2014

Not-for-profit entities industry developments - 2014; Audit risk alerts

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This Audit Risk Alert (alert) replaces Not-for-Profit Entities Industry Developments—2013.

This alert is intended to provide auditors of financial statements of not-for-profit entities with an overview of recent economic, industry, technical, regulatory, and professional developments that may affect the audits and other engagements they perform. This alert also can be used by an entity's internal management to address areas of audit concern.

This publication is an other auditing publication, as defined in AU-C section 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards (AICPA, Professional Standards). Other auditing publications have no authoritative status; however, they may help the auditor understand and apply generally accepted auditing standards.

In applying the auditing guidance included in an other auditing publication, the auditor should, using professional judgment, assess the relevance and appropriateness of such guidance to the circumstances of the audit. The auditing guidance in this document has been reviewed by the AICPA Audit and Attest Standards staff and published by the AICPA and is presumed to be appropriate. This document has not been approved, disapproved, or otherwise acted on by a senior technical committee of the AICPA.

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Feedback

The Audit Risk Alert *Not-for-Profit Entities Industry Developments* is published annually. As you encounter audit or industry issues that you believe warrant discussion in next year's alert, please feel free to share them with us. Any other comments you have about the alert also would be appreciated. You may e-mail these comments to A&APublications@aicpa.org.
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How This Alert Helps You

.01 This Audit Risk Alert (alert) helps you plan and perform your audits of not-for-profit entities (NFPs) and also can be used by an entity's internal management to identify issues significant to the industry. It also provides information to assist you in achieving a more robust understanding of the business, economic, and regulatory environments in which your clients operate. This alert is an important tool to help you identify the significant risks that may result in the material misstatement of financial statements and delivers information about emerging practice issues and current accounting, auditing, and regulatory developments. For developing issues that may have a significant impact on NFPs in the near future, the "On the Horizon" section provides information on these topics, including guidance that either has been issued but is not yet effective or is in a development stage. You should refer to the full text of accounting and auditing pronouncements, as well as the full text of any rules or publications that are discussed in this alert. Additionally, the Audit Risk Alert General Accounting and Auditing Developments—2013/14 (product no. ARAGEN13P) explains important issues that affect all entities in all industries in the current economic climate.

.02 It is essential that the auditor understand the meaning of audit risk and the interaction of audit risk with the objective of obtaining sufficient appropriate audit evidence. Auditors obtain audit evidence to draw reasonable conclusions on which to base their opinion by performing the following:

- Risk assessment procedures
- Further audit procedures that comprise
  - tests of controls, when required by generally accepted auditing standards (GAAS) or when the auditor has chosen to do so
  - substantive procedures that include tests of details and substantive analytical procedures

.03 The auditor should develop an audit plan that includes, among other things, the nature and extent of planned risk assessment procedures, as determined under AU-C section 315, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (AICPA, Professional Standards). AU-C section 315 defines risk assessment procedures as the audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and relevant assertion levels. As part of obtaining the required understanding of the entity and its environment, paragraph .12 of AU-C section 315 states that the auditor should obtain an understanding of the industry, regulatory, and other external factors, including the applicable financial reporting framework, relevant to the entity. This alert assists the auditor with this aspect of the risk assessment procedures and further expands the auditor's understanding of other important considerations relevant to the audit.
Economic and Industry Developments

The Current Economy

.04 When planning and performing audit engagements, an auditor should understand both the general and specific economic conditions facing the industry in which the client operates. Economic activities relating to factors such as interest rates, availability of credit, consumer confidence, overall economic expansion or contraction, inflation, real estate values, and labor market conditions are likely to have an effect on an entity's business and, therefore, its financial statements.

Key General Economic Indicators

.05 The following key economic indicators illustrate the state of the U.S. economy during 2013 as we entered into 2014.

.06 The gross domestic product (GDP) measures output of goods and services by labor and property within the United States. It increases as the economy grows or decreases as it slows. According to the Bureau of Economic Analysis, real GDP increased at an annual rate of 3.2 percent in the fourth quarter of 2013 (advance estimate), compared to an increase of 4.1 percent in the third quarter of 2013, resulting in an estimated overall increase in GDP of 1.9 percent for 2013, compared with an increase of 2.8 percent in 2012. From December 2012 to December 2013, the unemployment rate declined from 7.8 percent to 6.7 percent. The annual average rate of unemployment increased from 4.6 percent in 2007 to 9.3 percent in 2009 and stands at 7.4 percent for 2013. An unemployment rate of 6.7 percent represents approximately 10.4 million people.

.07 After a few years of slow, but nevertheless positive growth, the U.S. economy is showing signs of true recovery. Although consumers continued to spend less, manufacturing continued to remain flat, and job growth continued to decline, during the beginning of 2013, there were improvements in most of these areas by the end of the year. At the end of 2013, both Standard and Poor's 500 and the Dow Jones Industrial Average were at or near their highest point since before the recession started in December 2007.

.08 The lack of a clear direction by Congress is causing uncertainty in financial markets, banks, corporations, and government agencies. As a result, support from these sources, such as loans, donations, and grants may be reduced or eliminated for a longer period of time until the federal budget and taxation issues are resolved.

.09 The Federal Reserve decreased the target for the federal funds rate more than 5.0 percentage points from its high of 5.25 percent prior to the financial crisis, to less than 0.25 percent, where it remained through December 2013. The Federal Reserve described the economic recovery in its December 18, 2013, press release as follows:

- Household spending and business fixed investment have continued to advance.
- Economic activity and employment have continued to expand at a moderate pace.
- Although declining, the unemployment rate remains elevated.
The housing sector has shown further signs of improvement.

The inflation rate remains lower than expected.

The Federal Reserve also noted in the press release that "to support continued progress toward maximum employment and price stability, the Federal Open Market Committee today reaffirmed its view that a highly accommodative stance of monetary policy will remain appropriate for a considerable time after the asset purchase program ends and the economic recovery strengthens." In order to support a stronger economic recovery, it is expected that the federal funds rate will be kept between 0 and 0.25 percent as long as the unemployment rate remains above 6.5 percent.

**The State of NFPs**

The NFP sector continues to play a large role in the world economy. Currently, more than 1.6 million NFPs are registered with the IRS. Contributions to these entities in 2012 exceeded $316 billion, whereas total revenues in the sector exceeded $2 trillion, and assets topped $4.3 trillion. According to U.S. Department of Labor statistics, 26.5 percent of the population of the United States, or 64.5 million people, did volunteer work for NFPs during the year ended in September 2012, putting in a total of more than 5 billion hours of their time.

Contributions to NFPs and demand for the services they provide are increasing. Although the overall economic situation has been improving recently, contributions and government funding have not yet returned to prerecessionary levels. Of particular concern is a lack of availability of affordable lines of credit; increased competition for a smaller pool of contributions; maintaining effective internal controls with a reduced staff; and an increase in the number of delayed or uncollectible promises to give, grants, and accounts receivable.

**Governance and Accountability**

In recent years, the accelerating pace of social and technological change, the complexity of a digitized and globalized business environment, and evolving regulatory demands have intensified the need for not-for-profit boards and management to focus more on fundamental questions about risk, such as the following:

- What are our risks?
- How do we know?
- What are we doing about them?
- How can we take advantage of the risks to enhance our performance?

These questions have driven most organizations’ enterprise risk management (ERM) initiatives, which have been prevalent, albeit in cycles, since the early 1990s in corporate America and more recently in the exempt world.

The experience with these efforts has been mixed. In some cases, ERM has consisted of identifying a list of risks, prioritizing those risks, and developing loose plans to mitigate them. Too frequently, the reaction to this process from managers and executives has been frustration, bordering on exasperation. Although they understand that the risk assessment identifies the uncertainties and dangers the organization faces, they often believe that the risks
had already been known and adequately addressed by mitigation, transfer, or acceptance.

16 Why does this matter? By nurturing an organizational culture that embraces all employees' collective responsibility for risk management, a smart and tailored ERM program can result in a resilient organization that is shielded from many of the negative consequences of unexpected events. In addition, the organization can reap the benefits of its leadership's ability to make strategic choices—decisions that intentionally involve taking risks.

17 Taking an ERM program beyond risk identification and assessment to the next level means using ERM processes, methodology, and intellectual capital throughout the organization in tandem with tailored change-management practices. In this way, an effective and efficient ERM program can drive a real strategic competitive advantage for the organization.

Understanding ERM

18 Following is one commonly accepted ERM definition, based on the work of the Committee of Sponsoring Organizations of the Treadway Commission (COSO):

Enterprise risk management is a process, effected by an entity's board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives.

19 ERM, therefore, is an important strategic element of an organization's governance framework, for which the chief executive and board are responsible.

20 The foundational elements of ERM are as follows:

- Leadership's comprehensive understanding of risk and a repeatable process to
  - establish acceptable levels of strategic risk for the organization and articulate a risk appetite based on them
  - identify, analyze, and prioritize the critical risks to achieving business objectives
  - communicate the guidance necessary to enable management of risks that fall within the risk-appetite parameters

- An ERM governance structure that aligns responsibility for oversight of ERM design with responsibility for escalation

- Information systems that support decisions, monitoring, transparency, and effective communication

- Recognition of the influence of the organization's culture on its risk profile

21 In practice, organizations that have undertaken ERM programs generally have taken the initial steps successfully—identifying and prioritizing risks and providing high-level reports from the top executives to the board of directors. It is not unusual, however, for the effort to then falter because of a
lack of common approaches to capturing the substantial strategic and operational advantages that an ERM program can provide.

.22 To manage risk and protect their brand values, several NFPs have started the ERM journey to change their cultures and drive decision making through a risk lens.

**Measuring the Effectiveness of NFPs**

.23 Measuring the effectiveness of non-profits is an evolving process that continues to be a top priority for charity watchdog organizations and NFPs. Watchdogs are starting to take a different approach in their assessments due to the complexities with comparing the results for charities across various sectors and comparing the results for charities within one sector that implement similar programs with different methods. Because of the difficulty in comparing end results of NFPs, many watchdogs are focusing on an NFP's transparency about its results rather than an NFP's specific results. Just as the watchdog's approach to measuring effectiveness is evolving, effectiveness reporting is still developing for most NFPs. An NFP that typically appeals to donors by "storytelling" may find creating a more measured report about its impact challenging.

.24 Although measuring effectiveness is a complex task, experienced accountants are able to use their skills to support this new area of reporting. Many of the characteristics that make accountants effective in financial reporting also serve well to create reliable effectiveness reporting.

.25 The work an NFP does may be across various programmatic segments, beneficiaries, or locations, but accountants know how to break issues down into manageable, bite-sized parts. They are skilled at seeing past the layers and observing the key relevant conclusions.

.26 An accountant's experience as an attester can help ensure accurate data are presented. For example, an NFP may overstate its claim of effectiveness by attributing certain outcomes to its work when, in reality, the NFP's work was only one factor contributing to the outcome. Accountants may help an NFP balance the accurate reporting of results when the NFP is navigating issues around how much its work can be attributed to particular outcomes.

.27 As NFPs begin navigating effectiveness reporting as a norm, accountants should ask themselves how they can contribute to accurate, reliable, and trustworthy reporting.

**NFP Fund-Raising Trends**

.28 As the world has become more connected, NFPs are taking advantage of new trends in social media. NFPs are reaching out via Twitter, Facebook, and blogs to promote their mission and raise funds. If properly used, social media can be a very effective and inexpensive fund-raising tool and a good avenue to maintain an ongoing relationship with donors. However, there are donors that don’t own smartphones and who think that a tweet is the sound that a bird makes. Use of today’s communication technology isn’t necessarily a generational issue or even an economic issue. Many people who have the capacity to engage an NFP as a donor, volunteer, or service recipient do not participate in the latest technology. Many NFPs are still using letters, phone calls, or television ads as effective ways to reach those donors that expect a
more personal or direct means of contact to make and maintain the connection between the donor, the NFP, and its mission.

**Crowd Funding**

.29 Crowd funding has been used by NFPs since as early as 1949 when the first telethon was hosted. With advances in technology, the Internet is now the easiest and most accessible way for a large group of people to invest and pool money to fund a cause. Whether utilizing television, phone, mail, or the Internet, many NFPs turn to crowd funding techniques to raise funds to support their various programs.

.30 From the auditors' perspective, various risks exist relating to these transactions. There is the risk that the funds contributed are not being used to support the intended cause. Accountability for how the funds are spent must be transparent to the contributors, especially given that the Attorneys General in many states focus on misleading advertising in solicitations. This situation contributes to audit risk due to the fact that auditors themselves could be held accountable, at some level, for ensuring such programs and causes are legitimate. The NFP that uses crowd funding platforms to raise funds should ensure that proper controls are in place to monitor the projects, and the funds are being used for the appropriate purpose.

.31 There is also a risk of material misstatement related to the joint cost allocation of the expenses incurred to operate the crowd funding appeal. The allocation of the expenses between fund-raising and program is under a great deal of scrutiny by charity watchdogs and regulators. When recording these allocations, the NFP should ensure that the activity has satisfied the purpose, audience, and content criteria to allow the allocation and that the allocation method has basis in generally accepted accounting principles (GAAP).

.32 There is also a risk related to properly classifying donor restrictions on these contributions. Even if the NFP intended the funds to be unrestricted or restricted for a specific use, the actual wording of the fund-raising materials could result in some other treatment. Examples of some questions that can assist in the assessment of restrictions are as follows:

- In a broad based appeal, how clearly did the entity define what the funds raised would be used for?
- Is there a clear indication that a portion of the funds raised may be used to help offset supporting services?
- If so, how explicit is that language, and does it comply with requirements in both the accounting standards and the laws of the state in which the appeal was conducted?

.33 Compliance with government regulations is another risk that the NFP should consider related to crowd funding via the Internet. Because the appeal has global reach, does the NFP need to be registered in additional states or countries as an approved fund-raising organization?

**Globalization of Fund-Raising**

.34 In a world made smaller each year by advances in technology, charitable giving is an increasingly global experience. Corporate philanthropy and corporate social responsibility are two key catalysts for international giving. According to the 2013 report, "Giving in Numbers," issued by the Committee
Encouraging Corporate Philanthropy (CECP), 21 percent of total corporate giving was to international end-recipients. The countries in which companies give are fundamentally tied to corporate strategies and the countries where their employees are present. However, globally supporting local non-profits pose certain tax challenges depending on the parties and assets involved. Regional differences exist in the type of contributions made, whether direct cash, foundation cash, or non-cash goods. Certain regions, such as Asia, put a tax burden on the donation of gifts-in-kind, making a company less likely to favor these donations. Although some companies are giving to areas with emerging markets as a part of their international giving strategy, some of this giving is spurred by country mandate. For example, according to the CECP report "Giving Around the Globe," in 2013, "the Indian Parliament passed a law requiring all Indian companies with annual profits of more than approximately $80 million to allocate 2 percent of that profit to Corporate Social Responsibility efforts. India is among the first countries in the world to use such wide-reaching regulation to mandate giving."

