchange for new finance lease liabilities	XXX	XXX
Right-of-use assets obtained in exchange for new operating lease liabilities	XXX	XXX
Weighted-average remaining lease term—finance leases	XX years	XX years
Weighted-average remaining lease term—operating leases	XX years	XX years
Weighted-average discount rate—finance leases	XX%	XX%
Weighted-average discount rate—operating	XX%	XX%

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CALCULATING WEIGHTED AVERAGES

- Weighted avg lease term – uses current lease liability (discounted future payments)
- Weighted avg discount rate – uses undiscounted remaining future lease payments

LEASE DATA:

	(a) Remaining future lease payments	(b) Lease liability at reporting date	(c) Remaining lease term (months)	(d) Discount rate for the lease
Lease 1	24,000	23,324	24	3.0%
Lease 2	12,000	11,930	5	3.5%
Lease 3	159,458	132,661	109	4.0%
	195,458	167,915		

WEIGHTED-AVERAGE LEASE TERM:

		(b) x (c)
Lease 1		559,776
Lease 2		59,650
Lease 3		14,460,049
	∑ ((b) x (c))	15,079,475
	÷ ∑(b)	167,915
	Weighted-average months	89.80
	÷	12
	Weighted-average years	7.48

WEIGHTED-AVERAGE DISCOUNT RATE:

		(a) x (d)
Lease 1		720.00
Lease 2		420.00
Lease 3		6,378.32
	∑ ((a) x (d))	7,518.32
	÷ ∑(a)	195,458
	Weighted-average	3.85%

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FUTURE MATURITIES DISCLOSURE

- Lessee should also disclose a maturity analysis of its finance and operating lease liabilities, separately showing:
  - Undiscounted cash flows on an annual basis for a minimum of each of the next 5 years
  - Sum of undiscounted cash flows for all years thereafter
  - Reconciliation of undiscounted cash flows to the discounted finance lease liabilities and operating lease liabilities

	Operating leases		Finance leases	
	Year Ending December 31,		Year Ending December 31,	
	20X2	20X1	20X2	20X1
20X2		$XXX		$XXX
20X3	$XXX	XXX	$XXX	XXX
20X4	XXX	XXX	XXX	XXX
20X5	XXX	XXX	XXX	XXX
20X6	XXX	XXX	XXX	XXX
20X7	XXX		XXX	
Thereafter	XXX	XXX	XXX	XXX
Total	XXX	XXX	XXX	XXX
Less interest	(XXX)	(XXX)	(XXX)	(XXX)
Present value of future minimum lease payments	$XXX	$XXX	$XXX	$XXX

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POLICY ELECTION RECAP

- Short-term lease exception
- Reasonable capitalization threshold
- Not separating lease and nonlease components
- Major part of the economic life
- Substantially all of the fair value
- Risk-free rate
- Financial statement presentation
- Transition elections
  - Transition method
  - Transition “package of three”
  - Hindsight in transition
  - Easements at transition

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SHORT-TERM LEASES

- A short-term lease is a lease that, *at commencement*, has a lease term of 12 months or less, *including renewal periods the lessee is reasonably certain to exercise*, and does not include an option to purchase the underlying asset that the lessee is reasonably certain to exercise.
- **Q: Do leases that have a remaining term of 12 months or less at the ASC 842 application date, but at commencement had a term of more than 12 months, qualify for the short-term lease exception?**
- **A:** No, these would not qualify since the assessment is as of the commencement date.

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REASONABLE CAPITALIZATION THRESHOLD

- "…entities will likely be able to adopt reasonable capitalization thresholds below which lease assets and lease liabilities are not recognized…"
- **Q: How is the "reasonable" capitalization threshold determined? Can you just use the same threshold that is used for PP&E?**
- **A:** Possibly, but further consideration is needed. The threshold for PP&E only considers the impact of assets. ASC 842 accounting will affect both assets and liabilities. There will also be some accumulation over time due to overlapping lease terms. One reasonable approach is to determine what is material for assets and liabilities separately and then using the lesser of those two amounts. The impacts of excluding items/amounts from footnote disclosures should also be considered.

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APPLICATION OF CAPITALIZATION THRESHOLD

- **Q: Do you apply the recognition threshold based on discounted or undiscounted lease payments?**

- **A:** We believe a two-step method would be appropriate, in which you first consider the undiscounted amount and then consider the discounted amount. If the undiscounted amount is below the recognition threshold, you can exclude the lease from accounting under ASC 842. If the undiscounted amount is greater than the recognition threshold, you should perform the present value calculation to determine if the present value is below the recognition threshold. If so, you would exclude the lease from accounting under ASC 842.

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APPLICATION OF CAPITALIZATION THRESHOLD

- **Q: Should the recognition threshold be applied to the entire contract or to each underlying asset?**

- **A:** In our opinion it would be appropriate to apply the recognition threshold to each separate lease component. In many cases, this will be each underlying asset, but you may need to determine in accordance with ASC 842-10-15-28, that each ROU asset is neither highly dependent nor highly interrelated with other ROU assets in the contract. In addition, if you elect not to account for lease components separate from nonlease components, you may need to allocate the consideration for the nonlease components to the lease components prior to applying the recognition threshold.

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LEASES BELOW CAPITALIZATION THRESHOLD

- **Q: What are the presentation and disclosure requirements for leases that fall below the recognition threshold?**

- **A:** As the leases have been deemed to be immaterial, there are no presentation and disclosure requirements. The expenses would be recognized as period expenses in the financial statements and no related lease disclosures are necessary. We recommend that the expenses related to these immaterial leases be included in other expense line items, separate from "lease" or "rent" expense type captions. Additionally, footnote disclosures should not include these amounts, which would cause discrepancies between amounts reported in the statements and in the notes.

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LEASE MODIFICATIONS

- **Modifications**: Changes to terms and conditions of a lease contract that impact the scope of, or the consideration for a lease
  - For example, a change that adds or terminates the right to use one or more underlying assets or extends or shortens the contractual lease term
  - Depending on facts and circumstances, a lease modification may be accounted for as one modified lease, or two leases – the original lease and a separate new lease
  - Separate new lease when modification grants additional right of use and lease payments increase commensurate with standalone price for additional right of use

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LEASE REMEASUREMENT EVENTS

- **Remeasurement events**: Changes in circumstances, or events relating to a lease, such as the following:
  - A contingency on which variable payments are based is resolved, and becomes fixed
  - A change in the assessment of whether a termination or renewal option is reasonably certain of being exercised (i.e., change in lease term)
  - A change in the assessment of reasonable certainty as to whether a purchase option will be exercised
  - A change in amounts probable of being owed by the lessee pursuant to a residual value guarantee

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REMEASURING LEASE LIABILITIES AND ROU ASSETS

- Lessees may have to reallocate contract consideration to lease and nonlease components and remeasure lease liabilities and ROU assets during the lease term
- How the lease liability is remeasured and the ROU asset is adjusted will depend on the reason for the lease remeasurement. You may need to:
  - Reassess existence of lease,
  - Reassess classification,
  - Reallocate contract consideration to components,
  - Remeasure lease liability and adjust ROU asset,
  - Update discount rate
- Adjust ROU asset by an amount equal to the adjustment to the lease liability
  - If carrying amount of ROU asset reduced to $0, recognize any remaining amount of the remeasurement in net income

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LEASE TERMINATION

- Termination in its entirety
  - Write off ROU asset and lease liability
  - Any difference between the carrying amounts should be recorded in net income as a gain or loss
  - If termination penalty paid, that amount is included in gain or loss
- Partial termination
  - Terminating ROU for some but not all underlying assets or reducing leased space
  - ROU asset should be reduced proportionate to the partial termination of the existing lease
  - Difference between the decrease in carrying amount of lease liability resulting from the modification and the proportionate decrease in carrying amount of the ROU asset should be reported in net income
- Purchase of leased asset during lease term
  - Any difference between the purchase price and the carrying amount of the lease liability prior to purchase shall be recorded as an adjustment to the carrying amount of the asset

