WINDES
AUDIT | TAX | ADVISORY

# WINDES NONPROFIT ADVISOR

The Windes Nonprofit Advisor is a periodic technical publication focusing on the tax, regulatory, and accounting issues that nonprofit organizations routinely confront.

The Windes Nonprofit Group possesses extensive experience in preparing and reviewing more than 150 Forms 990, 990-T, 990-PF, and state tax-exempt forms, in addition to having experience in the preparation and filing of both federal and state tax exemption applications for public charities, private foundations, and other exempt organizations. Furthermore, we can assist in providing valuable guidance (governance / reasonable compensation documentation / public support test / special events / lobbying / transactions with related parties) to nonprofit organizations.

The Windes Nonprofit Group prepares audited financial statements and ERISA audits for more than 85 nonprofit organizations. For retirement plans, Windes has experts on staff for 403(b) plan administration and compliance, including plan document issues, Form 5500 preparation and filing, non-discrimination testing, and government compliance programs.

Our Nonprofit Group is composed of the following individuals who are dedicated to providing nonprofit organizations with high-level tax, regulatory and accounting consulting, tax compliance services, and financial statement audit and assurance services:

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# The Impact of Tax Reform on Nonprofit Organizations

On December 2, members of the Senate joined their House counterparts in passing a new tax plan. As a result, the competing tax plans went into a reconciliation process with a tentative agreement on a reconciled tax plan announced on December 13, which increased the likelihood that the new tax plan will be signed into law by the President before the end of the year. The expected tax framework will affect almost every taxpayer (individuals and businesses), and its provisions have the potential to have longstanding impacts on the nonprofit sector.

We do not yet have details of the reconciliation between the two plans. However, upon initial review of the competing plans, below are some elements thought to have the largest potential impact on the nonprofit sector:

## Standard Deduction and Incentives for Charitable Giving

Both the House and Senate versions of the law would roughly double the standard deduction for taxpayers, resulting in an expected reduction of the number of taxpayers who itemize their deductions from 30% of taxpayers to roughly 5%. In addition, both versions of the law would raise the limit on cash donations for those who still itemize and would repeal the “Pease limitation” on itemized deductions that currently limits deductions for upper-income individuals. As a result of this change in law, the charitable deduction would be out of reach for 95% of taxpayers, potentially reducing the incentive for charitable giving. The nonpartisan Joint Committee on Taxation (“JCT”) estimates that giving to charitable nonprofits could fall by more than $13 billion each year due to this change. While the loosening of the charitable deduction limitations and repeal of the “Pease limitation” would be helpful, that would only affect the 5% of taxpayers who still itemize. Congress considered compensating for this by offering additional universal deductions for charitable contributions, but neither the House nor Senate included this in its final bill.

## State and Local Tax (SALT) Deductions

Both the Senate and House versions of the law repeal the deductibility of state and local income taxes and would cap property tax deductions at $10,000. The possible impact on charitable nonprofits is that it would likely increase pressure on state and local governments to enact tax and spending cuts, leading to elimination of programs serving people in need and increasing the burdens on charitable nonprofits and foundations to fill the gaps.

## Estate Tax

Both the Senate and House versions of the tax bill would essentially double the exemptions on the estate tax to about $11 million for individuals and $22 million for couples. The JCT estimates this will cost the Treasury an estimated $94-$151 billion dollars over 10 years. The estate tax is an important source of revenue for the work of charitable nonprofits, as it encourages donors to address future needs in their communities through estate planning. Raising the estate tax exemptions disincentivises this sort of planned giving.

## Private Foundation Excise Tax

The House version of the tax bill would establish a streamlined private foundation excise tax of 1.4% on net investment income that is between the current rates of 2% and 1%. The Senate version makes no changes to current law. The JCT estimates that the House's plans will raise about $500 million in revenue over a decade, which means that it is a tax increase on private foundations that will result in fewer or smaller grants to charitable organizations.