Global corporations that give internationally plan to increase or maintain their giving in the next year. Giving solutions continue to be needed to help businesses and employees target the programmatic efforts of the communities in which they operate or have a customer base. Donors may find their charity of choice or method of giving does not have tax advantages, and they must decide whether to give in spite of the tax challenges or refocus their efforts to navigate cross-border complexities.

More information about international corporate giving and the reports cited previously are available at www.cecp.co.

International Voucher Programs

In the international community, vouchers are increasingly being utilized as an alternative to the direct distribution of food or cash because of their many benefits. Vouchers can significantly reduce the cost of transporting and storing food and the risks associated with transporting and distributing large amounts of cash.

When food is available in the target area, voucher programs also offer the recipient more variety because the vouchers may be used to purchase one of a number of food items in a local marketplace. Additionally, if a substantial amount of food is brought into an area to serve the population, there could be the unintended consequence of undermining the local agricultural economy by eliminating demand for their products.

Voucher programs are managed differently depending on the involvement of the donor, the local governing body, and the NFP. For example, cash remitted to pay for the redeemed vouchers may be granted to an NFP for it to manage in its program. Alternatively, the NFP may be hired to distribute vouchers to a list of predetermined beneficiaries. The cash to pay for redeemed vouchers may be given directly from the donor to the shop in the local marketplace where the vouchers are redeemed. In order to accurately account for these programs, an NFP ought to assess whether it has received a grant for the cash associated with the vouchers and whether it has discretion over the beneficiaries. In some circumstances, an NFP may be acting as an agent over the cash or vouchers and not have discretion or ownership sufficient to recognize income.
Voucher programs continue to evolve, and new technology, such as mobile vouchers, enables donors to provide beneficiaries direct access to resources. In the future, there may be a more limited need for NFP programmatic management, or in certain circumstances, an elimination of the need for NFP involvement altogether.

The State of Higher Education

There seems to be a perfect storm brewing for U.S. higher education. Recent data show enrollment declining, tuition increases slowing, financial aid dropping, donations remaining relatively flat, and federal student loan defaults increasing. It's no wonder Moody's issued a negative outlook for higher education in 2014, citing some of these very issues.

In its November 2013 report, Moody's pointed to "heightened competition for government funds, donors, and students combined with pressure to increase compensation and invest in programs and facilities" as issues that will affect the financial performance of many institutions in 2014. Uncertainty around government funding for research and financial aid were also highlighted, particularly in a less than stable federal budget environment. Citing relatively high unemployment, income stagnation, and other macroeconomic pressures, Moody's noted "Affordability remains a key issue as the weak economic environment continues to affect families' ability to pay for higher education and reduces institutions' discretionary spending capacity."

In an effort to address the high cost of college, in August 2013, President Obama unveiled his College Affordability Plan. The centerpiece of the proposal is the development of a college rating system that he has asked Congress to tie to the allocation of federal student aid. The rating system will be based on access, affordability, and outcomes. Although on the surface this seems positive, there are many issues that will need to be addressed in order for it to be a useful tool to parents and students trying to select the school with the best value. In a statement to the Department of Education in November 2013, the National Association of College and University Business Officers (NACUBO) highlighted the following areas to be addressed in order to make the rating system successful:

- It must accommodate the diversity of U.S. higher education.
- It should not discourage investments critical to the education mission that are not easily measurable (such as communication skills, critical thinking, civic participation, and global knowledge).

In addition, NACUBO stressed that dramatic shifts in governmental resources must continue to be a part of the conversation about making college affordable for American families.

On a positive note, preliminary data from the annual NACUBO Commonfund Study of Endowments indicate that endowment earnings were higher in fiscal year 2013. These data, collected from 461 colleges and universities, show an average return of 11.7 percent, up considerably from -0.3 percent in fiscal 2012. This growth in earnings should provide some cushion for anticipated declines in other sources of revenue.

Focus on Governance

As a spotlight continues to be shown on the performance of higher education institutions, governance becomes crucial to the success of colleges
and universities. In 2012, the Association of Governing Boards of Universities and Colleges (AGB) released the "AGB Statement on External Influences on Universities and Colleges." The statement provides guidance to governing boards in dealing with challenges to governance from a variety of sources. At the time the statement was released, Jim Geringer, AGB board chair stated, "Colleges and universities must work harder than ever before to meet heightened public demands for accountability, transparency, improved educational quality, greater student access and degree attainment, and more effective cost containment."

The statement highlights the following four basic principles that governing boards should observe:

- Preserve institutional independence and autonomy.
- Demonstrate board independence to govern as established in charter, state law, or constitution.
- Keep academic freedom central and be the standard bearer for the due-process protection of faculty, staff, and students.
- Assure institutional accountability to the public interest.

In order to ensure the future success of their institutions, it is essential for governing boards to maintain their independence from external influences while still being open to input from all key constituencies. The board must set the appropriate tone at the top in order to "preserve and enhance a legacy of learning, scholarship, and free inquiry that is unique to the college or university."

**Not-for-Profit Spin-Offs**

In October 2013, the Science Coalition issued its report, "Sparking Economic Growth 2: Companies Created from Federally Funded Research, Fueling American Innovation and Economic Growth" (the report), illustrating how federal investment in basic scientific research stimulates the economy. The report highlights 100 companies that got their start as the result of federal research funding.

These companies, spin-offs from 51 different higher education research institutions, are making significant contributions to the economy. In addition to bringing transformative innovations in energy, medicine, defense, and technology to market, they are creating new jobs and boosting local economies and succeeding at rates greater than most new businesses in the United States.

The total investment in the fundamental research that gave root to these companies was approximately $330 million. Yet, federal funding for research and development (R&D) has been on a downward trend for the past decade. In fiscal year 2013, R&D accounted for just 3.8 percent of the federal budget, a historic low point, and the budget sequestration assures that research funding will continue to be squeezed for many years to come. The report notes that this is a dangerous trend because the discoveries that flow from research require sustained funding over many years to yield results.

Today, universities conduct the majority of basic science (53 percent) in the United States. The majority of that work, approximately 60 percent, is funded by the government. Basic scientific research is key to the mission of many higher education institutions and, with federal funding continuing to decline, those colleges and universities will have to find alternative sources of
revenue to augment their research operations. This could include greater use of the institution's general funds, budget cuts in non-research areas, increases in tuition, and a greater need for donor funding.

**Legislative and Regulatory Developments**

**OMB Final Rule—Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards**

The Office of Management and Budget (OMB) issued the long-awaited grant reform rules on December 26, 2013. This guidance, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (final rule), streamlines and consolidates into one document the guidance from a number of circulars, including Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* (A-133). The final rule is effective for audits of fiscal years ending on or after December 31, 2015.

Some of the significant changes in relation to OMB Circular A-133 requirements are as follows:

- The threshold for a single audit increases from $500,000 to $750,000 or more of federal awards in a fiscal year.
- The type A/B Major Program determination threshold increases from $300,000 to $750,000 or more of federal awards expended (minimum).
- Revisions to the steps taken in the determination of major programs to be tested and the percentage of coverage required for low and high risk auditees.
- An increase in the questioned costs reporting threshold from $10,000 to $25,000.
- Consolidation of guidance and requirements, which resulted in additional terminology and changes to the descriptions of certain requirements.

More information and resources on the final guidance, Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards, are available at [www.whitehouse.gov/omb/grants_docs](http://www.whitehouse.gov/omb/grants_docs) and through the AICPA Government Audit Quality Center at [www.aicpa.org/interestareas/governmentalauditquality/Pages/GAQC.aspx](http://www.aicpa.org/interestareas/governmentalauditquality/Pages/GAQC.aspx).

**Federal Audit Clearinghouse Data Collection Form**

In January 2014, the Federal Audit Clearinghouse (FAC) released the final 2013 Data Collection Form (DCF) and related instructions. Some of the more significant changes are as follows:

- **New Federal Award Findings page.** The most significant change on the revised DCF is a new federal awards findings page that needs to be completed by the auditor. Auditees with findings can expect that more information about their findings will need to be included by the auditor on this new page.
- **Reporting federal loan and loan guarantees.** The instructions indicate that when a Catalog of Federal Domestic Assistance program consists of part loan/loan guarantee and non-loan/loan guarantee...
components, the loan/loan guarantee expenditure detail should be listed on one line, and the non-loan/loan guarantee expenditure detail on a second line.

- **Audit finding reference numbers.** There is a new standard format for audit finding reference numbers, which is the four-digit audit year, a hyphen, and a three-digit sequence number (for example, 2013-001, 2013-002, ... 2013-999).

- **Questions regarding time zone and holiday/weekend due dates.** The OMB has agreed to allow extensions until the next business day for nine-month due dates that fall on non-business days, such as weekends and holidays. Additionally, if a submission is considered on time in the auditee’s time zone but marked as late by the FAC system, a request can be made to the FAC for a time-zone adjustment.

- **The FAC's New Internet Data Entry System (IDES).** The FAC has been designated by the OMB as the clearinghouse for receipt of single audit reports. The central collection point for the DCF and required reporting packages is the FAC website.

.57 Additional information is available at https://harvester.census.gov/fac/ or through the AICPA Government Audit Quality Center at www.aicpa.org/interestareas/governmentalauditquality/Pages/GAQC.aspx.

### Cause-Related Marketing

.58 Businesses and NFPs have collaborated in a variety of ways to increase both the sales of the businesses and the revenues of the NFPs. In general, these alliances are convenient because NFPs benefit from the existing spending patterns of the donor-consumer. These arrangements, collectively referred to as cause-related marketing, are common both on the Internet and with brick-and-mortar retail stores.

.59 Examples of cause-related marketing include the following:

- A restaurant allowing patrons to add an extra dollar on to their bill to go towards a charitable cause.
- An NFP and a marketing company contracting together for the marketing company to sell magazine subscriptions, with an advertised portion of the proceeds going to support the NFP's mission.
- An NFP licensing its trademarked name and logo to a business for the business to use in marketing its product. A specific example of this would be Coca-Cola licensing the Olympic Rings from the U.S. Olympic Committee to use the rings in Coca-Cola advertising.

.60 NFPs that participate in cause-related marketing either actively or passively should be aware of the possible state regulation, unrelated business income tax, and risks to tax-exempt status that may arise as a result of the NFP’s participation.

.61 Some states consider businesses that engage in cause-related marketing to be "commercial co-venturers" with the NFP. As a result, the business, the NFP, or both may be subject to certain state registration, reporting, and other requirements. It is important that both the business and the NFP confirm and comply with the requirements, if any, in each state where the cause-related marketing will actually occur.
.62 Often, in cause-related marketing efforts, the NFP’s role is passive and consists solely of receiving the funds from the business’ efforts. In these cases, the funds given to the NFP may be characterized as a charitable contribution from the business to the NFP. However, if the NFP is actively participating in the marketing efforts, then the NFP should assess whether that active participation causes the funds received to be characterized as taxable unrelated business income.

.63 Additionally, the NFP should ensure the marketing arrangement is structured to reduce or eliminate risks to the NFP’s tax exempt status. Factors such as active participation by the NFP in the marketing efforts, size of the marketing-related revenues relative to the NFP’s total operations, possible private inurement to the business, and other factors should be considered.

.64 Due to the regulatory and tax-related issues associated with cause-related marketing, NFPs should perform the necessary level of research and analysis for each marketing arrangement, including consulting with tax and legal experts as necessary.

Affordable Care Act Excise Tax on Certain Benefit Plans

.65 Although it’s already well into 2014, many individual Americans are still trying to figure out the impact of the 2010 Patient Protection and Affordable Care Act (ACA) on their health benefits. The same can be said of many NFP higher educational institutions and how it will affect their employees. In the NFP world, there is a history of mission-oriented individuals accepting lower pay as a trade-off for extensive health benefits. The notion was that doing good work was not highly compensated, but at least individuals were fully insured. That idea of full health insurance coverage is now being challenged because of the potential cost of providing those benefits.

.66 One significant issue for NFPs is the 30-hour rule. Employees are considered full-time employees when they reach 30 hours of work a week. As a result of the 30-hour rule, some NFPs have reduced the number of hours employees work so that they are considered part-time employees and, therefore, do not qualify for health care coverage under the ACA. As an example, over the past several years, colleges and universities have increased the ratio of adjunct faculty to tenured professors to stretch their labor dollars. With the onset of the ACA, some institutions have begun limiting adjunct faculty to 29 hours of work to avoid being required to pay health care benefits.

.67 A second issue for NFPs is the 50 full-time equivalent workers (FTE) rule. Large organizations with greater than 50 employees will incur certain penalties if they do not provide employee health insurance coverage that meets the criteria specified in the ACA. Large employers offering plans in which the individual is paying a high percentage of the health care cost or plans that exceed specified employee contribution limits will incur a monthly penalty.

.68 A third issue for NFPs and their employees is the 40-percent excise tax on plans with what are considered to be extravagant benefits and, therefore, have a high insurance premium cost. These are known as Cadillac plans. Such plans that provide extensive health care coverage and have insurance premiums of more than $10,200 for individuals and $27,500 for families will incur the excise tax. Although the average employer-sponsored health plan has an insurance premium of $5,884 for an individual and $16,351 for a family, according to the Kaiser Family Foundation’s 2013 Employer Health Benefits
Survey, some plans used by NFPs may cost more than the limits and incur the excise taxes. NFPs are beginning to review their cost of coverage to determine if they are subject to the excise tax and may adjust their benefits and cost structure accordingly.

**IRS Activities**

*Theft and Fraud Disclosures*

.69 In 2008, the IRS made several revisions to Form 990 that were intended to provide more transparency and a mechanism for the public to ascertain how an NFP was spending its money, including those donations made by the public. One of those revisions includes a question that asks filers, “Did the organization become aware during the year of a significant diversion of the organization's asset?” The IRS has defined *significant* as either $250,000 or 5 percent of the organization's gross receipts or assets for the filing year. In addition, the NFP is required to disclose the nature of the diversion, dollar amount, and corrective action taken. In recent years, however, many NFPs have been criticized for not including the appropriate level of detail, including failure to disclose the exact amount (many have said "greater than $250,000"). Others have been very brief (just a few sentences) in describing the nature of the diversion and the corrective action taken.

.70 In planning and performing audits, a useful step for NFP auditors would be to review the Form 990 to identify any theft or fraud that has been reported. In addition, auditors should consider whether the incident is an isolated one or indicative of a broader internal control weakness and the adequacy of the disclosure and response provided by the NFP with regard to these events.

.71 Likewise, management of NFP organizations should ensure the Form 990 disclosures are accurate and complete. Additionally, management should be sure to understand how the breakdown, if any, in internal control occurred so that corrective measures can be taken to avoid future incidents.