RELATED PARTY LEASES

- Accounted for based on legally enforceable terms and conditions, which would be the same as if the lease was between unrelated parties.
- Is a "short-term" lease truly short term? Possible indicators of legally enforceable terms and conditions:
  - Existence of significant leasehold improvements
  - Underlying asset financed through debt provided, or guaranteed, by lessee
  - Cash flow from lessee critical to lessor's ability to meet debt obligations
  - Economically disruptive or commercially unrealistic for lessee to move operations in short-term
  - Other agreements (operating agreements, management agreements, etc.) that directly or indirectly impose enforceable terms and conditions
- Discount rate – rate implicit in the lease may be very high
- Lease classification – impact of discount rate on "substantially all the fair value"

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CONSIDERATIONS AT TRANSITION

- Cumulative effect adjustments are expected to be rare
  - Given the “package of three” practical expedient, we expect cumulative effect adjustments will be rare. If the package of three is not elected, the chance of a cumulative effect adjustment would be higher due to reassessment of the three items noted above.
  - Example - sale-and-leaseback transactions
  - Errors in prior accounting under ASC 840 are not part of the cumulative effect upon adoption
- Short-term lease exception is based on original commencement date, NOT months remaining at ASC 842 adoption.
- Discount rates for operating leases should be established at the application date, NOT original lease commencement date

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CONTRIBUTED AND BELOW MARKET LEASES

- NFP entities may be granted a lease for no ($0 or de minimis) or below market consideration.
- Addressed in ASU 2016-02 BC 220
- Will need to consider both lease and contribution accounting:
  - Lease – consideration paid (Topic 842)
  - Contribution – fair value is excess of consideration (Topic 958-605)
- No specified period and no consideration
  - Recognize fair value as contribution revenue and rent expense on a periodic basis
- Specified period (e.g. 3 years) and no consideration
  - Recognize contribution revenue and receivable for present value of total known future donated rent’s fair value in period contributed
  - Recognize rent expense in the period of use
  - Amortize contribution receivable of specified period

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CHANGES FOR LESSORS

- Changes mostly to align with lessee guidance and ASC 606
  - Lease classification
  - Recognition of selling profit from direct-financing leases
  - Initial direct costs
  - Executory costs
  - Policy election to not separate components of the contact if certain criteria met
  - Financial statement presentation
  - Expanded disclosures

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THE **AGENDA**

- ASU 2020-07
  - Gifts in Kind Presentation and Disclosure
- CECL – Topic 326
- Statement on Auditing Standards 134
- Statement on Auditing Standards 137

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ASU 2020-07 – GIFTS IN KIND

- Objective:
  - To increase transparency about contributed nonfinancial assets through enhancements to presentation & disclosure
- Scope:
  - Contributions of nonfinancial assets (fixed assets, use of fixed assets, materials & supplies, intangibles, services)
- Transition and Effective Date
  - Retrospective transition required
  - Effective for years beginning after June 15, 2021
    - FY 2021-2022 for June year-ends; CY 2022 for December year-ends

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TYPES OF IN-KIND CONTRIBUTIONS

- Donations of:
  - Tangible property
    - Inventory/supplies including food, clothing, medical supplies, pharmaceuticals, household goods, furniture and equipment
  - Contributed services
  - Real estate
  - Donated advertising
  - Utilities or use of long-lived assets (donated facilities/rent)
  - Collection items
  - Intangible property
    - Patents, royalties, copyrights

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CONTRIBUTED SERVICES

- Create or enhance non-financial assets
  - Capitalized as part of the cost of the asset
- Require and are provided by individuals possessing specialized skills
- Services would typically need to be purchased if not donated
  - Accountants, lawyers, teachers, etc.
- Services received from affiliate
  - Requires recognition of all services received from personnel of an affiliate that directly benefit the recipient not-for-profit entity
  - Should be measured at the cost recognized by the affiliate unless cost will significantly over/under state the value, then recognize at either cost of FMV

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FREQUENTLY MISSED GIFTS IN-KIND

- Contributed advertisement and radio time
- Contributed use of facilities, utilities (in-kind rent receivable)
- Contributed personnel costs from an affiliate
- Contributions for fundraisers
  - Auction items, marketing materials
- Contributed administrative costs
- Contributed collection items
- Below-market interest rates
- Donated goods held at year end
  - Might be able to perform physical inventory observation and audit inputs to perform a roll-back to prior period balances

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OVERVIEW OF REQUIREMENTS – ASU 2020-07

- Present contributed nonfinancial assets as a separate line item in the statement of activities, apart from contributions of cash or other financial assets.

- Disclose a disaggregation by category of nonfinancial asset. For each category, also disclose info about how the assets are used (or monetized), including any associated donor/grantor restrictions, and how they are valued (at initial recognition).

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GIFTS IN-KIND REQUIREMENTS

- Present contributed nonfinancial assets as separate line item in the statement of activities
- Disclose disaggregation by category of nonfinancial asset including if monetized and policy on monetizing
- Disclose a description of donor restrictions associated with nonfinancial asset
- Provide description of the valuation techniques and inputs used to arrive at a fair value measure for contributed nonfinancial assets in accordance with paragraph 820-10-50-2(bbb)(1) of Codification for initial recognition
- Disclose principal market (or most advantageous market) used to arrive at fair value measure if it is a market in which the recipient NFP is prohibited by donor restrictions from selling or using the contributed asset

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STATEMENT OF ACTIVITIES PRESENTATION

	Without Donor Restrictions	With Donor Restrictions	Total
Support, revenues, and gains			
Contributions and grants, primarily private	18,510	5,670	24,180
Gifts-in-kind	67,680		67,680
Government grants	9,680	-	9,680
Other income	465	-	465
Net assets released from restrictions	1,430	(1,430)	-
Total support, revenues, and gains	97,765	4,240	102,005
Expenses			
Food bank operations	86,940	-	86,940
Supporting services:			-
General and Administrative	1,050	-	1,050
Fundraising	3,475	-	3,475
Total expenses	91,465	-	91,465
Change in net assets	6,300	4,240	10,540

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STATEMENT OF ACTIVITIES PRESENTATION

	Without Donor Restrictions			With Donor	
	Financial	Non-Financial	Total	Restrictions	Total
Support, revenues, and gains					
Contributions and grants, primarily private	18,510	67,680	86,190	5,670	91,860
Government grants	9,680	-	9,680	-	9,680
Other income	465	-	465	-	465
Net assets released from restrictions	1,430	-	1,430	(1,430)	-
Total support, revenues, and gains	30,085	67,680	97,765	4,240	102,005
Expenses					
Food bank operations	21,730	65,210	86,940	-	86,940
Supporting services:					
General and Administrative	1,050	-	1,050	-	1,050
Fundraising	3,475	-	3,475	-	3,475
Total expenses	26,255	65,210	91,465	-	91,465
Change in net assets	3,830	2,470	6,300	4,240	10,540

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DISCLOSURE REQUIREMENTS – PRE-EXISTING

- Describe the programs or activities for which the contributed services were used, including the nature and extent received for the period and amount recognized as revenues
  - Nature and extent includes nonmonetary information (number and trends of donated hours received or service outputs provided by volunteer efforts) and other monetary information
- Disclose the fair value of contributed services received but not recognized as revenues if practicable.