## Nonprofit College and University Endowments

Both the Senate and House versions would create a new 1.4% excise tax on net investment income of nonprofit colleges and universities. The threshold impacted varies by bill, as the House calls for taxes on assets of greater than $250,000 per full-time student (minimum 500 students) and the Senate version calls for taxes on assets of greater than $500,000 per full-time student (minimum 500 students). The impact of this will result in fewer earnings on endowments being available to support the mission of the university or college. It could also dissuade future endowment giving, as a donors may be wary that the earnings on their gifts will be going to the Treasury as opposed to supporting the mission of the organization.

## Executive Compensation

The House and Senate versions of the law would subject tax-exempt organizations to an excise tax on compensation in excess of $1 million paid to any of their five highest-paid employees during the tax year. The excise tax would apply to all compensation paid to a covered person for services, including cash and the cash value of all compensation (including benefits) paid in a medium other than cash. Payments to a tax-qualified retirement plan and amounts that are excludable from the executive's gross income would be excluded from the excise tax. The Senate version of the bill would expand and modify the excise tax on excess benefit transactions (i.e. coaches and investment advisers become disqualified persons).

## Other

There are other changes proposed related to The Johnson Amendment, private activity bonds, unrelated business income, donor-advised funds, and volunteer mileage rates.

## Conclusion

While we wait on the final details of the reconciled plan, we encourage all stakeholders in the nonprofit sector to educate themselves on the proposed changes and prepare for the future.

If you have any questions about these matters and how your interactions with the nonprofit sector could be affected, please contact Michael Barloewen at mbarloewen@windes.com, Donita Joseph at djoseph@windes.com, or call toll free at **844.4WINDES** (844.494.6337).

# IRS Announces 2018 Retirement Plan Cost of Living Adjustments and Work Plan

The IRS has announced cost of living adjustments (COLA) applicable to qualified plans along with the issues they will be focusing on in plan examinations during the coming year.

The limit on elective deferrals to 401(k), 403(b), and 457 plans will increase from $18,000 to $18,500. Catch-up contributions will remain limited to $6,000.

The limitation on contributions to participants (including 401(k) or 403(b) amounts, but excluding catch-up contributions) increases from $54,000 to $55,000. The limit on the annual benefit paid from a defined benefit plan is raised from $215,000 to $220,000.

The annual compensation that can be considered for retirement plan purposes increases from $270,000 to $275,000. The threshold for determining a highly compensated employee remains at $120,000 paid in the prior year.

A full list of the COLA adjustments can be found at the following address:

https://www.irs.gov/retirement-plans/cola-increases-for-dollar-limitations-on-benefits-and-contributions

In September, the Tax Exempt/Government Entity division of the IRS announced their 2018 compliance program. Their "compliance strategies" for next year include examining plans with the following attributes:

- **Mergers/consolidations:** plans with transferred assets due to a merger or acquisition.
- **Discrimination:** Plans that have failed the "gateway" test or the Actual Deferral Percentage (ADP) (elective deferrals) or Actual Contribution Percentage (ACP) (matching) tests. *Note that 403(b) deferrals are not subject to the ADP test.*
- **Disclosure:** Plans that fail to provide timely notices to employees, including a safe harbor notice.
- **Coverage:** Plans that failed to meet the Universal Availability requirements and other coverage failures for non-403(b) plans.
- **Distributions:** Plans that failed to make required minimum distributions, plans that permitted improper hardship withdrawals, or that distributed an incorrect benefit amount.
- **Contributions:** Plans that made erroneous allocations of contributions or improper use of forfeitures due to utilization of an incorrect definition of compensation. Also, plans that failed to make matching contributions per the plan terms.
- **Elective Deferrals:** Plans that failed to withhold the proper amount of elective deferrals per participant elections, and Section 457 plans with excess deferrals. The IRS will also examine plans with participants that have utilized the special 15-year catch-up contribution available only to 403(b) plans.