*Executive Compensation Limits*

.72 For several years, NFPs have been subject to the IRS's intermediate sanctions. More recently, states have started to develop and implement their own regulations over executive compensation limits.

.73 *Intermediate sanctions* are personal excise taxes paid by disqualified persons (typically CEOs, COOs, and CFOs) who provide services to an NFP and are deemed to receive excessive compensation for those services. This tax can also extend to those individuals who participated in the decision to pay the compensation (such as a board member). Fortunately, the risk of intermediate sanctions can be managed by establishing a rebuttable presumption that the compensation is reasonable. This is accomplished by establishing policies over the determination of the compensation level, including approval by a board or subcommittee, benchmarking, and documentation of the process.

.74 Although the rebuttable presumption exists at the federal level, some states have enacted regulations that will limit executive compensation in certain instances with no permitted rebuttable presumption. For example, in New York State, an executive order was issued stating that NFPs that receive state funding from certain departments are required to limit compensation paid to any executive to $199,000 per year. In the event of noncompliance, the
sanctions imposed could significantly affect the NFP and may include reallocation of state funds to be used to provide program services; suspension, modification, or revocation of license(s) for program services; suspension, modification, or termination of contracts with the NFP; and other actions or penalties deemed appropriate by the applicable state agency. Under the proposed regulation, if an NFP elects to exceed the $199,000 established limit, the NFP must satisfy the following:

- Any compensation paid to an executive in excess of $199,000 cannot be paid with New York State funds.
- Using a compensation survey, the compensation must be in the 75th percentile or less of compensation provided to comparable executives at similar nonprofits.
- The board (including at least two independent members) must assess "appropriate comparable compensation data" and approve the total compensation package.

As the scrutiny continues to increase over executive compensation, NFPs should continue to establish and improve their processes over setting and approving executive compensation. For example

- ensuring that executive compensation, including benefits, is reasonable and will be perceived by the public as reasonable.
- adopting policies providing clear and practical guidance for establishing reasonable compensation, including avoiding excess benefit transactions.
- obtaining comparable data for executive compensation benchmarking.
- reviewing the data to ensure it is comparable—don’t just accept the information as presented in a consultant report.
- establishing a policy that requires the total compensation of the executives to be disclosed or approved by the full governing board (not just a committee).

### IRS Focus on Higher Education

#### College and University Compliance Project

On April 25, 2013, the IRS released the final report from the College and University Compliance Project. The report summarizes audits of 34 public and independent colleges and universities selected for examination based upon their responses to the College and University Compliance Project questionnaire that was sent to 400 higher education institutions in late 2008. The report cited findings in the areas of unrelated business taxable income (UBTI) and executive compensation.

In the area of UBTI, the examinations resulted in

- increases to UBTI for 90 percent of colleges and universities examined totaling about $90 million.
- over 180 changes to the amounts of UBTI reported by colleges and universities on Form 990-T.
- disallowance of more than $170 million in losses and net operating losses (that is, losses reported in one year that are used to offset
profits in other years), which could amount to more than $60 million in assessed taxes.

.78 One of the primary reasons cited for increases in UBTI was the "lack of profit motive." Institutions were claiming losses from activities that did not qualify as a trade or business. Nearly 70 percent of examined colleges and universities reported losses from activities for which expenses had consistently exceeded unrelated business income (UBI) for many years. UBI must be generated by a trade or business. An activity qualifies as a trade or business only if, among other things, the taxpayer engaged in the activity with the intent to make a profit. A pattern of recurring losses indicates a lack of profit motive. The IRS disallowed reporting of activities for which the taxpayer failed to show a profit motive. It is interesting to note that the primary indicator the IRS utilized was whether an activity showed a loss for more than five consecutive years.

.79 Another area that received attention was that of executive compensation, particularly the reasonableness of compensation. Here, the IRS looked closely at potential excess benefit transactions under Internal Revenue Code (IRC) Section 4958 as it applied to the independent institutions included in the examination.

.80 An excess benefit transaction occurs when a disqualified person receives more than reasonable compensation for services rendered to the organization. See "Executive Compensation Limits" in this document for further discussion on this topic.

.81 The IRS found that about 20 percent of the independent institutions examined failed to meet the rebuttable presumption standard because of weaknesses in their comparability data. These weaknesses revolved around the inclusion of institutions in the data set that were dissimilar in terms of the following:

- Location
- Endowment size
- Revenues
- Total net assets
- Number of students
- Selectivity

.82 The report explicitly states that because the sample of institutions examined was not random, no assumptions should be drawn about UBI and compensation at other colleges and universities. Despite this caveat, auditors may want to focus on these areas when assessing overall audit risk and completeness of financial statement disclosures.

Form 1098-T Issues

.83 In August 2013, many colleges and universities began receiving IRS Notice 972CG, "Notice of Proposed Civil Penalty." The notice proposes fines for missing or incorrect taxpayer identification numbers (TIN) on Form 1098-Ts for the 2011 tax year. Form 1098-T is the information return that reports higher education tuition and related expenses. The proposed penalties are $100 for each information return document sent with a missing or incorrect TIN, up to a maximum penalty of $1.5 million per year ($500,000 for organizations with
average annual gross receipts of $5 million or less). Institutions are required to respond to the notice within 45 days, either by agreeing to pay the full amount of the proposed penalty or by disagreeing with the proposed penalty, in whole or in part, and providing a signed statement explaining the basis for the disagreement, including any supporting documentation.

.84 Although colleges and universities have been required to file Form 1098-T for more than a decade, this is the first year in which the IRS has proposed penalties for missing or incorrect TINs. In fact, IRS rules compel institutions to file Form 1098-T without TINs and do not allow higher education institutions access to TIN matching services that are available to filers of other types of informational returns, such as banks or employers.

.85 In February 2014, the IRS announced that it will waive penalties for the 2011 tax year. No indication was given that such a waiver would be provided for any subsequent tax years. If the institution is unable to obtain a waiver of the penalty from the IRS, it may need to book a liability for any fines that it expects to have to pay.

**IRS Announces Changes to 2013 Form 990**

.86 The 2013 Forms 990 and 990-EZ, schedules, and instructions have been revised to modify and clarify certain reporting requirements. Before you begin preparing tax-exempt client returns, make sure you educate yourself on the revisions. For a quick glance at the changes, you can find a chart prepared by the IRS, which summarizes some of the more significant changes to Form 990, Form 990-EZ, schedules, and instructions for tax year 2013 at www.irs.gov/pub/irs-tege/2013_Form990_SignificantChanges.pdf.

**Department of the Treasury and the IRS Issue Priority Guidance Plan for 2013–2014**

.87 The joint Department of the Treasury and IRS Priority Guidance Plan for 2013–2014 contains the following items of interest to tax-exempt organizations:

- Revenue procedures updating grantor and contributor reliance criteria under IRC Sections 170 and 509.
- Revenue procedure to update Revenue Procedure 2011-33 for EO Select Check.
- Guidance under IRC Section 501(c)(4) relating to measurement of an organization’s primary activity and whether it is operated primarily for the promotion of social welfare, including guidance relating to political campaign intervention.
- Final regulations under IRC Sections 501(r) and 6033 on additional requirements for charitable hospitals as added by Section 9007 of the ACA. Proposed regulations were published on June 26, 2012 and April 5, 2013.
- Additional guidance on IRC Section 509(a)(3) supporting organizations.
- Guidance under IRC Section 4941 regarding a private foundation’s investment in a partnership in which disqualified persons are also partners.
Not-for-Profit Entities Industry Developments—2014

- Final regulations under IRC Section 4944 on program-related investments. Proposed regulations were published on April 19, 2012.
- Guidance regarding the new excise taxes on donor-advised funds and fund management as added by IRC Section 1231 of the Pension Protection Act of 2006.
- Guidance under IRC Section 6033 on returns of exempt organizations.
- Final regulations under IRC Section 6104(c). Proposed regulations were published on March 15, 2011.
- Final regulations under IRC Section 7611 relating to church tax inquiries and examinations. Proposed regulations were published on August 5, 2009.

Additional information on these and other topics is available at www.irs.gov/uac/Priority-Guidance-Plan.

Listing of Published Guidance—2013

Readers should be aware that the IRS website contains a digest of published guidance for tax-exempt entities issued in 2013 at www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/Listing-of-Published-Guidance. The published guidance includes Treasury regulations, revenue rulings, revenue procedures and notices, and announcements of recently published issues of interest to tax-exempt entities.

The IRS website also contains an archive that presents digests of IRS-published guidance of interest to tax-exempt entities for the years 1954–2011. The archived guidance can be found at www.irs.gov/Charities-&-Non-Profits/Archive-of-Published-Guidance. Additionally, the IRS has a useful tool for NFPs to assist them with maintaining their tax-exempt status through compliance with IRS requirements. The publication Compliance Guide for 501(c)(3) Public Charities is available at www.irs.gov/pub/irs-pdf/p4221pc.pdf.

Audit and Attestation Issues and Developments

Audit Risks for NFPs

As discussed in AU-C section 315 and AU-C section 330, Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained (AICPA, Professional Standards), some possible audit responses to significant risks of material misstatement include increasing the extent of audit procedures, performing procedures closer to year-end, or modifying audit procedures to obtain more persuasive evidence. Additionally, given constantly changing economic conditions that could affect your NFP clients, auditors may consider changes in the environment throughout the audit and potentially modify audit procedures to ensure that risks are adequately addressed.

Although it is impossible to predict and include all accounting, auditing, and attestation issues that may affect your NFP engagements, this alert covers the primary areas of concern. As you perform your engagements, continue to remain alert to economic, legislative, and regulatory developments as well as the associated accounting, auditing, and attestation issues.
Applicability of the Updated Internal Control Framework

In May 2013, COSO issued an updated Internal Control—Integrated Framework (the framework). COSO’s original framework was issued in 1992 and is recognized as the leading guidance for designing, implementing, and conducting a system of internal control and assessing its effectiveness. Additionally, the auditing profession has used the original framework in analyzing organizations’ internal controls.

The world has changed significantly since the early 1990s, when the original framework was issued—from increased globalization to more reliance on technology to changing regulations. The new framework was created to refresh the original framework and ensure its continued relevance in the future.

The following are five key points NFPs and their auditors should know about the new framework:

- **Core concepts remain unchanged.** The definition of internal control stays essentially the same, defined as "a process effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance." The focus continues to be on those three categories of objectives: operations, reporting, and compliance. Additionally, the new framework retains the five components of internal control, which are control environment, risk assessment, control activities, information and communication, and monitoring activities. The requirement that each of these five components is present and functioning for an effective internal control system remains the same. As a result, the criteria to assess the effectiveness of an organization's internal controls are relatively unchanged.

- **Codification of underlying principles.** The original framework provided implicit concepts on the core principles of internal control. To help users better understand what constitutes effective internal control, the new framework codifies 17 principles associated with the 5 components of internal control. These broad-based principles help support the criteria used in establishing internal controls. In addition, these principles are reinforced by 79 total points of focus that provide guidance in designing, implementing, and conducting internal control and assessing whether relevant principles are present and functioning.

- **Increased role of the reporting objective.** As noted previously, the three categories of objectives for internal control are in operations, reporting, and compliance. The original framework focused on financial reporting. The new framework, however, expands the focus to both financial and nonfinancial reporting and both internal and external reporting. As a result, this change essentially leads to coverage of all reporting aspects within an organization.

- **More relevant context to today's environment.** The new framework, which, along with the appendixes, is documented in over 170 pages, has updated the context to today's environment. Specifically, the context has considered changes in expectations for governance oversight; globalization of markets and operations; complexities in business; complexities in various laws, rules,
regulations, and standards; expectations for competencies and accountabilities; use of and reliance on technologies; and, finally, expectations relating to preventing and detecting fraud. Each of these areas has significantly changed over the past 20 years; thus, the new framework was updated to better address these changes.

- **Original framework will transition out in 2014.** COSO believes the underlying concepts and principles of the original framework are still fundamentally sound today. However, after December 15, 2014, COSO will consider the original framework superseded. In other words, the new framework will be the framework referenced from that point forward.

.96 NFPs should begin utilizing the new framework in evaluating and updating their internal controls. As noted previously, much of the original framework has carried over to the new framework, so it is not anticipated that a NFP would need to make significant changes to its internal control simply due to the issuance of the new framework.

.97 Auditors should review their audit practice aids, particularly those relating to understanding the auditee's internal control, to determine if any changes are needed to reflect changes to the framework, such as the codification of the 17 principles associated with the 5 components of internal control.

.98 Additional information regarding the new framework can be found on COSO's website at www.coso.org.

**Final Standard Issued in ASB Clarity Project**


.100 SAS No. 128 addresses the external auditor's responsibilities if using the work of internal auditors. Using the work of internal auditors includes

- using the work of the internal audit function in obtaining audit evidence, and
- using internal auditors to provide direct assistance under the direction, supervision, and review of the external auditor.

.101 SAS No. 128 does not apply if the entity does not have an internal audit function. If the entity has an internal audit function, the requirements in SAS No. 128 relating to using the work of the internal audit function in obtaining audit evidence do not apply if

- the responsibilities and activities of the function are not relevant to the audit, or
- based on the external auditor's preliminary understanding of the function obtained as a result of procedures performed under AU-C section 315, the external auditor does not expect to use the work of the function in obtaining audit evidence.

.102 Nothing in SAS No. 128 requires the external auditor to use the work of the internal audit function to modify the nature or timing, or reduce
the extent, of audit procedures to be performed directly by the external auditor; it remains the external auditor's decision to establish the overall audit strategy. Furthermore, the requirements in SAS No. 128 relating to using internal auditors to provide direct assistance do not apply if the external auditor does not plan to use internal auditors to provide direct assistance.

.103 Readers should refer to the full text of the SAS for further information.

**Auditing Functional Expenses**

.104 Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 958-720-45-2 specifies that to help donors, creditors, and others in assessing an NFP's service efforts, including the costs of services and how it uses resources, a statement of activities or notes to financial statements should provide information about expenses reported by their functional classification, such as major classes of program services and supporting activities.

.105 FASB ASC 958-205-45-6 requires voluntary health and welfare entities to report information about expenses by their functional classes, such as major classes of program services and supporting activities as well as information about expenses by their natural classifications (such as salaries, rent, electricity, interest expense, depreciation, awards and grants to others, and professional fees) in a matrix format in a separate financial statement called a statement of functional expenses.

.106 Generally, voluntary health and welfare entities are formed for the purpose of performing voluntary services for various segments of society, supported by the public, and operated as a tax-exempt NFP entity. An NFP can be presumed to be supported by the public if contributions (excluding government support) are 20 percent to 30 percent or more of total revenue and support (including in-kind contributions). In limited cases, an NFP may meet the percentage threshold but be able to rebut the presumption that it is supported by the general public (and, therefore, not required to present a statement of functional expenses). Examples of evidence that rebuts the presumption include contributions from a single donor whose reporting requirements are met through other means, a large nonrecurring contribution from a single donor that causes the NFP to meet the "significant" threshold, or contributions from donors that are not representative of the general public because their reporting requirements are met through different means (such as board contributions). FASB ASC 958-720-45-16 states that other NFPs are encouraged, but not required, to provide information about expenses by their natural classification.