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DISCLOSURE REQUIREMENTS – NEW

- Disclose a disaggregation by category of nonfinancial asset.
- For each category, also disclose:
  - Information about how the assets are used (or monetized)
  - Any associated donor/grantor restrictions
  - How the gifts are valued at initial recognition

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DISCLOSURE REQUIREMENTS - EXAMPLE

GIK Disclosure – Tabular Example

	20X2	Usage in programs/ Activities	Donor-imposed Restrictions	Fair Value Techniques
Food	$ 49,920	Mobile Food Pantry	$10,000 restricted for emergency hurricane response in the local community. The remainder was unrestricted.	Estimated average US wholesale price per pound for each food category as determined by America's Food Product Valuation Survey, which is performed annually by Crackers, LLP.
Clothing	13,540	Adult and Children's Programs	Unrestricted	Estimated US wholesale prices of identical or similar products using pricing data under a 'like-kind' methodology considering the goods condition and utility for use at the time of the contribution.
Supplies	4,220			
	$ 67,680			

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DISCLOSURE REQUIREMENTS - EXAMPLE

GIK Disclosure – Narrative Example

For the year ending June 30 20X2, GIK recognized within the statement of activities included:

	20X2
Food	$ 49,920
Clothing	13,540
Supplies	4,220
	$ 67,680

GIK Valuation Techniques: Contributed food items are valued using average US wholesale price per pound for each food category as determined by America's Food Product Valuation Survey, which is performed annually by Crackers, LLP. All other GIK is valued using estimated US wholesale prices of identical or similar products using pricing data of similar products under a 'like-kind' methodology, considering the goods condition and utility for use at the time of the contribution.

Donor Restrictions and GIK Use: No GIK was restricted, except for $10,000 of food contributions restricted for emergency hurricane response in the local community.

The Organization does not sell donated GIK and only distributes goods for program use, including the Mobile Food Pantry and Adult and Children Programs.

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CECL (TOPIC 326)

- CECL: Current Expected Credit Loss impairment model
- Transition and effective date:
  - Fiscal years beginning in 2023 (annual and interim). Early adoption is permitted
  - Record a cumulative effect adjustment to opening net assets of the earliest period presented.
  - Transition disclosures required

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BACKGROUND

- Current GAAP requires waiting to recognize credit losses until it is probable a loss has been incurred
- Limitations:
  - Restricts the ability to record expected losses that are not yet probable
- Why the change?
  - Users of the financial statements are making their own assessments
  - Potential overstatement of assets
- Topic 326 will now require forward-looking estimates

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WHO AND WHAT IS AFFECTED?

- Topic 326 applies to all entities in varying degrees
- Financial assets measured at amortized cost basis
  - Financing receivables
  - Receivables from Topic 606 or Topic 610 revenue transactions
  - Net investments in leases recognized by lessor (Topic 842)
  - Off-balance-sheet credit exposures (guarantees, loan commitments)
  - Reinsurance recoverables (Topic 944)
  - Programmatic Loans

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EFFECT ON RECEIVABLES

- CECL could effect trade receivables (e.g. Student, Patient), Student Loans Receivable
- Current practice:
  - Assessing history of payment
  - Aging of receivables
- What might be new:
  - Future considerations
    - Reasonable and supportable forecast period
    - Reversion to history after the "reasonable and supportable" period
  - Additional disclosures to help users understand how credit losses are estimated

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WHAT IS SCOPED OUT?

- Financial assets measured at fair value through change in net assets
- Promises to give (pledges receivable)
- Loans and receivables between entities under common control
- Receivables arising from operating leases under Topic 842
- Loans issued under defined contribution employee benefit plans

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MAIN PROVISIONS

- Financial assets or groups of financial assets measured at amortized cost are presented in the net amount expected to be collected
- Expected credit losses are included in the change in net assets
- Expected credit loss measurement
  - Historical experience
  - Current conditions
  - Reasonable and supportable forecasts

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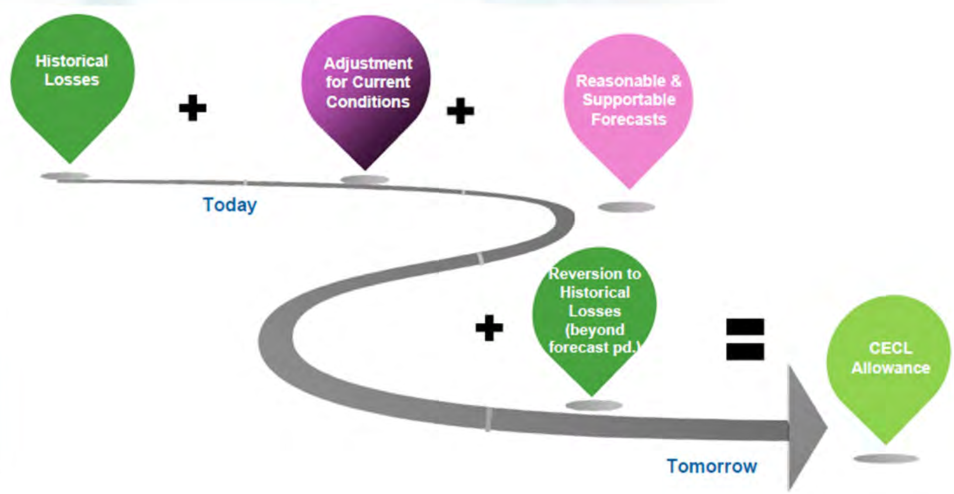
PATH TO CECL ALLOWANCE



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ESTIMATION REQUIREMENTS

- Over the contractual term of the financial asset
- Need to consider more than just past events
  - Current conditions
  - Reasonable and supportable forecasts
- May include internal information, external or both
- Considerations:
  - Organization's environment
  - Factors specific to the borrower
  - Prepayments

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ESTIMATION CONSIDERATIONS

- Financial assets with similar risk characteristics can be pooled for evaluation
- Financial assets with unique risk characteristics should be evaluated individually
- If the risk of loss is expected to be zero based on adjusted historical credit loss information, the Organization is not required to record an estimated credit loss
- For periods beyond which forecasts can be made, the Organization should revert to historical loss information through remaining contractual term

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ESTIMATION APPROACHES

- Discounted cash flow
- Cumulative loss rate
- Vintage loss rate
- Roll-rate (migration analysis)
- Probability-of-default
- Aging schedule

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CECL - PRESENTATION

- For financial assets measured at amortized cost within the scope of Topic 326, Organizations should separately present on the statement of financial position, the allowance for credit losses that is deducted from the asset's amortized cost basis.
- Off-balance-sheet credit exposures:
  - Estimate of expected credit losses presented as a liability on the SOFP
  - Liability is reduced when instrument expires, results in recognition of a financial asset, or are otherwise settled
  - Expected credit losses recorded separately from allowances related to recognized financial instruments

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CECL - DISCLOSURES

- Accounting policies and policy elections
- Credit quality information
- Allowance for credit losses
- Past-due status
- Nonaccrual status
- Purchased financial assets with credit deterioration
- Collateral-dependent financial assets
- Off-balance-sheet credit exposures

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CECL - DISCLOSURES

- Summary of significant accounting policies for financial assets under Topic 326 should include:
  - Nonaccrual policies, including the policies for discontinuing accrual of interest, recording payments received on nonaccrual assets and resuming accrual of interest, if applicable
  - The policy for determining past-due or delinquency status
  - The policy for recognizing writeoffs within the allowance for credit losses

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CECL - DISCLOSURES

- Disclosures required in the period of adoption:
  - Nature of the change in accounting principle, including an explanation of the newly adopted accounting principle
  - Method of applying the change
  - As of the beginning of the first period for which ASU 2016-13 is applied:
    - Effect on the adoption of any line item in the statement of financial position, if material
    - Cumulative effect of the change on net assets or other components of equity in the SOFP

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STATEMENT ON AUDITING STANDARDS NO. 137

- The Auditor's Responsibilities Relating to Other Information Included in Annual Reports
- Effective for periods ending on or after December 15, 2021
- Annual report definition:
  - Document that "contains, accompanies, or incorporates by reference the financial statements and the auditor's report thereon."