In addition to the above issues, the IRS indicated that they will extensively use “Compliance Checks” targeting 403(b) and 457(b) plans. These information requests require only a mailed in response, but can result in an expanded audit.

If you have any concerns over your plans compliance with any of these audit issues, please contact Richard Green at rgreen@windes.com or toll free at **844.4WINDES** (844.494.6337).

# FASB Proposes Changes to Nonprofit Grant and Contribution Accounting Aiming to Resolve a Longstanding Diversity of Practice

The Financial Accounting Standards Board (FASB) issued a proposed Accounting Standard Update (ASU) intended to clarify and improve the scope and the accounting guidance for contributions received and made primarily by nonprofits. Stakeholders were asked to review and provide comment on the proposed ASU and the comment period was completed on November 1, 2017.

This new standard was prompted in response to the recently issued ASU 2014-09, Revenue from Contracts with Customers, which raised questions in the nonprofit world as to whether grants and contracts are in the scope of that guidance. This led FASB to determine that a response was necessary to finally address a longstanding diversity of practice among accountants regarding the appropriate classification of federal and state grants as either contributions or exchange transactions.

## History

For revenue recognition for nonprofit organizations, the distinction between contribution and exchange (or reciprocal vs. nonreciprocal) is critical and can significantly alter the timing of revenue recognition on the contract or agreement. For government contracts, many accountants (and organizations) simply conclude that, in many cases, the federal or state government is purchasing goods or services because they believe that government transactions are reciprocal in nature (that is, the government expects commensurate value in return). They also point to the government's service delivery requirements (for example, eligibility requirements), its proposal process for soliciting and awarding grants for the acquisition of desired goods or services, its ability to disallow grant expenses incurred, and other reimbursement requirements as indicators that many government grants are exchange transactions. There is also a widely-held belief that a government body simply does not make contributions. Therefore, these accountants and organizations will account for transactions as exchange transactions even when the substance of the transaction may strongly suggest that contribution guidance should be used.

Alternatively, other accountants and organizations may reasonably conclude that federal and state government grants often represent contributions, because the time and place of service delivery for programs are usually at the discretion of the organization; the grant amount is typically less than the total program cost; and the assets are delivered to individuals or organizations other than the government.

This has created a longstanding diversity of practice that has always been more or less tolerated with the official position of the relevant accounting standards being that each government grant should be evaluated based on its specific requirements.

## Objective of exposure draft

The proposed new standard aims to clarify revenue recognition related to characterizing grants as either exchanges (reciprocal) or contributions (nonreciprocal), and in distinguishing between conditional and

unconditional contributions. The proposed ASU provides nonprofit organizations with a more robust framework to evaluate and determine proper accounting for contracts. The guidance addresses two key issues in determining proper revenue recognition treatment.

The first issue is evaluating whether we are talking about reciprocal (exchange) vs. nonreciprocal (nonexchange/contribution) transactions, and this takes a more narrow view than is typically practiced, which will likely result in many contracts currently accounted for as “exchange” to be accounted for as “nonexchange.”

The second issue relates to those determined to be contributions (“nonexchange”) and provides guidance regarding conditional or unconditional treatment of these contributions. There is more information provided about what must be present to determine whether a donor imposed condition exists.

Examples included in the exposure draft help clarify this analysis. It seems clear from the exposure draft that the result of this standard, should it be approved and issued, will be to reduce the amount of contracts currently accounted for as “exchange” transactions and create a framework for having more contracts accounted for as conditional contributions. It seems likely that federal and state contracts are most likely to have their accounting treatment changed as a result of the proposed standard.

## Effective date and conclusion

The proposed standard is intended to follow the same effective dates as the aforementioned ASU 2014-09, Revenue from Contracts with Customers, and is meant to be considered in conjunction. That means that, assuming the exposure draft is finalized, a typical nonprofit organization with a calendar year-end will adopt both of the new revenue recognition standards in the year ended December 31, 2019.