.107 The accurate classification of expenses as either program expenses or supporting services expenses (fund-raising and general and administrative expenses) is critical for many NFPs.

.108 Watchdog agencies evaluate key ratios, such as the ratio of program expenses to total expenses. This ratio is also used by donors, foundations, financial institutions, and other important constituencies. The higher the percentage of program expenses to total expenses, the better. Some watchdog agencies would find a program expense ratio below 65 percent or 75 percent to be unsatisfactory. Organizations that can support a program expense ratio of 85 percent or 90 percent can make the claim that 85 cents or 90 cents of every contributed dollar goes directly into program services.
Often, NFPs may not have reviewed their functional expense allocation methodologies for many years, and the related expenses may not be allocated correctly. Management should review the expense allocations to determine if they are still appropriate, and auditors should ensure they have reviewed the methodology employed.

Some audit procedures for functional expenses could include the following:

- Obtain or update an understanding of the allocation methodology of expenses by functional classification.
- If payroll and related costs are a significant part of total expenses, then specifically review the NFP's methodology for allocating payroll and related costs to the functional classifications.
- Verify the consistent application of the allocation methodology.
- Verify that the NFP has updated its allocation methodology in a timely manner for any changes in its cost structure. Triggering events could include
  - office space being added or given up;
  - new debt being entered into;
  - a significant new program being started or discontinued;
  - staff positions being added or removed.
- Review and test management's policies and procedures for allocating costs to the various functional categories that they support, including the allocation of joint costs.
- Perform an analytical review of functional classifications.
- Verify that the NFP's presentation of program services in the statement of activities or notes to the financial statements is appropriate, consistent, and includes the appropriate costs.
- Verify that the number of programs reported for program expenses is adequate based on the complexity of the NFP and its activities.
- Verify that the NFP's presentation of supporting services in the statement of activities or notes to the financial statements is appropriate, consistent, and includes the appropriate categories, such as fund-raising, management, and general.

Audit Reporting on Forms Prescribed by Regulators

Some state and local government regulators require NFPs to include an audit or attest report from an independent CPA, along with financial information submitted to the regulator. Often, the CPA's report is on a form prescribed by the regulator. Problems arise when the form prescribed by the regulator is not in compliance with the requirements of the applicable audit or attest standards.

State accountancy laws require CPAs to follow the applicable professional standards issued by the AICPA when issuing an audit or attest report. The professional standards that may apply depend on the type of report to be
issued and include GAAS, Statements on Standards for Accounting and Review Services, or Statements on Standards for Attestation Engagements.

.113 SAS No. 122, effective for audits of periods ending on or after December 15, 2012, significantly revised the required elements and wording of the auditor's report. As a result, there is now an increased risk that regulator-prescribed forms have not been updated for SAS No. 122 and do not include the required elements and wording to be compliant with current GAAS.

.114 A CPA may issue an audit or attest report by signing a form prescribed by the regulator as long as that form includes all the required elements and wording of the applicable professional standards. If the prescribed form does not include all the required elements and wording, the CPA is required to reword the prescribed form or attach an appropriately worded separate report.

.115 The AICPA has developed a webpage with resources to assist practitioners who are asked to sign regulator-prescribed forms that do not comply with professional standards. It can be accessed online at www.aicpa.org/interestareas/frc/auditattest/pages/regulatorprescribedauditorsreports.aspx.

Concerns Regarding Comfort Letters

.116 Increasingly, CPAs are receiving requests from clients, lenders, loan brokers, health insurance providers, adoption agencies, regulators, and various other agencies to confirm client information. In turn, the AICPA has received several inquiries from CPAs on what they often refer to as comfort letters.

.117 AU-C section 920, Letters for Underwriters and Certain Other Requesting Parties (AICPA, Professional Standards), defines a comfort letter as a letter issued by an auditor in accordance with AU-C section 920 to requesting parties in connection with an entity’s financial statements included in a securities offering. However, the requests that CPAs are actually receiving from third parties pertain to verification letters. The requested information may relate to a pending loan, employee medical insurance, child adoption applications, or use-tax certification. Mortgages originated by private mortgage companies, which were resold to Fannie Mae and Freddie Mac and are past due, are subject to required quality reviews. Quality review standards may require the mortgage originator to contact CPAs whose comfort letters or third-party verifications are contained within the loan file to confirm the statements made in such letters. In most cases, CPAs are asked to provide a confirmation letter containing specific language, a verification statement, a comfort letter, or a certification form.

.118 Due to this increase, CPAs are finding this process more and more confusing, and the information regarding comfort letters or third-party verifications is increasingly important to assure that practitioners are providing optimal service. Responses to questions most frequently asked about third-party verification letters can be found at www.aicpa.org/InterestAreas/FRC/DownloadableDocuments/Third_Party_Verification/QA_Third_Party_Verification.pdf.

Additional Guidance Issued for Audits of Group Financial Statements

.119 Application of AU-C section 600, Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)
(AICPA, *Professional Standards*), continues to be a challenge for auditors as they implement the clarity standards. The following questions and answers point out some of the major changes in the standard, which may assist auditors in recognizing when they are involved in an audit of group financial statements:

1. **What are group financial statements?** Group financial statements include the financial information of more than one component. The concept of group financial statements is broader than consolidated or combined financial statements because it encompasses business activities in addition to separate entities. Additionally, this standard applies in all audits of group financial statements regardless of whether different auditors are involved in the audit.

2. **What is a component?** A component is an entity or business activity for which group or component management prepares financial information that is required to be included in the group financial statements. Components may include, but are not limited to, subsidiaries, geographical locations, divisions, investments, products or services, functions, processes, or component units of state or local governments. Equity method investments are also components that are scoped into the standard. However, other investments using fair value measurements are generally not considered components.

3. **How are the previous concepts of other auditor and principal auditor changed in this standard?** The focus of the previous standard was the interaction between the auditors. AU-C section 600 changes that focus to the unique characteristics of a group reporting entity and how an auditor should obtain sufficient audit evidence to render an opinion on the group financial statements. An auditor who performs work on the financial statements, or financial information, of a component is now referred to as the component auditor rather than an other auditor. The auditor of the group financial statements, which encompasses the firm and group engagement team, including the group engagement partner, replaces the concept of the principal auditor. A member of the group engagement team may perform work on the financial information of a component for the group audit at the request of the group engagement team. When this is the case, such a member of the group engagement team is also a component auditor. Note that when the component is being audited by the group engagement team, the group engagement team is filling the role of the component auditor. Although members of the group engagement team may be filling the role of a component auditor, typically this will not add any additional performance requirements to the group audit other than, in some circumstances, the need to apply component materiality.

4. **Do the requirements change for making reference to the work of other auditors?** AU-C section 600 better articulates the degree of involvement required when reference is made to the audit of component auditors in the auditor's report on the group financial statements. It establishes certain conditions that are necessary for the group engagement partner to make reference to a component auditor in the auditor's report on the group financial statements. Moreover, AU-C section 600 clarifies that the group engagement partner is
responsible for the opinion on the group financial statements regardless of whether reference is made to component auditors. Additionally, AU-C section 600 establishes requirements that apply to all group audits regardless of whether reference is made to the work of the component auditor. These requirements expand the level of communication with the component auditors and the considerations of the group engagement partner when determining the acceptability of using the component auditor's work.

5. Are there new procedures that are required when assuming responsibility for the work of other auditors? Certain provisions of AU-C section 600 apply to all group audits regardless of whether reference is made to the audit of a component auditor in the auditor's report on the group financial statements. AU-C section 600 specifically articulates the procedures the group engagement team is required to perform when a component auditor is involved in the group audit. Additional specific procedures are applicable when the auditor of the group financial statements assumes responsibility for the work of a component auditor or is performing audit procedures on the components directly.

.120 In June 2013, two technical questions and answers were issued and added as paragraphs .42–.43 of TIS section 8800, "Audits of Group Financial Statements and Work of Others" (AICPA, Technical Practice Aids), to provide nonauthoritative guidance on the implementation of AU-C section 600. They are as follow:

.42 Component Audit Report of Balance Sheet Only

Inquiry—Company X prepares consolidated financial statements that include the operations of entity A. The auditor for entity A has audited the balance sheet only and has disclaimed an opinion on the other financial statements. May the group auditor of Company X, who was engaged to issue an opinion on the consolidated financial statements of the group, make reference in the report on the group financial statements to the audit of the balance sheet of entity A?

Reply—No. A component auditor's report on a balance sheet only does not provide sufficient appropriate audit evidence on revenues, expenses, and cash flows of the component to enable the group engagement partner to make reference. Accordingly, the group engagement team would have to perform procedures on the financial information of entity A in order to obtain sufficient appropriate audit evidence.

[Issue Date: June 2013.]

.43 Using Another Accounting Firm to Perform Inventory Observations

Inquiry—An accounting firm outsources its year-end inventory observation procedures for an audit to another accounting firm due to location of the inventory. Is the other accounting firm considered a component auditor in accordance with AU-C section 600?

Reply—The other auditor performing inventory observation is not considered a component auditor. However, paragraph .02 of AU-C section 600 states that "an auditor may find this section, adapted as necessary in the circumstances, useful when that auditor involves other auditors in the audit of financial statements that are not group
financial statements. For example, an auditor may involve another auditor to observe the inventory count or inspect fixed assets at a remote location.” Paragraph .16 of AU-C section 220, Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards (AICPA, Professional Standards), requires the engagement partner to be satisfied that those performing the audit possess the appropriate competence and capabilities. In accordance with paragraph .17 of AU-C section 220, the engagement partner is responsible for the direction, supervision, and performance of the audit engagement. The requirements and application material in AU-C section 600 relating to understanding a component auditor, setting materiality, determining the type of work to be performed, and involvement in the work performed by component auditors provide relevant guidance for meeting the requirements in AU-C section 220 with regard to the other auditor.

[Issue Date: June 2013.]

Completeness and Accuracy of System-Generated Reports

.121 As computers have become commonplace in the business world, audit evidence has become increasingly stored in digital format. Digital storage provides the ability to easily create, alter, and store documents as well as to potentially provide access to a large group of users. This situation presents challenges to auditors in assessing and documenting controls as well as the completeness of the populations used for sampling.

.122 In most audits today, some of the items that might be selected for testing likely come from, or are supported by, data or reports produced by an NFP’s IT system. When testing controls, keep in mind that the effectiveness of those controls depends, in part, on the completeness and accuracy of the system-generated reports and information. Accordingly, when auditors select controls for testing, they also might consider the need to test either the controls over the system-generated data and reports or the completeness and accuracy of the data.

.123 Auditors may want to consider involving an IT audit team member to assist in this process. At a minimum, auditors should ensure that they are effectively documenting the procedures and the basis for reliance.

Presumption of Fraud Risk With Revenue Streams

.124 Three conditions generally are present when fraud occurs. First, management or other employees have an incentive or are under pressure, which provides a reason to commit fraud. Second, circumstances exist—for example, the absence of controls, ineffective controls, or the ability of management to override controls—that provide an opportunity for a fraud to be perpetrated. Third, those involved are able to rationalize committing a fraudulent act.

.125 Beginning with the issuance of SAS No. 99, Consideration of Fraud in a Financial Statement Audit (AICPA, Professional Standards, AU-C sec. 240) in October of 2002, the auditing standards explicitly stated that “the auditor should ordinarily presume that there is a risk of material misstatement due to the fraud relating to revenue recognition.” Auditors need to ensure that they are cognizant of the reasons for heightened revenue testing.

ARA-NPO .125
Management is responsible for the preparation and fair presentation of financial statements, including reported revenues. Among the financial reporting objectives that may be relevant to assertions about revenue for an NFP are the following:

- Recorded sales during the accounting period represent actual deliveries of goods or rendering of services to customers who have made firm, enforceable commitments to purchase such goods or services.
- Recorded pledges during the accounting period represent actual unconditional donor pledges.
- Deferred revenues are recognized in the period when deliveries are made, services are rendered, or other conditions requiring deferral are no longer present.
- Estimated amounts of reserves for sales returns, provision for rebates and discounts, and allowances for uncollectible receivables and pledges are reasonable.
- Policies for revenue recognition are adequately disclosed.

The risk of fraud is a serious concern for all types of entities, but fraud can be particularly damaging to an NFP, and a damaged reputation can have devastating consequences.

### Accounting Issues and Developments

#### Definition of a Public Business Entity

In December 2013, FASB issued Accounting Standards Update (ASU) No. 2013-12, Definition of a Public Business Entity—An Addition to the Master Glossary. The definition of a public business entity will be used by FASB, the Private Company Council, and the Emerging Issues Task Force (EITF) to determine the scope of new accounting and reporting guidance. The ASU amends the Master Glossary of the FASB ASC to include one definition of public business entity for future use in U.S. GAAP. The definition does not affect existing requirements.

The ASU specifically excludes all NFPs from the definition of a public business entity such that a public versus nonpublic distinction will no longer be made between NFPs in future standard setting. Prior to the issuance of this ASU, distinctions about the appropriate guidance for NFPs to follow within U.S. GAAP was made on the basis of whether an NFP had publicly traded debt securities, including conduit debt.

This ASU recognizes FASB’s belief that NFPs have characteristics of both public and private companies. As a result, the previous bright line for determining reporting alternatives—the issuance of publicly traded debt—has been erased. Going forward, meaning effective immediately, application of accounting standards for NFPs will be handled on a standard-by-standard basis. This ASU allows FASB the opportunity to select public company alternatives, nonpublic company alternatives, or neither when determining reporting alternatives for NFPs. It will be important for accounting and auditing professionals to provide input and feedback to FASB via the comment letter process to help keep NFP financial reporting alternatives appropriate.
Recognizing Services Received From Personnel of an Affiliate

.131 In April 2013, FASB issued ASU No. 2013-06, Not-for-Profit Entities (Topic 958): Services Received from Personnel of an Affiliate (a consensus of the FASB Emerging Issues Task Force), which addresses the situation in which employees of a separately governed affiliated entity regularly performs services (in other than an advisory capacity) for, and under the direction of, the recipient entity. This issue was brought to the attention of the FASB EITF by the AICPA Not-for-Profit Expert Panel because differing views exist in practice about whether a recipient NFP should consider services received from personnel of an affiliate as a contribution and whether that NFP entity would apply the contributed services guidance. The purpose of this ASU is to specify the guidance for which NFPs apply for recognizing and measuring services received from personnel of an affiliate to improve consistency in financial reporting.