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SAS 137 - OBJECTIVES

- To consider whether a material inconsistency exists between the other information and the financial statements
- To remain alert for indications that:
  - A material inconsistency exists between the other information and the auditor's knowledge obtained in the audit or
  - A material misstatement of fact exists or the other information is otherwise misleading
- To 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
- To report in accordance with this SAS

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SAS 137 - RESPONSIBILITIES

Management	Auditor
Communicate during planning if annual report is published	Read the report and consider whether material inconsistencies exist
If so, provide management's acknowledgement of which document(s) comprise the annual report that will be subject to auditor's procedures	Auditor has obtained the annual report by the date of the auditor's report - a separate section is included in the auditor's report with the heading "Other information" Management did not provide the annual report before the date of the auditor's report - the auditor will request written representations from management that the final documents will be provided when available, and prior to issuance by the entity

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SAS 137 – OTHER INFORMATION EXAMPLE

Other Information [Included in the Annual Report][5]

Management is responsible for the other information [*included in the annual report*]. The other information comprises the [*describe information included in the annual report*] but does not include the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information, and we do not express an opinion or any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and consider whether a material inconsistency exists between the other information and the financial statements, or the other information otherwise appears to be materially misstated. If, based on the work performed, we conclude that an uncorrected material misstatement of the other information exists, we are required to describe it in our report.

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STATEMENT ON AUDITING STANDARDS NO. 134

- Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of Financial Statements
- Effective for periods ending on or after December 15, 2021.
- What changed?
  - The AICPA issued several new pronouncements (SAS) that have a substantial impact on the auditor's report
  - Changes include significant format and content changes

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SAS 134 – APPLICABILITY

Applies to any GAAS engagement *(therefore, all of these reports change)*

- FS audits
- FS GAGAS audits
- Single Audits
- HUD compliance audits
- Audits of special-purpose reports
- Audits performed under both GAAS and ISAs

Does not apply to:

- FS reviews, compilations, preparations
- AUPs
- SSPAs (SSAE/examination)
- SOCs
- Consulting projects

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STATEMENT ON AUDITING STANDARDS NO. 134

- Why Change?
  - Background –
    - The auditor's report is not issued for the benefit of the auditor, but rather for the benefit of the user of the financial statements
    - Auditor's report needs to be responsive to user needs, not auditor needs
  - The AICPA and Auditing Standards Board determined there was an expectation gap between what the user needed and what the old report provided
  - The report changes enhance the relevance and usefulness of the auditor's report and provide more clarity about who is responsible for what

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SUMMARY OF CHANGES TO AUDITOR'S REPORT

What doesn't change?

- Types of opinions (unmodified, modified – qualified/adverse, disclaimer)
- Emphasis-of-Matter and Other-Matter paragraphs

What's new

- Reordering and rewording
- Expanded text about management's and auditor's responsibilities
- If applicable –section for "substantial doubt about going concern"
- If applicable – other matters paragraph re: client's annual report
- If applicable – section for Key Audit Matters

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DETAILS OF CHANGES TO THE AUDITOR'S REPORT

- Enhanced information:
  - Descriptions of management responsibility related to consideration of the entity's ability to continue as a going concern
  - Expanded descriptions of the auditor's responsibilities, including:
    - Consideration of the entity's ability to continue as a going concern
    - Professional judgment and professional skepticism
    - Auditor's communication with those charged with governance

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DETAILS OF CHANGES TO THE AUDITOR'S REPORT

- New information includes:
  - A definition of "reasonable assurance"
  - A statement that the risk of fraud is greater than the risk of error
  - A description of the concept of materiality
  - Information about key audit matters, if applicable
- Format changes:
  - Opinion must be presented first
  - Basis of opinion is second

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OPINION MODIFICATIONS

- Identifying when to modify the audit opinion. SAS 134 impact on AU-C 705, Modifications to the Opinion in the Independent Auditor's Report
  - Aligns with the form and content of report modifications with the new report letter requirements in AU-C 700
  - Does NOT change the existing requirements regarding circumstances in which a modification to the auditor's opinion is required

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IDENTIFYING WHEN TO MODIFY THE OPINION

- Qualified opinion when:
  - Auditor, having obtained sufficient evidence, concludes that misstatements are material but not pervasive; or
  - Auditor cannot obtain sufficient evidence but concludes the possible effect of undetected misstatements, are material but not pervasive
- Adverse opinion when:
  - Auditor, having obtained sufficient evidence, concludes that misstatements are both material and pervasive.
- Disclaimer of opinion when:
  - Auditor cannot obtain sufficient evidence on which to base an opinion, and concludes the possible effects of misstatements are both material and pervasive.

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REPORT MODIFICATION EXAMPLES

Topic	Description
Inventory	Auditor was unable to observe year-end inventory due to COVID pandemic restrictions
Leases	Auditee refuses to implement ASC Topic 842 for 12/31/2022 financial statements
Subsidiary	Auditee prepares parent-only financials and does not include subsidiary required to be consolidated
Contributions	Auditee uses cash basis for revenue recognition of contributions
PPP Loan	Loan forgiven, but auditee “double-dipped” using same payroll costs for the PPP loan and federal grants

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SAS 134 – REPORTING KEY AUDIT MATTERS (KAM)

- SAS 134 introduces AU-C 701, Communicating Key Audit Matters in the Independent Auditor's Report
- Only required to report on KAM's if engaged to do so
- KAM's are:
  - Those matters, that in the auditor's professional judgment, were of most significance to the audit of the FS of the current period. KAMs are selected from matters communicated to those charged with governance

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SAS 134 – REPORTING KEY AUDIT MATTERS (KAM)

- If engaged to do so, the auditor should determine, from those matters communicated to those charged with governance, those matters that required significant auditor attention in performing the audit, taking into consideration:
  - Areas of higher assessed risk of material misstatement
  - Areas that involved significant management judgment (i.e. estimates)
  - The effect on the audit of significant events or transactions that occurred during the period.

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SAS 134 – REPORTING KEY AUDIT MATTERS (KAM)

Example Paragraph in Auditor's Report

Key Audit Matters

Key audit matters are those matters that were communicated with those charged with governance and, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

[*Description of each key audit matter in accordance with section 701*].

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ANY **QUESTIONS?**

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10 – 10:50 a.m.

Excel: Fast Track Data Cleanup

Jennifer Buchholz, MOS, MCT, *Owner and Lead Trainer, Excel & Flourish*

Excel – Fast Track Data Cleanup

Jennifer Buchholz
Excel & Flourish
2022

If you download, clean up and make meaning of mountains of data, you may find you're spending more time than necessary in that clean up phase. This session is a quick orientation to the variety of ways to clean up data in Excel with some options for automating that cleanup. We'll cover the old favorites: text to columns, text case formatting, flash fill and others. We'll also introduce you to a not so common feature for automating data cleanup – Power Query.

Automation

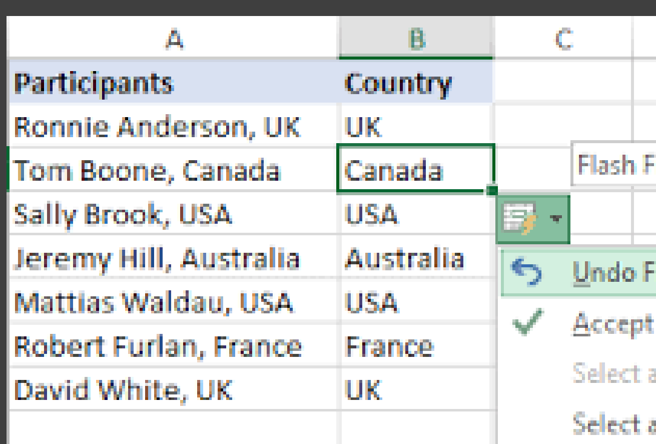
Data scientists spend
- **60%** of their time on cleaning and organizing data
- **19%** of their time collecting data sets comes

=

around 80% of their time on preparing and managing data for analysis.