The comment period on this proposed guidance has now passed. All eyes will be on the Nonprofit Advisory Committee’s (NAC) next meeting scheduled for December 2017, during which a summary of feedback is likely to be discussed, as well as an updated timeline for potential finalization of the standard, which had been tentatively scheduled for the second quarter of 2018.

For questions or more information, please contact Michael Barloewen at mbarloewen@windes.com or toll free at **844.4WINDES** (844.494.6337).

# Cybersecurity Risk Management

While organizations today enjoy the benefits from having systems connected to cyberspace, they must contend with the significant risks of theft, fraud, and abuse. Therefore, organizations must take an active role in mitigating these risks. As potential threats become more sophisticated and frequent, cybersecurity has become a top issue for management, boards of directors, and audit committees. There is an interest in timely and useful information to validate that organizations have adequately identified and mitigated risks and that processes are in place to minimize damage, recover data, and ensure continuous operations in the event of a breach.

Recognizing these trends, the American Institute of Certified Public Accountants (AICPA) has recently issued the Cybersecurity Risk Management Reporting Framework. This guidance helps organizations develop and communicate their cybersecurity risk management programs. Organizations can now engage CPAs to examine and provide an opinion on the design and effectiveness of their cybersecurity risk management programs. This examination service is part of the System and Organization Controls (SOC) set of attestation services. Organizations may already be familiar with SOC 1, 2, and 3 services.

The Cybersecurity Risk Management Reporting Framework comprises the following components:

### Management's Description of an Entity's Cybersecurity Risk Management Program (Description Criteria)

This criteria has been developed as a tool to help an organization explain its risk management program in a consistent and understandable manner. The description criteria is categorized into various sections, a few of which address the nature of information at risk, program objectives relating to confidentiality and integrity of data, significant cybersecurity risk, and cybersecurity risk governance structure.

### Trust Services Control Criteria for Security, Availability and Confidentiality (Control Criteria)

This criteria is a tool for organizations and CPAs to use in evaluating the effectiveness of controls within an organization's cybersecurity risk management program. This tool will be quite valuable for an organization's management in developing and monitoring its cybersecurity risk program, whether or not the organization plans to report externally.

As potentially damaging cyberattacks continue to affect more organizations, and as news about cybersecurity, hacking, ransomware, and data breaches becomes commonplace, organizations are becoming increasingly concerned about their susceptibility.

Here are some questions organizations should answer to evaluate their risk:

- Have we identified all the types of sensitive data in our organization, and do we have an inventory of where that data resides?

- How well-protected is our high-value and sensitive information?
- How often do we assess our susceptibility to compromised data, and what were the results of the most recent test?
- How quickly would we know if we had a security breach?
- Do we have a plan of action in place in the event of a breach?
- Do we have cybersecurity insurance coverage and what are its limitations?
- Do our cybersecurity functions have access to adequate resources?

In our ongoing efforts to ensure that we provide relevant and valuable services, Windes has developed a cybersecurity practice that can help identify, evaluate, measure, and manage cybersecurity risks. In addition, we encourage you to explore the AICPA's Cybersecurity Resource Center, which is hosted on the AICPA website and contains a number of tools, training, and relevant articles that are useful to organizations and their boards.

If you have questions or would like more information, please contact Jeremy King at jking@windes.com or **844.4WINDES** (844.494.6337).

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Windes is a recognized leader in the field of accounting, assurance, tax, and business consulting services. Our goal is to exceed your expectations by providing timely, high-quality, and personalized service that is directed at improving your bottom-line results. Quality and value-added solutions from your accounting firm are essential steps toward success in today's marketplace. You can depend on Windes to deliver exceptional client service in each engagement. Since 1926, we have gone beyond traditional services to provide proactive solutions and the highest level of capabilities and experience.

The Windes team approach allows you to benefit from a wealth of technical expertise and extensive resources. We service a broad range of clients, from high-net-worth individuals and nonprofit organizations, to privately held businesses. We act as business advisors, working with you to set strategies, maximize efficiencies, minimize taxes, and elevate your business to the next level.

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