.132 This ASU applies to NFPs, including NFP business-oriented health care entities that receive services from personnel of an affiliate that directly benefit the recipient NFP and for which the affiliate does not charge the recipient NFP. An affiliate is defined in the FASB ASC Master Glossary as a party that, directly or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with an entity. This ASU does not address transactions between affiliates for which the affiliate charges the recipient NFP at least for the approximate amount of direct personnel costs (for example, compensation and any payroll-related fringe benefits) or the approximate fair value of the services provided.

.133 This ASU requires a recipient NFP to recognize all services received from personnel of an affiliate that directly benefit the recipient NFP. Those services should be measured at the cost recognized by the affiliate for the personnel providing those services. However, if measuring a service received from personnel of an affiliate at cost will significantly overstate or understate the value of the service received, the recipient NFP may elect to recognize that service received at either (1) the cost recognized by the affiliate for the personnel providing that service or (2) the fair value of that service.

.134 This ASU also specifies that FASB ASC 850-10 applies to services received from personnel of an affiliate.

.135 This ASU is effective prospectively for fiscal years beginning after June 15, 2014, and interim and annual periods thereafter. A recipient NFP may apply the ASU using a modified retrospective approach under which all prior periods presented upon the date of adoption should be adjusted, but no adjustment should be made to the beginning balance of net assets of the earliest period presented. Early adoption is permitted.

Service Concession Arrangements

.136 A service concession arrangement is an arrangement in which a grantor (a public-sector entity) engages an operating entity to operate the grantor's infrastructure (for example, airports, roads, and bridges). Under these arrangements, an operating entity may provide the construction, upgrading, or maintenance services of the grantor's infrastructure. These arrangements
are becoming more prevalent as governmental entities seek alternative ways to provide services to the public in a more efficient and cost-effective manner.

.137 In January 2014, FASB issued ASU No. 2014-05, Service Concession Arrangements (Topic 853) (a consensus of the FASB Emerging Issues Task Force), which provides specific accounting guidance in this area. Prior to the issuance of this ASU, it was unclear when an operating entity should account for a service concession arrangement as a lease under FASB ASC 840, Leases.

.138 This ASU clarifies that an arrangement should not be accounted for as a lease when it contains both of the following conditions:

- The grantor controls, or has the ability to modify or approve, the services that the operating entity must provide with the infrastructure, to whom it must provide them, and at what price.
- The grantor controls, through ownership, beneficial entitlement, or otherwise, any residual interest in the infrastructure at the end of the term of the arrangement.

.139 Service concession arrangements are typically found in NFPs that provide a public benefit through the operation of infrastructure. For example, a local government may enter into an arrangement with a private university to operate the government’s power plant. While the university maintains the infrastructure and receives the revenue generated by the plant, the governmental entity determines to whom the power can be provided and at what price. At the end of the arrangement’s term, any residual interest in the power plant reverts to the government. When such arrangements exist, auditors should carefully review the terms of the agreement to ensure that the proper accounting treatment is being applied.

**Level 3 Fair Value Measurement Disclosures**

.140 Certain level 3 disclosure requirements in ASU No. 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs, should be reviewed to ensure disclosures are presented appropriately and consistently. For level 3 fair value measurements, quantitative information about the significant unobservable inputs used in the measurement should be disclosed. However, the ASU further clarifies that disclosure is not required if quantitative unobservable inputs are not developed by the reporting entity when measuring fair value (for example, when prices from prior transactions or third-party pricing information without adjustment are used). Only quantitative unobservable inputs that are significant to the fair value measurements and are reasonably available to the reporting should be disclosed.

.141 Additional level 3 disclosures required by this ASU include a description of the valuation processes used by the reporting entity (including, for example, how an entity decides its valuation policies and procedures and analyzes changes in fair value measurements from period to period) and a narrative description of the sensitivity of the fair value measurement to changes in unobservable inputs if a change in those inputs might result in a significantly higher or lower fair value measurement. If there are interrelationships between those inputs and other unobservable inputs used in the fair value measurement, a reporting entity shall also provide a description of those interrelationships and how they might magnify or mitigate the effect of changes in the unobservable inputs on the fair value measurement. To comply with that
disclosure requirement, the narrative description of the sensitivity to changes in unobservable inputs shall include, at a minimum, the unobservable inputs disclosed when complying FASB ASC 820, *Fair Value Measurement*.

**Obligations Resulting From Joint and Several Liability Arrangements**

.142 ASU No. 2013-04, *Liabilities (Topic 405): Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation Is Fixed at the Reporting Date (a consensus of the FASB Emerging Issues Task Force)*, was issued in February 2013 to provide guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this guidance is fixed at the reporting date. This ASU does not apply to obligations addressed within existing guidance in GAAP. Examples of obligations within the scope of this ASU include debt arrangements, other contractual obligations, and settled litigation and judicial rulings.

.143 This ASU requires an entity to measure obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of this guidance is fixed at the reporting date, as the sum of the following:

- The amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors
- Any additional amount the reporting entity expects to pay on behalf of its co-obligors

.144 Entities are also required to disclose the nature and amount of the obligation as well as other information about those obligations.

.145 The amendments in this ASU should be applied retrospectively to all prior periods presented that exist at the beginning of an entity's fiscal year of adoption. An entity may elect to use hindsight for the comparative periods (if it changed its accounting as a result of adopting the amendments in this ASU) and should disclose that fact.

.146 This ASU applies to all entities, both public and nonpublic, and is effective for public companies for fiscal years, and interim periods within those years, beginning after December 15, 2013. For nonpublic entities, the amendments are effective for fiscal years ending after December 15, 2014, and interim periods and annual periods thereafter. Adopting the guidance early is permitted.

**Accounting for Conservation Easements**

.147 NFPs may receive donations of land with conservation easements. They may also receive donations of conservation easements without the underlying land. Businesses and individuals may make these donations to NFPs to take advantage of the related tax deductions. The accounting for these donations by the NFP, including recognition, classification, and valuation, may be complex and require professional judgment.

.148 Conservation easements are legally binding, permanent restrictions on the use, modification, and development of property. Examples of such property include, but are not limited to, parks, farmland, or historic structures. When the easement is applied to the property, current and future owners of...
the easement and underlying property are bound by the terms of the conversation easement. The IRS has issued a document titled "Conservation Easement Audit Techniques Guide." This document can be found at www.irs.gov/pub/irs-utl/conservation_easement.pdf and may be helpful in providing more background on conservation easements.

**Conservation Easement Received With Land**

.149 When an NFP receives a donation of land that includes a conservation easement, the NFP must first determine the unit of account for the transaction and assess whether the land and easement are one or two units of account. The guidance in FASB ASC 350-30-30-1 should be considered when making that determination. If the conservation easement is specific to the land (that is, an attribute of the land that would transfer to a market participant), the NFP would record the land as an asset at the fair value of the land, taking into account the restriction (easement) in accordance with FASB ASC 820-10-35 and 820-10-55-54. FASB ASC 958-605-30-2 provides that a donation of land (that is, a nonreciprocal transfer) should be measured at its fair value on the date of donation in accordance with FASB ASC 820.

.150 If the land and the easement are accounted for as separate assets, the NFP would record the conservation easement as an intangible asset (noncurrent, if the entity presents a classified balance sheet) at its fair value at the date of donation and should then consider the guidance in paragraphs 3–7 of FASB ASC 985-605-45 to determine if the contribution revenue should be classified as unrestricted, temporarily restricted, or permanently restricted. Restrictions that are stipulated by the donor specifically to the NFP are not reflected in the measurement of the land, but rather in the classification of the net assets.

.151 For example, if the donor does not stipulate the NFP's use of donated land, but a conservation easement is legally attached to the land in perpetuity, then the easement is a legal restriction and not a donor restriction, and the revenue would be recorded as unrestricted. The intangible asset recorded should be assessed for impairment following the guidance in FASB ASC 350-30.

**Conservation Easement Received Without Land**

.152 When an NFP receives the donation of a conservation easement without receiving or possessing an interest in the land, the NFP would record the conservation easement as an intangible asset (noncurrent if the entity presents a classified balance sheet) at its fair value at the date of donation and should then consider the guidance in paragraphs 3–7 of FASB ASC 985-605-45 to determine if the contribution revenue should be classified as unrestricted, temporarily restricted, or permanently restricted. The intangible asset recorded should be assessed for impairment following the guidance in FASB ASC 350-30.

**Programmatic Investments**

.153 Instead of making cash grants to other entities, some NFPs provide benefits to their constituencies in the form of financial instruments. Like grants, these financial instruments have as their primary purpose the achievement of the NFP's programmatic mission. For example, an NFP might make a seed money grant to support a new performing arts organization, or it might instead make a seed money loan. A foundation might make a grant to capitalize
a community development loan fund, or it might make a long-term low interest loan to serve a similar purpose. However, as financial instruments, these other forms of financial support have the possibility of producing financial returns, and, thus, they share characteristics with an NFP's traditional investments. These financial instruments, referred to as programmatic investments, offer both financial and programmatic returns.

.154 Foundations are entering into increasingly sophisticated financial instruments allowed under current tax law to fulfill their mission. Not only are they making income statement-oriented grants, but they are also using their large balance sheets to meet the needs of their constituents through programmatic investments.

.155 Traditional programmatic-related investments are usually loans from a foundation to an existing NFP. However, many foundations are using mission-related investments (MRIs) as a means of accomplishing their mission through various financial instrument vehicles. Such MRIs can include the following:

- Letters of credit with banks that lend to underserved communities
- Fixed-income instruments that support environmental projects
- Public equity funds that target high social outcomes
- Real estate investments that target mixed-income housing
- Venture capital funds that target clean technologies or workforce development for underserved communities

.156 Accounting for such instruments requires significant analysis of investment documents to determine whether they are grants, loans, or equity investments. Grant accounting is fairly traditional and straightforward. Programmatic investments or loans are fairly common and easy to account for as long as a rigorous allowance method is utilized when assessing impairment. However, MRIs could possibly take on an equity component and be accounted for using cost, equity method, or fair value depending on the facts and circumstances.

.157 Careful understanding of the changing environment of foundation investments and grants coupled with critical reading of programmatic documents will ensure the proper accounting under U.S. GAAP.

**Contribution vs. Exchange Transaction**

.158 The FASB ASC glossary defines exchange transaction as a reciprocal transfer between two entities that results in one of the entities acquiring assets or services or satisfying liabilities by surrendering other assets or services or incurring other obligations. The FASB ASC glossary definition of contribution states that contributions are an unconditional transfer of cash or other assets to an entity or a settlement or cancellation of its liabilities in a voluntary, nonreciprocal transfer by another entity acting other than as an owner, and they differ from exchange transactions, which are reciprocal transfers in which each party receives and sacrifices something of approximately equal value.

.159 In some situations, exchange transactions can be easily distinguished from contributions. For example, sales in a museum bookstore or payments of employees' salaries clearly are exchange transactions: Each party gives up and receives equivalent economic value. In contrast, an example of a contribution
is a donation to an NFP's mass fund-raising appeal: Donors provide resources in support of the NFP's mission and expect to receive nothing of direct value in exchange. In most cases, the distinction between contribution and exchange transactions is clear. However, in other cases, there may be an element of both.

The following table contains the list of indicators from FASB ASC 958-605-55-8 that may be helpful in determining whether individual asset transfers are contributions, exchange transactions, or a combination of both. Depending on the facts and circumstances, some indicators may be more significant than others; however, no single indicator is determinative of the classification of a particular transaction. Indicators of a contribution tend to describe transactions in which the value, if any, returned to the resource provider is incidental to potential public benefits. Indicators of an exchange tend to describe transactions in which the potential public benefits are secondary to the potential proprietary benefits to the resource provider.

### Indicators That Can Distinguish Contributions From Exchange Transactions

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<tr>
<th>Indicator</th>
<th>Contribution</th>
<th>Exchange Transaction</th>
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<tr>
<td>Recipient not-for-profit entity's (NFP's) intent in soliciting the asset*</td>
<td>Recipient NFP asserts that it is soliciting the asset as a contribution.</td>
<td>Recipient NFP asserts that it is seeking resources in exchange for specified benefits.</td>
</tr>
<tr>
<td>Resource provider's expressed intent about the purpose of the asset to be provided by recipient NFP</td>
<td>Resource provider asserts that it is making a donation to support the NFP's programs.</td>
<td>Resource provider asserts that it is transferring resources in exchange for specified benefits.</td>
</tr>
<tr>
<td>Method of delivery</td>
<td>The time or place of delivery of the asset to be provided by the recipient NFP to third-party recipients is at the discretion of the NFP.</td>
<td>The method of delivery of the asset to be provided by the recipient NFP to third-party recipients is specified by the resource provider.</td>
</tr>
<tr>
<td>Method of determining amount of payment</td>
<td>The resource provider determines the amount of the payment.</td>
<td>Payment by the resource provider equals the value of the assets to be provided by the recipient NFP or the assets' cost plus markup; the total payment is based on the quantity of assets to be provided.</td>
</tr>
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### Not-for-Profit Entities Industry Developments—2014

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<tr>
<th>Indicator</th>
<th>Contribution</th>
<th>Exchange Transaction</th>
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<tbody>
<tr>
<td>Penalties assessed if the NFP fails to make a timely delivery of assets</td>
<td>Penalties are limited to the delivery of assets already produced and the return of the unspent amount. (The NFP is not penalized for nonperformance.)</td>
<td>Provisions for economic penalties exist beyond the amount of payment. (The NFP is penalized for nonperformance.)</td>
</tr>
<tr>
<td>Delivery of assets to be provided by the recipient NFP</td>
<td>Assets are to be delivered to individuals or organizations other than the resource provider.</td>
<td>Assets are to be delivered to the resource provider or to individuals or organizations closely connected to the resource provider.</td>
</tr>
</tbody>
</table>

* This table refers to assets. Assets may include services. The terms assets and services are used interchangeably in this table.

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**Classification of the Sale Proceeds of Donated Financial Assets in the Statement of Cash Flows**

.161 ASU No. 2012-05, Statement of Cash Flows (Topic 230): Not-for-Profit Entities: Classification of the Sale Proceeds of Donated Financial Assets in the Statement of Cash Flows (a consensus of the FASB Emerging Issues Task Force), requires an NFP to consistently classify within a statement of cash flows cash receipts from the sale of donated financial assets with cash donations received for similar purposes. The cash receipts from the sale of donated financial assets must, upon receipt, have been directed without any NFP-imposed limitations for sale and converted nearly immediately into cash. Accordingly, the cash receipts from the sale of those financial assets should be classified as cash inflows from operating activities, unless the donor restricted the use of the contributed resources to long-term purposes, in which case, those cash receipts should be classified as cash flows from financing activities. Otherwise, cash receipts from the sale of donated financial assets should be classified as cash flows from investing activities by the NFP. The decision tree that follows illustrates the process outlined in the ASU.
The amendments in this ASU are effective prospectively for fiscal years, and interim periods within those years, beginning after June 15, 2013. Retrospective application to all prior periods presented upon the date of adoption is permitted. Adopting the guidance early from the beginning of the fiscal year of adoption is permitted. For fiscal years beginning before October 22, 2012, adopting the guidance early is permitted only if an NFP's financial statements for those fiscal years, and interim periods within those years, have not yet been made available for issuance.