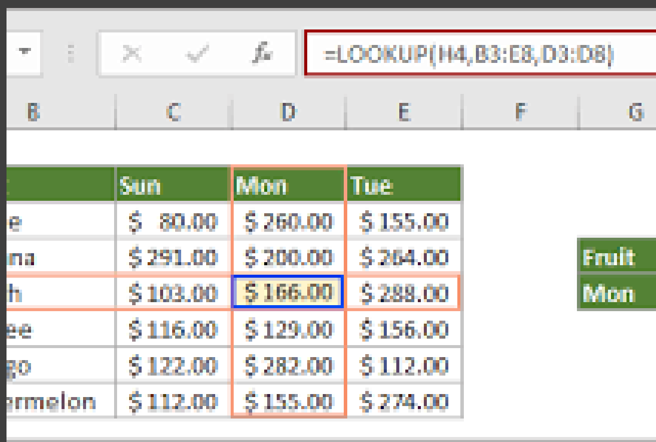
– *Forbes* 2016

NO CODE Data Cleanup in Excel



- Flash Fill
- Macros (no VBA coding required)
- PowerQuery
- Connecting Data

Connecting Data



- HLOOKUP
- VLOOKUP
- XLOOKUP
- INDEX MATCH
- Or… 2 alternatives
  - Relationships in PivotTables
  - PowerQuery

When is the last time you skilled up in Excel?

When is the last time your team skilled up in Excel?

Upcoming Classes with WICPA

- 10/19/22 Excel: Tips, Tricks & Shortcuts
- 4/14/23 Excel: Fast Track Data Cleanup

Excel & Flourish

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11 – 11:50 a.m.

Private Foundation & Donor Advised Funds Legislation

Kayla Gomski, CPA, *Senior Associate, Grant Thornton LLP*

Kelcey Leitl, CPA, *Director, Grant Thornton LLP*

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Private Foundation Pitfalls

PF rules, regulations, common pitfalls, and pending DAF legislation

September 20, 2022

Presenters

Kelcey Leitl
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Experience
Kelcey is a Director in the Not-for-Profit Tax Practice in Grant Thornton's Wisconsin practice based in the Appleton location and has over ten years of public accounting experience. During her time at Grant Thornton, Kelcey has obtained a wide range of Federal and State tax experience. Her public accounting experience includes proving tax services to a wide variety of clients, from small private companies to large multi-state companies in the manufacturing, construction, and health insurance sectors. After building a well-rounded skillset, Kelcey has specialized exclusively within the not-for-profit tax practice. She serves a variety of dynamic not-for-profit organizations, including private foundations and public charities. Kelcey is experienced in providing a wide range of services to her clients; including preparing and reviewing compliance tax returns, researching and resolving complex tax matters and assisting clients with IRS and state notices.

Professional qualifications and memberships
Kelcey is a Certified Public Accountant in Wisconsin. She is also a member of the American Institute of Certified Public Accountants and Wisconsin Institute of Certified Public Accountants.

Education
Kelcey has a Bachelor of Business Administration with majors in Accounting and Finance from the University of Wisconsin – Whitewater.

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Presenters

Kayla Gomski
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Experience
Kayla joined Grant Thornton back in 2016 and has served a variety of clients including partnerships, individuals, and tax-exempt organizations during her initial years with Grant Thornton. Kayla now utilizes her diverse skillset to serve as a manager specializing solely within Grant Thornton's Not-for-Profit tax practice. She has over 5 years of experience serving both private foundations and public charities.

Professional qualifications and memberships
Kayla is a Certified Public Accountant in Wisconsin. She is also a member of the American Institute of Certified Public Accountants.

Education
Kayla has a Master of Professional Accountancy from the University of Wisconsin – Whitewater.

Learning Objectives

1. What is a Public Charity vs. Private Foundation?
2. What are the different types of private foundations?
3. What federal information & tax returns must be filed?
4. What is the minimum distribution requirement & how is investment excise tax calculated?
5. Unrelated Business Income
6. What are the restrictions / potential PF pitfalls?
7. What are the various types of excise taxes imposed on private foundations?
8. Pending Donor Advised Fund (DAF) Legislation

What is a Public Charity vs. Private Foundation?

- **Two types of exempt organizations:**
  - Public Charity
  - Private Foundation

- **Public charity - a charitable organization (IRC §501(c)(3)) that does <u>not</u> constitute a private foundation**
  - <u>Four categories</u>: institutions (e.g., churches, educational organizations, hospitals, governmental units), publicly supported charities, supporting organizations, and organizations that test for public safety (See IRC §170(b)(1)(A)(i)-(vi))
  - Files Form 990

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What is a Public Charity V. Private Foundation? (continued)

- **Private foundation – a domestic or foreign charitable organization <u>other than</u> a public charity (IRC §509(a))**
  - Charitable organization IRC §501(c)(3)
  - Tax-exempt IRC §501(a)
  - <u>Generally</u> funded by one source (e.g., individual, family, or a business)
  - Revenue is derived from investments
  - Charitable Purpose
    - Must confine its grant making and active programs to charitable purposes
      - Foundation management must be certain that each of the foundation's grantees, or its programs, qualify under one or more rationales for being charitable
        - Organizational test (i.e., governing documents)
  - Files Form 990-PF

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What are the different types of private foundations?

- Two types of private foundations:
  - Private **Non-operating** Foundation ("PF, non-operating")
  - Private **Operating** Foundation ("POF")
- Private Non-operating Foundation - makes grants to other charitable organizations
- Private Operating Foundation - operates its own programs
  - hybrid of a private foundation and public charity (e.g., museum, library)
- Difference to the donor: charitable deduction (cash gift)
  - 30% of AGI to Private Non-operating Foundation
  - 50% of AGI to Private Operating Foundation (temporarily raised to 60%)

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Private Operating Foundation (POF)

To qualify as a POF, a foundation must satisfy numerical tests intended to ensure it conducts its exempt activities directly, rather than by supporting other organizations

- **Income Test:** Qualifying distributions directly for the active conduct of its exempt activities must be equal to substantially all (at least 85%) of the lesser of its (1) adjusted net income, or (2) minimum investment return
  - ✓ All POFs must satisfy this test

In addition to the income test, the POF must satisfy one of the following three tests:

1. Assets test
2. Endowment test
3. Support test

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Federal Information & Tax Return Filings

- Form 990-PF
  - Filed annually
  - On or before the 15th day of the fifth calendar month following the close of the period for which the return is required to be filed
    - YE December 31st = May 15th
    - YE June 30 = November 15th
  - Extension available for 6 months
  - Excise tax is payable in advance under the corporate estimated tax system
  - Document is open for public inspection
- Form 4720 – *Return of Certain Excise Taxes Under Chapter 41 and 42 of the Internal Revenue Code*, is filed to report the incidents and calculate (punitive) excise taxes

Minimum Distribution Requirement

- Minimum distribution requirement (IRC §4942)
  - Must annually distribute 5% of the average FMV of the foundation's investment assets for the preceding year
    - Noncharitable-use Assets
      - Securities/Investments, Cash
      - Due from broker account
      - Assets **not directly used** to carry on its charitable activities but may enable it to create wealth to support future charitable activities
  - No requirement for the first year of existence
- If distributions exceed the required amount, excess can be carried over for five years to offset the mandatory amount in succeeding years

Investment Income Tax – IRC §4940

- Imposes a flat 1.39% excise tax on net investment income for tax years beginning after December 20, 2019
  - For tax years beginning prior to December 20, 2019, a tax rate of 2% was imposed; with a potential reduction to 1% if certain distribution requirements were met
- Tax is calculated in Part V of Form 990-PF
- Tax is paid annually and quarterly estimates are required if the tax is estimated to be $500 or more
  - Installments: 15th day of the fifth, sixth, ninth, and twelfth months
  - Unpaid tax is subject to underpayment penalty, plus interest