**Recent Pronouncements**

AICPA auditing and attestation standards are applicable only to audits and attestation engagements of nonissuers. The PCAOB establishes auditing and attestation standards for audits of issuers. For information on pronouncements issued subsequent to the writing of this alert, please refer to the AICPA website at www.aicpa.org, the FASB website at www.fasb.org, and the PCAOB website at www.pcaob.org. You also may look for announcements of newly issued accounting standards in the *CPA Letter Daily* and the *Journal of Accountancy*.

**Recent Auditing and Attestation Pronouncements and Related Guidance**

The following table presents a list of recently issued auditing and attestation pronouncements and related guidance.

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*Nearly immediately* is not defined within the FASB ASC. However, the basis for conclusions of the Accounting Standards Update indicates that this term is intended to be a matter of days, not months, after receipt of the donor-contributed financial assets.
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<td><strong>Statement on Auditing Standards (SAS) No. 128, Using the Work of Internal Auditors (AICPA, Professional Standards)</strong> Issue Date: February 2014</td>
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| **SAS No. 127, Omnibus Statement on Auditing Standards—2013 (AICPA, Professional Standards)** Issue Date: January 2013 |
| This SAS amends AU-C section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)* (AICPA, Professional Standards) and AU-C section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks* (AICPA, Professional Standards). This statement includes amendments that address making reference to the audit of a component auditor when the component’s financial statements are prepared using a different financial reporting framework, clarify and provide guidance when determining that a component auditor has performed an audit that meets the relevant requirements of generally accepted auditing standards, clarify requirements for determining component materiality, and expand the definition of *special purpose framework of accounting*. This SAS is effective for audits of financial statements for periods ending on or after December 15, 2012. |

**Recent ASUs**

.165 The following table presents, by codification area, a list of recently issued ASUs, through the issuance of ASU No. 2014-05. However, this table does not include ASUs that are SEC updates (such as ASU No. 2012-03, *Technical Amendments and Corrections to SEC Sections: Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 114, Technical Amendments Pursuant to SEC Release No. 33-9250, and Corrections Related to FASB Accounting Standards Update 2010-22 [SEC Update]*) or ASUs that are technical corrections to various topics. FASB ASC does include SEC content to improve its usefulness for public companies, but the content labeled as SEC.
staff guidance does not constitute rules or interpretations of the SEC nor does such guidance bear official SEC approval.

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Recently Issued Technical Questions and Answers

AICPA nonauthoritative accounting and audit and attest technical questions and answers address a variety of practice issues encountered by practitioners. The following table presents a list of recently issued nonauthoritative audit, attest, and accounting technical questions and answers issued by the AICPA. Recently issued questions and answers can be accessed at www.aicpa.org/InterestAreas/FRC/Pages/RecentlyIssuedTechnicalQuestionsandAnswers.aspx.

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**Reporting**

| TIS section 9100.08 (June 2013) | "Audit Firm With Multiple Offices on Their Company Letterhead and Effect on Report" |
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| TIS section 9110.23 (March 2013) | "Modification of Compliance Report When Financial Statements Are Audited in Accordance With GAAS" |
| TIS section 9110.22 (March 2013) | "Use of Restricted Alert Language When Financial Statements Are Audited in Accordance With GAAS and Government Auditing Standards" |
| TIS section 9110.21 (March 2013) | "Reporting on Current-Value Financial Statements That Supplement Historical-Cost Financial Statements in Presentations of Real Estate Entities" |

### Recent AICPA Independence and Ethics Developments

.167 The Alert Independence and Ethics Developments—2012/13 (product no. ARAIET12P) contains a complete update on new independence and ethics pronouncements. This alert will heighten your awareness of independence and ethics matters likely to affect your practice. Obtain this alert by calling the AICPA at 888.777.7077 or visiting www.cpa2biz.com.

### AICPA Code of Professional Conduct

.168 In January 2014, the AICPA's Professional Ethics Executive Committee (PEEC) adopted a restructured and codified AICPA Code of Professional Conduct (AICPA Code) so that members and other users of the AICPA Code can apply the rules and reach correct conclusions more easily and intuitively. To achieve this, PEEC restructured the AICPA Code into several parts organized by topic, edited it using consistent drafting and style conventions, incorporated a conceptual framework for members in public practice and business, revised certain provisions to reflect the conceptual framework approach (also known as the threats and safeguard approach), and, where applicable, referenced existing nonauthoritative guidance to the relevant topic. PEEC maintained the substance of the existing AICPA ethics standards. PEEC believes this was achieved; however, during the process, PEEC identified some areas that needed revision and have been highlighted as substantive changes. The revised AICPA Code will be effective December 15, 2014.

### New Structure of the Code

.169 The restructured AICPA Code is divided into separate parts. The first part is the preface, which is applicable to all members and covers topics such as the structure of the code; the principles of professional conduct; the defined terms that are used in the code; nonauthoritative guidance; and new, revised, and pending interpretations. The remaining three parts are divided according to a member's practice. Part 1 is applicable to members in public practice, part 2 is applicable to members in business, and part 3 is applicable to all other members, such as those who are retired or unemployed. By structuring the AICPA Code this way, PEEC believes that members will be able to easily identify what provisions apply to them. For members who are both in public practice and business, content that is relevant to both parts appears in the corresponding citation (an explanation of numeric citations follows). The actual
content differs only where necessary (for example, part 1 might refer to a firm, whereas part 2 might refer to an employer).

**Numeric Citations**

.170 The new citation numbering system for the AICPA Code looks like this: ET section X.XXX.XXX. The single digit that begins the citation identifies in which part the content resides. Accordingly, content from the preface begins with the single digit 0.XXX.XXX, whereas content for part 1 begins with a 1.XXX.XXX, part 2 with a 2.XXX.XXX, and part 3 with a 3.XXX.XXX. Next are two sets of three-digit numbers that identify the topics and, when applicable, subtopics or sections. To facilitate use, when a topic, subtopic, or section appears in two or more parts, the same number is used.

**Rules of Conduct**

.171 The bylaws of the AICPA require that members adhere to the rules of the AICPA Code. This has not changed with the restructured code. However, the specific rule numbers are no longer being used. For example, Rule 101, Independence, is now referred to as the Independence Rule. In addition, the manner in which the interpretations are aligned with the rules has changed. In the currently effective version of the AICPA Code, content is aligned under the applicable rules, whereas in the restructured AICPA Code, the rules are aligned with the interpretations under a broad topic. For example, the Contingent Fees Rule and Commission and Referral Fees Rule and related interpretations appear under ET section 1.500, "Fees and Other Types of Remuneration" (AICPA, Professional Standards).

.172 Given this construct, there are some situations in which the rule appears multiple times in the AICPA Code. For example, the Integrity and Objectivity Rule appears under the Integrity and Objectivity topic of both parts 1 and 2. However, the interpretations of this rule do not necessarily appear in both parts 1 and 2. Rather, they are aligned with the member’s practice. For example, under the Integrity and Objectivity topic, there is a subtopic called Conflicts of Interest in both parts 1 and 2. In part 1, there is an interpretation that addresses conflicts of interest concerns when a member in public practice is also a director of an entity. However, this interpretation does not appear in part 2 because it would not be applicable to such members.

.173 Finally, all ethics rulings have been redrafted as interpretations and codified under the appropriate topic.

**Conceptual Framework**

.174 PEEC incorporated two conceptual framework interpretations into the restructured AICPA Code: one for members in public practice and another, very similar one for members in business. In addition, for members in public practice who provide attest services to clients, there is a conceptual framework for independence that focuses on the specific threats to independence. The conceptual framework for independence is a redraft of the extant Conceptual Framework for AICPA Independence Standards (AICPA, Professional Standards, ET sec. 100-1). These conceptual framework interpretations are designed to assist members when they encounter a relationship or circumstance that creates threats to their compliance with the rules and when the AICPA Code contains no specific guidance to assist the member. When specific guidance is absent, under the conceptual framework interpretations, the member
should evaluate whether that circumstance or relationship would lead a rea-
sonable and informed third party that is aware of the relevant information to
conclude that there is an unacceptable threat to the member's compliance with
the rules.

.175 In addition to the two conceptual framework interpretations, certain
interpretations were recast to reflect the conceptual framework approach that
represents a significant change. For example, the existing interpretation that
prohibits a covered member from having a direct financial interest in a client
is proposed to read as follows:

If a covered member had or was committed to acquire any direct finan-
cial interest in an attest client during the period of the professional
engagement, the self-interest threat to the covered member's compli-
ance with the Independence Rule would not be at an acceptable level
and could not be reduced by the application of safeguards. Accordingly,
independence would be impaired.

PEEC believes this will enhance understanding of the AICPA Code by pro-
viding additional context to the code and guidance on the application of the
framework. However, recasting will not change the substance of the existing
AICPA Code by allowing members to apply judgment where none is permitted
today. For example, as noted in the preceding statement, if a covered member
holds stock in an audit client, the only safeguard that would eliminate or suffi-
ciently mitigate the self-interest threat to independence would be to eliminate
the interest or cease being a covered member, which is the same requirement
as under the current AICPA Code. Thus, recasting does not weaken the code or
allow for judgment where none is permitted now. Some interpretations in the
code, such as those for acts discreditable, false advertising, and confidentiality,
do not lend themselves to a conceptual framework approach and, as such, were
not recast. For those interpretations, PEEC applied only drafting and style
conventions.

Nonauthoritative Guidance

.176 The primary objectives of restructuring the AICPA Code is so that
members and other users can apply the code more easily, thus, minimizing
the risk of misapplication. To assist members in understanding and applying
the AICPA Code, periodically the Ethics division develops nonauthoritative
guidance (for example, frequently asked questions and Basis for Conclusions
documents) that resides outside the AICPA Code. As described in the "Nonau-
thoritative Guidance" section of the Ethics codification, during the restruc-
turing, PEEC reevaluated the nonauthoritative guidance and either proposed that
some of it be made authoritative and incorporated into the revised AICPA Code
or aligned links to the nonauthoritative content with the relevant topic.

Nonattest Services

.177 Several changes to Interpretation No. 101-3, "Nonattest Services," under Rule 101, Independence (AICPA, Professional Standards, ET sec. 101 par. .05), were made. PEEC believes these revisions will add clarity to the nonattest services guidance and enhance practitioners' understanding of the interpretation's requirements. Changes adopted affecting nonattest services included the following:

- Providing a limited exception to the period of impairment
Clarifying language regarding the general requirements for performing nonattest services, including enhanced definitions of management responsibilities

- Defining activities related to attest services and, therefore, not constituting a nonattest service subject to Interpretation No. 101-3
- Technical corrections to compliance requirements with independence regulations of certain regulatory bodies
- Addition of nonattest services
- Independence monitoring activities

.178 More detailed information on each of the changes follows.

**Period of Impairment Limited Exception When Performing Nonattest Services**

.179 Interpretation No. 101-3 states that members performing attestation services must remain independent during the period covered by the financial statements and the period of the professional engagement. This interpretation was modified to provide a limited exception if prohibited services were performed during the period covered by the financial statements, provided that the nonattest services were provided prior to the period of the professional engagement; the nonattest services related only to periods prior to the period covered by the financial statements; and the financial statements for the period to which the nonattest services relate were audited by another firm (or, in the case of a review engagement, reviewed by another firm).

**Management’s Responsibilities When Performing Nonattest Services**

.180 The term *management responsibilities* replaces the term *management functions*. PEEC believes that the term *management responsibilities* will better help members distinguish between management responsibilities and other types of services. In addition, this change converges terms used by other standard-setting bodies. A member assuming management responsibilities for an attest client would create a management participation threat so significant that no safeguards could reduce the threat to an acceptable level and, therefore, would impair independence. The interpretation adds explanatory language on what constitutes *management responsibilities*, which are defined as involving leading and directing an entity, including making significant decisions regarding the acquisition, deployment, and control of human, financial, physical, and intangible resources.

.181 Examples of activities that would be considered a management responsibility and would impair independence if performed for an attest client include

- setting policies or strategic direction for the client.
- directing or accepting responsibility for the actions of the client's employees, except to the extent permitted when using internal auditors to provide assistance for services performed under auditing or attestation standards.
- authorizing, executing, or consummating a transaction or otherwise exercising authority on behalf of a client or having the authority to do so.
• preparing source documents, in electronic or other form, evidencing the occurrence of a transaction.
• having custody of client assets.
• deciding which recommendations of the member or other third parties to implement or prioritize.
• reporting to those in charge of governance on behalf of management.
• serving as a client’s stock transfer or escrow agent, registrar, general counsel, or its equivalent.
• accepting responsibility for the management of a client’s project.
• accepting responsibility for the preparation and fair presentation of the client’s financial statements in accordance with the applicable financial reporting framework.
• accepting responsibility for designing, implementing, or maintaining internal controls.
• performing ongoing evaluations of the client’s internal control as part of its monitoring activities.

.182 Additional examples of nonattest services when independence would not be impaired were added for performance of reconciliations and network maintenance services.

.183 Members are cautioned that regulatory bodies, such as the SEC and Government Accountability Office, may have different requirements and, therefore, should be consulted when performing attestation work under those standards.

**Activities Not Considered Nonattest Services Because the Activities Are Considered to Be Related to Attest Services**

.184 PEEC also clarified that when performing attest services, members often have communications with the client that are a routine part of the engagement and, therefore, are not considered nonattest services and subject to the general requirements of Interpretation No. 101-3. Such communications may include the following:

• Client’s selection and application of accounting standards or policies and financial statement disclosure requirements
• Appropriateness of a client’s accounting and financial reporting methods
• Adjusting journal entries that the member prepared or proposed for the client’s consideration
• The form or content of the financial statements

**Engagements Subject to Independence Rules of Certain Regulatory Bodies**

.185 Changes to Interpretation No. 101-3 added the PCAOB as an example authoritative regulatory body for which compliance is required when performing nonattest services for a client for which independence is required under regulations of the regulatory body.
**Additional Nonattest Services**

.186 This revision concludes that financial statement preparation, cash-to-accrual conversions, and reconciliations are considered outside the scope of the attest engagement and, therefore, constitute nonattest services subject to the general requirements of the interpretation. This revision is effective for engagements covering periods beginning on or after December 15, 2014.

**Independence Monitoring Activities**

.187 This revision clarifies the impact that performing ongoing and separate evaluations have on independence. Although the revisions include a description of these two types of monitoring activities, members seeking further guidance on distinguishing between ongoing and separate evaluations are directed to the COSO *Internal Control—Integrated Framework*. This revision is effective for engagements covering periods beginning on or after December 15, 2013.