Investment Income Tax – IRC §4940 (continued)

- **Net** investment income includes:
  - Gross investment income
  - Add: Net capital gain
  - Less: allowable deductions
- **Gross** investment income includes:
  - Dividends
  - Interest
  - Rents
  - Royalties
  - Security loan payments
  - Income from annuities, derivatives and similar investments
- **Gross** investment income does **not** include any income subject to unrelated business income tax (UBIT)

Investment Income Tax – IRC §4940 (continued)

- **Expenses**
  - Ordinary and necessary expenses incurred for the production of gross investment income are allowed as deductions against gross investment income including a portion of foundation's operating expenses attributable to investment activities
    - Expenses paid that are allocable to tax-exempt interest are not deductible
  - No specific method of allocating expenses is required. The method chosen must be reasonable and applied consistently.
  - Expenses that are incurred for both investment and charitable purposes must be allocated between the investment / charitable activities
    - i.e. compensation, employee benefits, professional fees, etc.

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Alternative Investments

- Separate entity for federal tax purposes
- §512(c) provides a look-through for UBIT purposes
- Activities **attributed** to partners
  - Pass-through taxation to partners
- Activity from the K-1 is reportable with the foundation's Net Investment Income on the 990-PF…unless it is UBI

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Unrelated Business Income (UBI) - Exclusions

- Exclusions from Unrelated Trade or Business under §513
  - Activities in which substantially all work is performed by **volunteers**
  - Activities operated for the **convenience** of members, students, patients, or employees
  - Sales of merchandise that is substantially all **donated** to the organization
- Exclusions from Unrelated Trade or Business under §512
  - Dividends, payments for securities loans, interest, annuities, royalties, rental income from real property, capital gains

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Unrelated Business Income (UBI) – Exclusion Exceptions

- Exceptions to § 512 exclusions:
  - Rents
    - Personal property included
    - Services provided
  - Income from controlled subsidiary
    - Rents, Interest, Annuities, Royalties
  - Unrelated debt-financed income

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Unrelated Business Income (UBI)

- Unrelated business income is income from a **regularly-carried-on trade or business** that is **not substantially related** to the organization's exempt purpose

- UBI common to PFs:
  - UBI generated from K-1s – Partnership, S-Corp, LLC Income
    - Look for UBI footnote or Code "V" in Box 20 of the 1065 Sch K-1

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UBI Tax Filings

- Form 990-T, *Exempt Organization Business Income Tax Return*
  - Must file for each year gross UBI is $1,000 or greater
  - Due on before the 15th day of the fifth calendar month following the close of the period (same as Form 990-PF)
  - Extension available for 6 months
  - Document is open for public inspection
- States
  - Some states do not impose taxes on UBI
  - Some states have no UBI threshold for filing

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Investment Income: K-1s from Partnerships, S-Corps, and LLCs

- **Included in UBTI:**
  - Passive income generated through use of borrowed funds (specifically debt-financed)
  - Understand what is generating the partnership income to determine if it is Unrelated Business Income
  - All **S corporation** income is UBI
    - Gain/loss on disposition of S corporation is UBI

Misconception: You do not need to be a general partner or controlling member for UBI to be generated

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Investment Income: K-1s from Partnerships, S-Corps, and LLCs (continued)

Other Considerations

- Reportable Transactions disclosed on K-1s may require filing Form 8886
- International Filings
  - Penalties can range from 10% up to $100,000 for failure-to-file
  - Various Forms that may be required to file
    - Forms 926 and 5471 (foreign corporations)
    - Form 8865 (foreign partnership)
    - FBAR (offshore accounts)

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Private Foundation Restrictions

- There are several restrictions and requirements on private foundations, including:
  - Restrictions on self-dealing between private foundations and their substantial contributors and other disqualified persons;
  - Requirements that the foundation annually distribute income for charitable purposes;
  - Limits on their holdings in private businesses;
  - Provisions that investments must not jeopardize the carrying out of exempt purposes; and
  - Provisions to assure that expenditures further exempt purposes

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Disqualified Person

- A disqualified person is:
  - Substantial contributor
  - Foundation manager
  - Person who owns more than 20% of a corporation, partnership, trust that is itself a substantial contributor
  - Family member of an individual described above
  - Corporation, partnership, trust or estate in which persons described above own a total interest of more than 35%
  - Certain government officials

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Disqualified Person (continued)

- Substantial contributor:
  - Contributed more than $5,000 to the private foundation **AND**
  - That amount exceeded 2% of total contributions received in the taxable year and all prior years
    - 2% test includes all contributions received during the cumulative period of the foundation's existence
  - Once a substantial contributor, the person will remain such for all future years (typically)

Disqualified Person (continued)

- Substantial contributor (continued):
  - A person ceases to be a substantial contributor if the person (and all related persons):
    - Has not made any contributions to the foundation during the 10-year period ending with that tax year, **AND**
    - Was not a foundation manager of the foundation at any time during that 10-year period, **AND**
    - Contributions are determined by the IRS to be insignificant compared to the total contributions to the foundation by **one other person**
- Foundation manager:
  - Includes an officer, director, or trustee of a foundation, or an individual who has similar powers or responsibilities

Disqualified Person – Foundation Manager

- Includes an officer, director, or trustee of a foundation, or an individual who has similar powers or responsibilities
- Officer
  - Unless otherwise provided, a person elected or appointed to manage daily operations during the tax year (president, VP, secretary, treasurer, and possibly board chair).
  - Determined by organizing documents/bylaws or state law.
  - Also, treat the top financial officer and top management official as an officer.

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Disqualified Person – Family Member

- Includes only the individual's spouse, ancestors, children, grandchildren, great-grandchildren, and the spouses of children, grandchildren, and great-grandchildren
- Brothers and sisters of an individual donor are not members of the donor's family
- The spouse of a grandchild of an individual would be
- Legally adopted child of an individual is treated as a child of such individual by blood

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Self-Dealing – IRC §4941

- Imposes a tax on a disqualified person for each act of self-dealing between the disqualified person and the foundation
- Self-dealing is defined as participating in any of the six specific direct or indirect transactions between the disqualified person and the foundation
- A disqualified person is defined based on their relationship with the foundation and directors

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Participation in an act of self-dealing

- A person is considered to have participated in a transaction knowing that it is an act of self-dealing only if:
  - The person has actual knowledge of enough facts so that, based only upon those facts, the transaction would be an act of self-dealing
  - The person is aware that such an act may violate federal tax law governing self-dealing
  - The person negligently fails to make reasonable attempts to learn whether the transaction is an act of self-dealing, or the person is aware that the transaction is an act of self-dealing

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Participation in an act of self-dealing (continued)

- A disqualified person who engages or takes part in a transaction alone or with others will be treated as participating in an act of self-dealing
- Participation by a foundation manager includes silence or inaction on the manager's part where there is a duty to speak or act. However, a foundation manager will not have participated in an act of self-dealing when the manager has opposed the act in a manner consistent with carrying out the manager's responsibilities to the private foundation.