**On the Horizon**

.188 Auditors should keep abreast of auditing and accounting developments and upcoming guidance that may affect their engagements. The following sections present brief information about some ongoing projects that have particular significance to NFPs or that may result in significant changes. Remember that exposure drafts are nonauthoritative and cannot be used as a basis for changing existing standards.

.189 Information on, and copies of, outstanding exposure drafts may be obtained from the various standard-setters’ websites. These websites contain in-depth information about proposed standards and other projects in the pipeline. Many more accounting and auditing projects exist in addition to those discussed here. Readers should refer to documents provided by the various standard-setting bodies for further information.

**Auditing and Attestation Pipeline—Nonissuers**

**Attestation Standards Clarity Project**

.190 The Attestation Recodification Task Force is in the process of clarifying Statements on Standards for Attestation Engagements and converging them with the International Standards on Assurance Engagements issued by the International Auditing and Assurance Standards Board. The task force has developed a draft Statement on Standards for Attestation Engagements that would replace the more general attestation standards (AT sections 20, 50, 101, and 201). Once this material is finalized, the task force expects to focus on the subject matter-specific standards (that is, AT sections 301–801).

.191 The following are some of the conclusions reached by the ASB regarding the proposed clarified attestation standards:

- The practitioner should be required to obtain a written assertion in an examination or review engagement.
- If the responsible party refuses to provide written representations, and the responsible party is not the engaging party, the practitioner may report directly on the subject matter and restrict the use of the report to the engaging party.
The clarified attestation standards should include a preface that explains what the attestation standards are and how they are organized.

A risk assessment model should be incorporated in the section of the attestation standards that addresses examination engagements.

The guidance in the clarified attestation standards should not be overburdened by the incorporation of all the detailed requirements in the clarified auditing standards.

The illustrative examination reports should address a variety of subject matters, for example, qualitative subject matter, such as the effectiveness of controls.

The guidance on compilations of prospective financial statements will be removed from the attestation standards, and the AICPA Accounting and Review Services Committee will address this topic.

Accounting Pipeline

FASB has a variety of research and standard-setting projects currently underway. The description and status of each project is available at www.fasb.org. Some of these projects that are of special interest to NFPs are discussed in the following paragraphs.

NFP Financial Reporting: Financial Statements

The objective of this project is to reexamine existing standards for financial statement presentation by NFPs, focusing on improving the following:

- Net asset classification requirements
- Information provided in financial statements and notes about liquidity, financial performance, and cash flows

Some of the key, tentative decisions reached by the FASB board on this project are listed subsequently.

Statement of Functional Expenses

The FASB board continued deliberations and tentatively decided to improve the reporting of expenses for all NFPs by

- requiring NFPs to report expenses by their nature and retaining the requirement to report expenses by function;
- continuing to allow NFPs the flexibility to present expenses by either function or nature, or both, on the face of the statement of activities or within the notes; and
- requiring NFPs to provide an analysis of all expenses by function and by nature in one location in the statement of activities, a separate statement of expenses (currently called a statement of functional expenses), or a schedule in the notes. That analysis would include all expenses, both operating and non-operating, and would neither require nor preclude functionalization of non-operating expenses. Although this analysis would typically be provided in the form of a matrix, that specific format would not be required.
.196 For voluntary health and welfare organizations that are currently required to present expenses by function and by nature in a matrix format in the statement of functional expenses, the decisions reached would allow them the same presentation and disclosure flexibility as other NFPs in how they communicate information about expenses.

Operating Measure

.197 The FASB board tentatively decided to define an intermediate operating measure on the basis of two key dimensions:

- A mission dimension based on whether resources are from or directed at carrying out an NFP’s purpose for existence.
- An availability dimension based on whether resources are available for current period activities and reflecting both external limitations and internal actions of an NFP’s governing board.

.198 Before conducting further outreach, the board directed the staff to explore whether the availability dimension should be limited to resources that are liquid.

.199 The board also considered three alternatives for presenting an intermediate measure in an NFP’s statement of activities. It tentatively decided to support an alternative that would present all legally available mission-related revenues before reductions for amounts designated by the governing board for use in future periods, rather than only the net of those amounts. That presentation also would include amounts of previously unavailable resources that the governing board made available for use in the current period.

.200 The board also discussed certain implementation matters but concluded that they would be better addressed later in the project. The board will consider at a future meeting whether the presentation of an intermediate operating measure would be required, permitted, or encouraged.

Presentation of Net Asset Classes

.201 The key tentative decisions reached by the FASB board with regard to net asset classes and presentation of restrictions are as follows:

- Replace the existing requirements of paragraph 1 of FASB ASC 958-210-45 and paragraph 1 of 958-225-45 to present totals for each of three classes of net assets on the face of a statement of financial position and for changes in each of those classes on the face of a statement of activities with similar requirements for each of two classes of net assets that convey net assets with donor-imposed restrictions and without donor-imposed restrictions. The board also decided to make conforming changes to the terminology and definitions of the net asset classes.

- Retain the current requirement to provide information about the nature and amounts of different types of donor-imposed restrictions but modify the requirement to (a) remove the hard-line distinction between temporary restrictions and permanent restrictions and (b) focus instead on describing differences in the nature with a focus on both how and when the resources (net assets) can be used.
• Require disclosure of information about the amount and purposes of board designations of net assets without donor-imposed restrictions.

Cash Flows

.202 The board tentatively decided to improve the statement of cash flows by requiring the direct method of reporting cash flows provided [used] by operating activities and removing the requirement to reconcile the change in net assets to net cash flows from operating activities (often referred to as the indirect method).

.203 The board also discussed revising the cash flow categories to better align them with the tentative decision for an intermediate measure of operations. The board agreed such revisions are desirable and decided that they would include the following:

- Cash gifts with donor-imposed restrictions that they be used to purchase, construct, or otherwise acquire long-lived assets for operating purposes would be classified as inflows from operating activities rather than as inflows from financing activities.
- Cash payments to purchase, construct, or otherwise acquire long-lived assets for operating purposes would be classified as outflows from operating activities rather than as outflows from investing activities.
- Cash dividends and interest income would be classified as inflows from investing activities rather than as inflows from operating activities.
- Cash payments of interest expense would be classified as outflows from financing activities rather than as outflows from operating activities.

.204 An exposure document is expected to be issued in the first half of 2014.

Revenue Recognition

.205 FASB and the International Accounting Standards Board (IASB) initiated a joint project to clarify the principles for recognizing revenue and develop a common revenue standard for GAAP and International Financial Reporting Standards (IFRSs) that would

- remove inconsistencies and weaknesses in existing revenue requirements.
- provide a more robust framework for addressing revenue issues.
- improve comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets.
- provide more useful information to users of financial statements through improved disclosure requirements.
- simplify the preparation of financial statements by reducing the number of requirements to which an entity must refer.

.206 A final standard is expected in the first half of 2014.

ARANPO .206
**Insurance Contracts**

.207 In January 2014, the FASB board discussed whether the scope of the insurance contracts project should continue to include all entities that issue insurance contracts as proposed in the exposure draft that was issued in June 2013. They decided to limit the scope to insurance entities as described in existing U.S. GAAP.

.208 The board also discussed a range of possible approaches the project could take, including considering a comprehensive redeliberation of the project based on the proposed ASU or considering targeted improvements to existing U.S. GAAP. They decided the project should focus on making targeted improvements to existing U.S. GAAP. For short-duration contracts, the board decided to limit the targeted improvements to enhancing disclosures. For long-duration contracts, the board concluded that decisions reached by the IASB in its 2013 IASB Exposure Draft *Insurance Contracts* should be considered when contemplating improvements to existing U.S. GAAP.

**Reporting Discontinued Operations**

.209 FASB issued an exposure draft *Presentation of Financial Statements (Topic 205): Reporting Discontinued Operations* on April 2, 2013. The comment period ended on August 30, 2013. The primary objective of the project is to improve the definition and reporting of discontinued operations. Some stakeholders have said that too many disposals of assets qualify for discontinued operations presentation. This results in financial statements that are not decision useful for users and in higher costs for preparers. The project will also enhance convergence of FASB’s and the IASB’s reporting requirements for discontinued operations. A final ASU is expected to be issued in the first half of 2014.

**Transfers and Servicing: Repurchase Agreements and Similar Transactions**

.210 On January 15, 2013, FASB issued proposed ASU *Transfers and Servicing (Topic 860)—Effective Control for Transfers with Forward Agreements to Repurchase Assets and Accounting for Repurchase Financings*. The objective of this project is to improve the existing accounting and disclosure guidance on repurchase agreements and other transactions involving a transfer and a forward agreement to repurchase the transferred assets at a fixed price from the transferee to address application issues and changes in the marketplace and to ensure that investors obtain useful information about these transactions.

**Troubled Debt Restructuring**

.211 In July 2013, FASB issued proposed ASU *Receivables—Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Collateralized Mortgage Loans upon a Troubled Debt Restructuring*. The amendments in this proposed ASU would clarify that an in-substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon (a) the creditor obtaining legal title to the residential real estate property or (b) completion of a deed in lieu of foreclosure or similar legal agreement under which the borrower conveys all interest in the residential real estate property to the creditor to satisfy that loan, even though legal title may not yet have passed. In addition, the proposal would require that an entity that
receives physical possession of residential real estate property collateralizing a consumer mortgage loan disclose a roll-forward schedule reconciling the change from the beginning to the ending balance of such foreclosed properties at every reporting period. An entity would also be required to disclose the recorded investment in consumer mortgage loans secured by residential real estate properties that are in the process of foreclosure according to local requirements of the applicable jurisdiction.

**Financial Instruments**

.212 The purpose of this project is to significantly improve the decision usefulness of financial instrument reporting for users of financial statements. The project will replace FASB's and the IASB's respective financial instruments standards with a common standard. The boards believe that simplification of the accounting requirements for financial instruments should be an outcome of this improvement. The project comprises three subparts. The status of those is as follows:

- Financial instruments classification and measurement. The objective is to improve financial reporting by providing a comprehensive measurement framework for classifying and measuring financial instruments. An initial exposure draft was issued in 2010. A proposed ASU was issued for reexposure on February 14, 2013, with a comment deadline of May 15, 2013. The proposed standard is currently being redeliberated by the FASB board.

- Financial instruments hedging exposure draft issued in 2008. Redeliberations have not yet occurred. Reexposure is not yet scheduled.

- Financial instruments credit losses. This discusses financial assets that are not accounted for at fair value through net income and are exposed to potential credit risk. Loans, debt securities, trade receivables, lease receivables, loan commitments, reinsurance receivables, and any other receivables that represent the contractual right to receive cash would generally be affected by the proposed amendments. The comment deadline was April 30, 2013. The proposed standard is currently being redeliberated by the FASB board.

**Leases**

.213 The purpose of this project is to develop a new approach to lease accounting that would ensure that assets and liabilities arising under leases are recognized in the statement of financial position. The proposed standard is currently being redeliberated by the FASB board.

**Going Concern**

.214 The purpose of this project is to provide guidance about (a) how an entity should assess its ability to continue as a going concern and (b) the timing, nature, and extent of any related disclosure requirements. The proposed standard is currently being redeliberated by the FASB board.

**Development Stage Entities**

.215 The project is intended to reduce cost and complexity in the financial reporting system by eliminating inception-to-date information from the
financial statements of development stage entities. As part of the project, the staff will research potential additional disclosures that could result in increased relevance for users of development stage entity financial statements. A final standard is expected to be issued in the first half of 2014.

**Investment Companies: Disclosures About Investments in Another Investment Company**

.216 The objective of this project is to require disclosures in an investment company’s financial statements that will provide transparency into the risks, returns, and expenses of an investee that is also an investment company. An exposure document is expected to be issued in the first half of 2014.

**Accounting for Goodwill for Public Business Entities and Not-for-Profits**

.217 The objective of this project is to reduce the cost and complexity of the subsequent accounting for goodwill for public business entities and NFPs. On November 25, 2013, the board added accounting for goodwill for public business entities and NFPs to the agenda. No documents have been issued to date.

**Accounting for Government Assistance**

.218 The objective of this research project is to explore whether there is a need to establish explicit guidance for the accounting and disclosure of government assistance that improves the content, quality, and comparability of financial information and financial statements and is responsive to the emerging issues in the changing financial and economic environment in which reporting entities operate. The results of this research effort will be used by the board to decide whether to add a standards-setting project to the board’s agenda.

**Disclosure Framework**

.219 The objective of this project is to improve the effectiveness of disclosures in notes to financial statements by clearly communicating the information that is most important to users of each entity’s financial statements. An exposure draft is not scheduled at this time.

**Resource Central**

.220 The following are various resources that practitioners engaged in the not-for-profit industry may find beneficial.

**Publications**

.221 Practitioners may find the following publications useful. Choose the format best for you—online or print.

- Audit and Accounting Guide *Not-for-Profit Entities* (2014) (product no. AAGNFP14P [paperback], ARANFP14E [eBook], WNP-XX [online with the associated Audit Risk Alert], or DNP-XX [CD-ROM])

- Audit Guide *Government Auditing Standards and Circular A-133 Audits* (2014) (product no. AAGGAS14P [paperback], AAGGAS14E [eBook] or WRF-XX [online with the associated Audit Risk Alert])
Audit and Accounting Guide Health Care Entities (2013) (product no. AAGHCO13P [paperback], AAGHCO13E [eBook] or WHC-XX [online with the associated Audit Risk Alert])

Audit and Accounting Guide Employee Benefit Plans (2014) (product no. AGEBP14P [paperback], AGEBP14E [eBook] or WEB-XX [online])

Audit Guide Analytical Procedures (2012) (product no. AAGANP12P [paperback], AAGANP12E [eBook] or WAN-XX [online])

Audit Guide Assessing and Responding to Audit Risk in a Financial Statement Audit (2012) (product no. AAGRAS12P [paperback], AAGRAS12E [eBook] or WRA-XX [online])

Guide Compilation and Review Engagements (2013) (product no. AAGCRV13P [paperback], or AAGCRV13E [eBook] or WRC-XX [online])

Audit Guide Audit Sampling (2012) (product no. AAGSAM12P [paperback], AAGSAM12E [eBook], or WAS-XX [online])

Alert Compilation and Review Developments—2013/14 (product no. ARACRV13P [paperback] or ARACRV13E [eBook])

Audit Risk Alert General Accounting and Auditing Developments—2013/14 (product no. ARAGEN13P [paperback], ARAGEN13E [eBook], or WGE-XX [online])

Alert Independence and Ethics Developments—2012/13 (product no. ARAIET12P [paperback], ARAIET12E [eBook], or WIA-XX [online])

Audit Risk Alert Employee Benefit Plans Industry Developments—2014 (product no. ARAEBP14P [paperback] or ARAEBP14E [eBook])

Checklists and Illustrative Financial Statements Not-for-Profit Entities (product no. ACKNFP13P [paperback] or WNP-CL [online])


IFRS Financial Statements—Best Practices in Presentation and Disclosure (2012/13) (product no. ATTIFRS12P [paperback] or WIF-XX [online])

Not-for-Profit Entities—Best Practices in Presentation and Disclosure (product no. ATTNPO13P [paperback] or WNT-XX [online])

Audit and Accounting Manual (2013) (product no. AAMAAM13P [paperback] or WAM-XX [online])

Continuing Professional Education

The AICPA offers a number of continuing professional education (CPE) courses that are valuable to CPAs working in public practice and industry, including the following:

Annual Update for Accountants and Auditors (2013–2014 edition) (product no. 730099 [text], 153675 [On-Demand], or 180099 [DVD and manual]). Whether you are in industry or public practice,
this course keeps you current and informed and shows you how to apply the most recent standards.

- **Internal Control Essentials for Financial Managers, Accountants, and Auditors** (product no. 731905 [text], 159821 [On-Demand], or 181859 [DVD and manual]). This course will provide you with a solid understanding of systems and control documentation at the significant process level.

- **International Versus U.S. Accounting: What in the World is the Difference?** (product no. 745942 [text]). Understanding the differences between IFRSs and GAAP is becoming more important for businesses of all sizes. This course outlines the major differences between IFRSs and GAAP.

.223 Among the many courses, the following are specifically related to the NFP industry:

- **Not-For-Profit: Start to Finish—How to Run and Finish the Race** (product no. 732987 [text]). This course trains you to clear the key hurdles in NFP accounting and reporting in an efficient and effective manner. Avoid the potholes of confusion and finish first by providing a financial picture that end users can truly understand.

- **Nonprofit Auditing and Accounting: The Annual Update (2013–2014 edition)** (product no. 732099 [text] or 182081 [DVD and manual]). Covering all the latest auditing and accounting developments affecting NFPs, this course will give you a complete understanding of changes in the NFP environment.

- **Not-for-Profit Organizations: The Accounting and Reporting Practices** (product no. 743281 [text]). Understand and apply the requirements of FASB and AICPA pronouncements to your NFP clients. Consider real world financial statements, cases, and problems faced by CPAs with NFP clients and executives of NFPs.

- **Government and Not-for-Profit Frauds: Frequent Frauds Found in These Entities** (product no. 733316 [text]). Through an informative case study approach, this course illustrates common frauds that make headlines and damage the reputations of governments and NFPs.

.224 Visit www.cpa2biz.com for a complete list of CPE courses.

**Online CPE**

.225 AICPA CPExpress, offered exclusively through CPA2Biz, is the AICPA's flagship online learning product. Divided into 1-credit and 2-credit courses that are available 24 hours a day, 7 days a week, AICPA CPExpress offers hundreds of hours of learning in a wide variety of topics. Subscriptions are available at www.cpa2biz.com/AST/Main/CPA2BIZ_Primary/Tax/Research/PRDOVR~PC-BYF-XX/PC-BYF-XX.jsp (product no. BYF-XX). Some topics of special interest to NFPs include the following:

- Nonprofit Auditing: Unique Auditing for a Unique Entity
- Fraud in Exempt Organizations: The Governmental and Not-for-Profit Environments
- Nonprofit Accounting: Financial Reporting
Webcasts

Stay plugged in to what is happening and earn CPE credit right from your desktop. AICPA webcasts are high quality CPE programs that bring you the latest topics from the profession's leading experts. Broadcast live, they allow you to interact with the presenters and join in the discussion. If you cannot make the live event, each webcast is archived and available for viewing. For additional details on available webcasts, please visit www.cpa2biz.com/AST/AICPA_CPA2BIZ_Browse/Store/Webcasts.jsp.

Member Service Center

To order AICPA products, receive information about AICPA activities, and get help with your membership questions, call the AICPA Service Center Operations at 888.777.7077.

Hotlines

Accounting and Auditing Technical Hotline

Do you have a complex technical question about GAAP, other comprehensive bases of accounting, or other technical matters? If so, use the AICPA's Accounting and Auditing Technical Hotline. AICPA staff will research your question and call you back with the answer. The hotline is available from 9 a.m. to 8 p.m. ET on weekdays. You can reach the Technical Hotline at 877.242.7212 or online at www.aicpa.org/Research/TechnicalHotline/Pages/TechnicalHotline.aspx. Members can also e-mail questions to aahotline@aicpa.org. Additionally, members can submit questions by completing a Technical Inquiry form found on the same website.

Ethics Hotline

In addition to the Technical Hotline, the AICPA also offers an Ethics Hotline. Members of the AICPA's Professional Ethics Team answer inquiries concerning independence and other behavioral issues related to the application of the AICPA Code of Professional Conduct. You can reach the Ethics Hotline at 888.777.7077 or by e-mail at ethics@aicpa.org.

AICPA Online Professional Library: Accounting and Auditing Literature

The AICPA has created your core accounting and auditing library online. The AICPA Online Professional Library is now customizable to suit your preferences or your firm’s needs. You can also sign up for access to the entire library. Get access—anytime, anywhere—to FASB ASC; the AICPA's latest Professional Standards, Technical Practice Aids, Audit and Accounting Guides, Audit Risk Alerts, Accounting Trends & Techniques; and more. One option is the AICPA Audit and Accounting Guides/Audit Risk Set with FASB Accounting Standards Codification that contains all guides, alerts, the Audit Risk Assessment Tool, and FASB ASC in the Online Professional Library (product no. WFA-XX [online]). To subscribe to this essential online service for accounting professionals, visit www.cpa2biz.com.
Industry Conference

The AICPA offers its annual NFP conference in June in Washington, DC. The National Not-for-Profit Industry Conference is a comprehensive forum that deals with the challenges facing NFP practitioners and financial executives today. It's where you'll find out the latest information on the effect of tax, management, auditing, and accounting issues pertaining to NFPs. You'll also receive training in operational strategies that are crucial to the well-being of an NFP. For additional information about the conference, call 888.777.7077 or visit www.cpa2biz.com.

In October, the AICPA offers its Government and Not-for-Profit Training Program in Las Vegas, NV. This conference has been designed to help you with both awareness and comprehension of the latest regulatory changes. With guidance on compliance, ethics, and governance issues specific to governmental and not-for-profit entities, you'll be prepared to meet the rigors of today's standards with newfound clarity. The sessions offered will enable increased interaction and the exchange of ideas among the participants and will seek to provide clarification on the tough subjects. For additional information about the conference, call 888.777.7077 or visit www.cpa2biz.com.

AICPA Government Audit Quality Center

The Government Audit Quality Center (GAQC) is a voluntary membership center for CPA firms and state audit organizations designed to improve the quality and value of governmental audits. Governmental audits are performed under Government Auditing Standards and are audits and attestation engagements of federal, state, or local governments; NFPs; and certain for-profit organizations, such as housing projects and colleges and universities that participate in governmental programs or receive governmental financial assistance. The GAQC keeps its members informed about the latest developments and provides them with tools and information to help them better manage their audit practice. CPA firms and state audit organizations that join demonstrate their commitment to audit quality by agreeing to adhere to certain membership requirements.

The GAQC has been in existence since September 2004. Since its launch, center membership has grown to 1,675 firms from 50 states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, and 17 state audit organizations. The CPA firm portion of the GAQC membership accounts for approximately 90 percent of the total federal expenditures covered in single audits performed by CPA firms in the Federal Audit Clearinghouse database (http://harvester.census.gov/sac/) for the year 2008 (the latest year with complete submission data).

The GAQC's focus is to promote the highest quality audits and save members time by providing a centralized place to find information that they need, when they need it, to maximize quality and practice success. Center resources include the following:

- E-mail alerts with the latest audit and regulatory developments and their effect on your audits
- Exclusive Internet seminars, webcasts, and teleconferences on compliance auditing and timely topics relevant to governmental and not-for-profit financial statement audits (optional CPE is available for a small fee, and events are archived online)
- Dedicated GAQC website at www.aicpa.org/GAQC with resources, community, events, products, and a complete listing of GAQC member firms in each state
- Online member discussion forums for sharing best practices and discussing issues members are facing
- Savings on professional liability insurance

For more information about the GAQC, visit www.aicpa.org/GAQC.

**AICPA Industry Expert Panel—Not-for-Profit Entities**

For information about the activities of the AICPA Not-for-Profit Entities Industry Expert Panel, visit the panel's webpage at www.aicpa.org/InterestAreas/FRC/IndustryInsights/Pages/Expert_Panel_Not_for_Profit_Entities.aspx.

**Industry Websites**

The Internet covers a vast amount of information that may be valuable to auditors of NFPs, including current industry trends and developments. Some of the more relevant sites for auditors with NFP clients include those shown in the appendix of this alert.

The NFP industry practices of some of the larger CPA firms also may contain industry-specific auditing and accounting information that is helpful to auditors.
## Appendix—Additional Internet Resources

Here are some useful websites that may provide valuable information to accountants:

<table>
<thead>
<tr>
<th>Website Name</th>
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| AICPA                                             | Summaries of recent auditing and other professional standards, as well as other AICPA activities                                                                                                        | www.aicpa.org  
|                                                   |                                                                                                                                                                                                    | www.cpa2biz.com  
|                                                   |                                                                                                                                                                                                    | www.ifrs.com    |
| AICPA Accounting and Review Services Committee    | Summaries of review and compilation standards and interpretations                                                                                                                           | www.aicpa.org/Research/  
|                                                   |                                                                                                                                                                                                    | CompilationReview/  
|                                                   |                                                                                                                                                                                                    | ARSC/Pages/ARSC.aspx |
| AICPA Financial Reporting Executive Committee      | Summaries of recently issued guides, whitepapers, and technical questions and answers containing financial, accounting, and reporting recommendations, among other things | www.aicpa.org/  
|                                                   |                                                                                                                                                                                                    | InterestAreas/FRC/  
|                                                   |                                                                                                                                                                                                    | AccountingFinancial  
|                                                   |                                                                                                                                                                                                    | Reporting/Pages/  
<p>|                                                   |                                                                                                                                                                                                    | FinREC.aspx       |
| Better Business Bureau                            | Information about not-for-profit entities (NFPs) and donors                                                                                                                                       | <a href="http://www.give.org">www.give.org</a>                                  |
| Board Source                                      | Resources to help strengthen NFPs' boards of directors                                                                                                                                             | <a href="http://www.boardsource.org">www.boardsource.org</a>                           |
| The Chronicle of Philanthropy                     | Articles from the <em>Chronicle of Philanthropy</em> newspaper and links to other sites                                                                                                                   | <a href="http://www.philanthropy.com">www.philanthropy.com</a>                          |
| CompassPoint Nonprofit Services                    | Workshops, consulting, publications, and other information and resources of interest to managers of NFPs                                                                                           | <a href="http://www.compasspoint.org">www.compasspoint.org</a>                          |
| CPAnet                                            | Links to other websites of interest to CPAs                                                                                                                                                    | <a href="http://www.cpanet.com">www.cpanet.com</a>                                 |
| Economy.com                                       | Source for analyses, data, forecasts, and information on the U.S. and world economies                                                                                                                | <a href="http://www.economy.com">www.economy.com</a>                               |</p>
<table>
<thead>
<tr>
<th><strong>Website Name</strong></th>
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<tbody>
<tr>
<td>The Federal Reserve Board</td>
<td>Source of key interest rates</td>
<td><a href="http://www.federalreserve.gov">www.federalreserve.gov</a></td>
</tr>
<tr>
<td>Financial Accounting Standards Board (FASB)</td>
<td>Summaries of recent accounting pronouncements and other FASB activities</td>
<td><a href="http://www.fasb.org">www.fasb.org</a></td>
</tr>
<tr>
<td>Government Accountability Office</td>
<td>Policy and guidance materials and reports on federal agency major rules</td>
<td><a href="http://www.gao.gov">www.gao.gov</a></td>
</tr>
<tr>
<td>Governmental Accounting Standards Board (GASB)</td>
<td>Summaries of recent accounting pronouncements and other GASB activities</td>
<td><a href="http://www.gasb.org">www.gasb.org</a></td>
</tr>
<tr>
<td>Guidestar</td>
<td>Information, news, and resources for NFPs and donors</td>
<td><a href="http://www.guidestar.org">www.guidestar.org</a></td>
</tr>
<tr>
<td>Independent Sector</td>
<td>A forum to encourage giving, volunteering, NFP initiatives, and citizen action</td>
<td><a href="http://www.independentsector.org">www.independentsector.org</a></td>
</tr>
<tr>
<td>Information for Tax-Exempt Organizations (an IRS site)</td>
<td>A Treasury Department site providing information and answers to frequently asked questions regarding tax-exempt entities</td>
<td><a href="http://www.irs.gov/charities/index.html">www.irs.gov/charities/index.html</a></td>
</tr>
<tr>
<td>International Accounting Standards Board</td>
<td>Summaries of International Financial Reporting Standards and International Accounting Standards</td>
<td><a href="http://www.iasb.org">www.iasb.org</a></td>
</tr>
<tr>
<td>International Auditing and Assurance Standards Board</td>
<td>Summaries of International Standards on Auditing</td>
<td><a href="http://www.iaasb.org">www.iaasb.org</a></td>
</tr>
<tr>
<td>International Federation of Accountants</td>
<td>Information on standards-setting activities in the international arena</td>
<td><a href="http://www.ifac.org">www.ifac.org</a></td>
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<tr>
<td>National Association of College and University Business Officers</td>
<td>Provides information geared to colleges and universities, including accounting tutorials on specific situations encountered in higher education accounting</td>
<td><a href="http://www.nacubo.org">www.nacubo.org</a></td>
</tr>
<tr>
<td>National Center for Charitable Statistics</td>
<td>Provides statistics on revenue and expenses of NFPs</td>
<td><a href="http://www.nccs.urban.org">www.nccs.urban.org</a></td>
</tr>
<tr>
<td>Nonprofit Risk Management Center</td>
<td>Provides information to help NFPs control their risks</td>
<td><a href="http://www.nonprofitrisk.org">www.nonprofitrisk.org</a></td>
</tr>
<tr>
<td>The NonProfit Times Online</td>
<td>Articles from the NonProfit Times newspaper and links to other sites</td>
<td><a href="http://www.nptimes.com">www.nptimes.com</a></td>
</tr>
<tr>
<td>Office of Management and Budget (OMB)</td>
<td>OMB information and literature, including cost circulars</td>
<td><a href="http://www.whitehouse.gov/omb/agency/default">www.whitehouse.gov/omb/agency/default</a></td>
</tr>
<tr>
<td>USA.gov</td>
<td>Portal through which all government agencies can be accessed</td>
<td><a href="http://www.usa.gov">www.usa.gov</a></td>
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