Self-Dealing – IRC §4941 (continued)

Self-dealing includes certain, specified transactions between the private foundation and disqualified persons:

- the sale, exchange or lease of property;
- lending money or extending credit
- furnishing goods, services or facilities
- payment of compensation or reimbursement
- transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation; and
- agreement by a private foundation to make any payment of money or other property to a government official [with exceptions]

Note: Self-dealing is defined without regard to whether the transaction is to the detriment or benefit of the private foundation

Self-Dealing – Sales/Exchanges

- Sale or exchange of property is self-dealing regardless of the size of the transaction and regardless of benefit to the foundation
- Transfer of real or personal property subject to a mortgage or similar lien which the foundation assumes, or property subject to a mortgage or similar lien which a disqualified person placed on the property within the last 10 years
- If the disqualified person leases property to a foundation without charge it may not be an act of self-dealing
  - However, it could become self-dealing if building improvements became part of the real property and increase the value

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Self-Dealing – Loans

- Lending of money by a disqualified person - shall not be an act of self-dealing if:
  - the loan is without interest or other charge, and
  - the proceeds of the loan are used exclusively for charitable purposes

- A pledge by a disqualified person is not considered an extension of credit as long as it's motivated by charitable purposes

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Self-Dealing – Goods, Services, or Facilities

- Furnishing of goods, services and facilities applies to providing such items as office space, secretarial help, meals, publications, cars, parking lots, laboratories, libraries, etc.
- Providing to a manager or volunteer is not self-dealing if the value is not excessive and the service/good **is necessary** to carry out the position
- Foundation can provide goods/services to disqualified person if such item or service is made on a basis no more favorable than to the general public

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Self-Dealing – Goods, Services, or Facilities (Continued)

- Furnishing of goods, services, or facilities by a disqualified person shall not be an act of self-dealing if:
  - The furnishing is without charge, and
  - If the goods, services, or facilities so furnished are used exclusively for charitable purposes

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Self-Dealing – Goods, Services, or Facilities (Continued)

- Furnishing of goods, services, or facilities to a disqualified person shall not be an act of self-dealing if:
  - Such furnishing is made on a basis no more favorable than that on which such goods, services, or facilities are made available to the public

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Self-Dealing – Compensation

- Generally, compensation or reimbursement of expenses to a disqualified person is an act of self-dealing
- Payments for personal services necessary to the exempt purpose is not considered self-dealing as long as the amounts are not excessive
- Services allowed are limited to managerial and professional services (i.e. janitorial services are not exempted)
- Payment of compensation (and the payment or reimbursement of expenses) to a disqualified person for personal services is not an act of self-dealing if:
  - Compensation is reasonable and necessary to carrying out the exempt purpose, and
  - Amount is not excessive

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Self-Dealing – Compensation (Continued)

- Excessive compensation is a subjective matter. One resource is:
  - Guidestar Non-Profit Compensation Report
- Excessive compensation paid for services that are reasonable and necessary to the exempt purpose may be corrected by repaying the excessive amount
- Termination of the employment or independent contractor relationship is not required

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Self-Dealing – Transfer/Use of Foundation Assets

- Examples of use of foundation assets self-dealing acts includes:
  - Payment or guarantee of a disqualified person's loan
  - Purchase or sale of stock if it is an attempt to manipulate the price to the advantage of a disqualified person
  - Grants or other payments made to satisfy the legal obligation of a disqualified person
  - Payment of a foundation manager's 'compensatory expenses' unless included as compensation

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Self-Dealing – Payment to a government official

- Agreement to pay money or property to a government official will generally be an act of self-dealing unless certain limited exceptions apply

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Indirect Self-Dealing

- Transactions between a disqualified person and an organization controlled by the private foundation
- An organization is considered controlled if:
  - The foundation, one or more foundation managers or a disqualified person, by aggregating their votes, require the organization to engage in a transaction that would be self-dealing

- Contribution to a public charity that is earmarked for the use of a disqualified person

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Tax on self-dealing

- On Self-dealer
  - A 10% first-tier tax is imposed on the amount involved
  - A 200% second-tier tax is imposed if the original act is not corrected within the taxable period
- On Foundation manager
  - A 5% first-tier tax is imposed if the manager took part in the act knowing it was self-dealing except those Foundation managers whose participation was not willful and was due to reasonable cause
  - A 50% second-tier tax is imposed if the manager refuses to agree to part or all of the correction of the self-dealing act

Tax on self-dealing

- Limits on liability for management: The maximum initial tax imposed on the foundation manager is $20,000 and the maximum additional tax is $10,000 for any one act

- There is no maximum on the liability of the self-dealer, including one who is a foundation manager

Self-Dealing - Real Examples

- Payment of DQ's (legally enforceable) charitable pledge
- Memberships / special privileges
  - i.e. symphony tickets with donation at a certain level, use of special lounge access only available to donors at certain level
  - Must be disclaimed upfront
- Benefit tickets
  - Bifurcation **NOT** IRS approved
  - PF purpose that **requires** attendance?
  - Must be disclaimed upfront
- Incidental or tenuous benefits ok
  - i.e. public recognition, naming rights, use as a member of the public

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Self-Dealing - Real Examples (continued)

- Sharing of Space:
  - PF should be billed and pay their share of costs directly to unrelated parties
  - Otherwise use by PF must be at no charge ("donated")
- Sharing of personnel:
  - Allows for the PF to pay "reasonable and necessary" compensation to a DQ person for the performance of **personal** services
    - What is "personal"? (not defined by statute or regs)
      - Accounting, legal, finance, investment = Yes
      - "essentially professional and managerial in nature"
      - Janitorial, maintenance, repair, cleaning, landscaping services = No
      - "operational services" do not qualify

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Undistributed Income – IRC §4942

- Required to spend or pay out, for charitable and administrative purposes, at least 5% of the average FMV for the preceding year of its investment assets
- A 30% initial tax is imposed for any undistributed income not distributed before the first day of the succeeding tax year
- Initial tax may not be imposed if the foundation can prove that failure to distribute was due to reasonable cause and not willful neglect
- Part XII, *Undistributed Income,* of Form 990-PF is used to compute the amount of any undistributed income from the current and prior years

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Excess Business Holdings – IRC §4943

- Excess business holdings consist of stock or other interest in a business enterprise that the foundation must dispose of to a person other than a disqualified person for its remaining holdings to be treated as permitted holdings
- Foundation is normally permitted to hold up to 20% of voting stock of a business enterprise
    - Can be up to 35% in certain circumstances
- A 10% first-tier tax is imposed
- A 200% second-tier tax of excess holdings at the end of the taxable year is imposed if not disposed of

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Excess Business Holdings – IRC §4943 (continued)

- Business enterprise is an active trade or business but does not include:
  - Trade or business that derives at least 95% of its gross income from passive sources
  - A functionally related business
- Private foundations may not own a sole proprietorship
- If a foundation has excess business holdings due to a gift/bequest – it has 5 years to reduce its business holdings to permissible levels (5 year extension may be available)

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Jeopardizing Investments – IRC §4944

- Tax on investments that jeopardize a private foundation's charitable purpose
- Determination is made when the investment is made. Once it is determined it that it does not jeopardize the exempt purpose, it will never be considered a jeopardy.
- Investments are evaluated on an investment-by-investment basis. However, the following should be cautioned:
  - Trading in securities on margin or futures
  - Investments in working interests in oil and gas wells
  - Purchase of puts, calls, straddles and warrants
- First-tier tax is 10% of the amount invested for each year
- Second-tier tax is an additional 25% of the amount invested

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Taxable Expenditures – IRC §4945

- Tax is imposed on foundation and any foundation manager who knowingly and willfully agrees to the expenditures
- Taxable expenditures include amounts paid:
  - To carry on propaganda or attempt to influence legislation
  - To influence the outcome of any public election or to carry on any voter registration drive
  - As a grant to an individual for travel, study or other similar purposes
    - Note: **prior** IRS approval for these can permit them
  - To non-qualified recipients

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Taxable Expenditures – IRC §4945 (continued)

- Taxable expenditures include amounts paid (continued):
  - As a grant to an organization unless it is:
    - A public charity under IRC §509(a)(1) or §509(a)(2)
    - A public charity under §509(a)(3)
      - Different rules/disallowance for non-functionally integrated
  - For any purpose other than an exempt purpose
  - Extra considerations with PF to PF giving
- First-tier tax is equal to 20% of the amount of each taxable expenditure
- Second-tier tax is equal to 100% of the expenditure

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Expenditure Responsibility

- PF is responsible to exert all reasonable efforts and establish adequate procedures to:
  - See that the grant is spent solely for the purpose for which it was made
  - Obtain full and complete reports from the grantee on how the funds were spent
  - Make full and detailed reports to the IRS (via Form 990-PF)
- Perform pre-grant inquiry
- Obtain grant agreement with ER obligations
- Have a monitoring system in place
- No less than annual grantee reports
  - Require the return of grant funds for non-compliance
- Submit results of ER work on 990-PF for each year grant is outstanding
  - Outstanding dollars or reports

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Grant-making, in general

- Rev Proc 2018-32
  - Sets forth the extent to which grantors and contributors may rely on the listing of an organization in IRS databases
- Need to go beyond 501(c)(3)… what kind of c(3)
  - Coding system of PF: PC, NC, SO, etc.
- Was the organization auto-revoked?

Foundation Status of Recipient

Use the following codes:

PF	Private non-operating foundation (section 509(a))
POF	Private operating foundation (section 4942(j)(3)) other than an EOF
EOF	Exempt operating foundation (section 4940(d))
PC	Public charity described in section 509(a)(1) or (2)
GOV	Domestic or foreign government (including Indian tribal governments) or instrumentality, or international organization designated by Executive Order under 22 U.S.C. 288
SO-DP	Type I, Type II, or Type III functionally integrated supporting organization if a disqualified person of the private foundation controls the supporting organization or a supported organization (sections 509(a)(3) and 4942(g)(4))
SO I	Type I supporting organization (sections 509(a)(3) and 509(a)(3)(B)(i)) other than an SO-DP
SO II	Type II supporting organization (sections 509(a)(3) and 509(a)(3)(B)(ii)) other than an SO-DP
SO III FI	Functionally integrated Type III supporting organization (sections 509(a)(3), 509(a)(3)(B)(iii), and 4943(f)(5)(B)) other than an SO-DP
SO III NFI	Non-functionally integrated Type III supporting organization (sections 509(a)(3), 509(a)(3)(B)(iii), and 4943(f)(5)(B))
TPS	Testing for public safety organization (section 509(a)(4))
NC	Organization not otherwise classified
I	Individual person

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Punitive Excise Taxes

Sanction	Imposed on who	1st Tier Rate	Imposed on	2nd Tier Rate	Assessed
Self Dealing	On self dealer	10%	Amount involved	200%	If not corrected
Self Dealing	On manager	5%	Amount involved/yr*	50%	If mgr refuses correction
Undistributed income	On private foundation	30%	Undistributed income/yr	100%	Each yr remains undistributed
Excess bus holdings	On private foundation	10%	FMV of excess holdings/yr	200%	Excess holdings
Jeopardizing investments	On private foundation	10%	Amount invested/yr	25%	Amount not removed
Jeopardizing investments	On manager	10%	Amount invested/yr**	5%	If mgr refuses correction
Taxable expenditures	On private foundation	20%	Each taxable expenditure	100%	Uncorrected expenditure
Taxable expenditures	On manager	5%	Each taxable expenditure***	50%	If mgr refuses correction

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Donor Advised Fund (DAF)

- A DAF, as defined by IRC 4966(d)(2), is a fund or account that is:
  - Separately identified by reference to contributions of a donor or donors
  - Owned and controlled by a sponsoring organization, and
  - With respect to which a donor (or any person appointed or designated by such donor) has, or reasonably expects to have, advisory privileges with respect to the distribution or investment of amounts held in such fund or account by reason of the donor's status as a donor

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Current DAF Legislation

- PFs are currently permitted to give grant funds to DAFs
- These contributions are allowed in the calculation of the PFs annual distribution requirements as a charitable disbursement
- Additional Form 990-PF disclosure if **both** are met
  - Foundation makes a distribution to a DAF, and
  - Foundation or any of its disqualified persons had advisory privileges over the DAF

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Proposed Legislation

Accelerating Charitable Efforts (ACE) Act

- New DAF classifications:
  - Qualified Donor Advised Fund
  - Qualified Community Foundation Donor Advised Fund
  - Nonqualified Donor Advised Fund
- Qualified Donor Advised Fund – DAFs with a written agreement that terminates the donor's advisory privileges for any contribution to the DAF within the 14 years following the year the contribution was made
  - The donor would receive a deduction at the time of the contribution only if a preferred organization has been identified for the purpose of making a distribution if one has not been made before advisory privileges terminate

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ACE Act (continued)

- Qualified Community Foundation Donor Advised Fund – is a DAF that is owned or controlled by a Qualified Community Foundation and meets at least one of the following:
  - Maximum Value of Advisory Privileges: no individual can have advisory privileges with respect to more than $1M, in total, held across DAFs sponsored by the qualified community foundation
  - Minimum Payout: the DAF is established under an agreement that requires qualified distributions of at least 5% of the value of the DAF's assets in each calendar year (as of the last day of the preceding calendar year)

ACE Act (continued)

- Qualified Community Foundation
  - An organization described in §501(c)(3)
  - Organized and operated for the purpose of understanding and serving the needs of a particular geographic community that is no larger than 4 States by engaging donors and pooling donations to create charitable funds to further those needs; <u>and</u>
  - Holds substantial assets (at least 25% of the organization's total assets) outside of donor advised funds

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ACE Act (continued)

- Changes to Qualified DAFs and Qualified Community Foundation DAFs
  - Generally unchanged for contributions of cash and publicly traded assets
  - Contributions of non-publicly traded assets (no readily available market quotations on an established securities market) – NO deduction would be allowed until the sponsoring organization sells the asset.
    - Deduction limited to the proceeds and credited to the account of fund identified with the donor

ACE Act (continued)

- Nonqualified Donor Advised Fund – DAFs other than Qualified DAFs and Qualified Community Foundation DAFs
- New restrictions for contributions to Nonqualified DAFs
  1. Non-cash Contributions: The donor would not be allowed a deduction unless the sponsoring organization sells the contributed assets and makes a qualifying distribution.
  2. All Contributions: The donor would not be allowed a deduction until the taxable year the sponsoring organization makes a qualifying distribution of the contribution (or the proceeds from the sale of the contribution)
  3. The amount of the deduction would be limited to the amount of the corresponding qualifying distribution

ACE Act (continued)

- New restrictions to contributions to Nonqualified DAFs (continued)
  4. Contributions would be required to be distributed within 50 years of donation or an excise tax would be imposed on the sponsoring organization (applicable to both Qualified DAFs and Nonqualified DAFs – not applicable for Qualified Community Foundation DAFs)

- Qualifying Distribution = a distribution that is not made to another DAF and that is not a taxable distribution under section 4966(c)
- Ordering Rule = Distributions treated on a first-in, first-out basis as made from contributions and earnings

ACE Act (continued)

- Additional changes:
  - Restrictions of PF administrative expenses paid to Disqualified Persons
    - Would not allow administrative expenses paid to DQs of the PF to be treated as qualifying distributions (except for those paid to foundation managers who are not also family members of other DQs)
  - Treatment of distributions to DAFs from PFs
    - The bill prohibits a distribution made to a DAF from being treated as part of the 5% annual payout (unless the DAF makes a qualifying distribution in the same year)
    - Certain reporting requirements would also be required with respect to private foundations that make contributions to a DAF.

ACE Act (continued)

- Additional changes (continued):
  - Exempts a private foundation that makes a significant qualifying distribution of 7% or more of the private foundation's assets (other than its direct-use assets) from the 1.39% excise tax for that taxable year
  - Exempts certain "limited-duration" private foundations from the excise tax on investment income
    - A recapture tax would apply if a private foundation initially meets the requirements but then later fails to meet the requirements

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Questions?

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