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THE NEWSLETTER OF THE BDO INSTITUTE FOR NONPROFIT EXCELLENCE℠

NONPROFIT **STANDARD**

Is that a Lease? A Focus on Nonprofit Lease Considerations under ASC Topic 842

By Amy Duffin, CPA

While Accounting Standards Codification (ASC) Topic 842 is applicable to all entities, the adoption of the new leasing standard by nonprofit organizations is bringing into focus some unique considerations that may impact the conclusion of whether a contract actually contains a lease.

WHAT IS A LEASE?

To set the stage for some of the nonprofit-specific lease considerations to follow, it is important to understand the definition of a lease under Topic 842. A lease is defined as follows: "A contract is or contains a lease if the contract conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration."[1]

FREE OR REDUCED RENT

A nonprofit organization may be given space, equipment or other assets to use free of charge, or be charged below-market rates for these items.

For these types of transactions, a nonprofit organization must consider whether to apply ASC Topic 842, Leases, ASC Topic 958-605, Not-for-Profit Entities Revenue Recognition – Contributions, or a combination of both standards. Let's illustrate these concepts with some specific examples.

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EXAMPLE 1: FREE RENT

Company A provides Nonprofit B with the right to use office space free of charge for five years. Company A retains legal title to the office building but allows Nonprofit B to use the space in furtherance of Nonprofit B's mission. If Company A had rented the space to another entity, Company A would have charged $1,000 per month for the first year of the lease with a 3% annual escalation of rent for each additional year of the five-year term, which is considered to be the market value.

What's the accounting for that?

On day one of the arrangement, Nonprofit B would record a contribution receivable, and related contribution revenue, for the full amount of rent payments over the five-year period ($63,710), discounted to present value using an appropriate discount rate. The revenue is donor-restricted due to time and is released from donor restrictions as the contributed asset (the office space) is used each period. On a straight-line basis each reporting period, Nonprofit B reduces the contribution receivable balance and records rent expense representing its use of the office space.

What is the basis for the accounting?

The transaction in this example falls within the scope of contribution accounting under Topic 958-605 but not lease accounting under Topic 842, because Topic 842 requires an exchange of consideration. In other words, because Nonprofit B does not pay Company A cash (or other assets) for the use of the office space, the transaction falls outside of Topic 842. If the contributed assets are being provided for a specific number of periods (in this example, the period is five years), the contribution revenue (and related receivable) should be recorded in the period received for the market value of the lease payments discounted to present value.[2] If the arrangement in this example had not specified the period of use, Nonprofit B would have recorded contribution revenue and the related rent expense each reporting period based on the fair value of the space for that period.

EXAMPLE 2: BELOW-MARKET RENT

Company C provides Nonprofit D with the right to use office space for $250 per month for five years. Company C retains legal title to the office building, but allows Nonprofit D to use the space in furtherance of Nonprofit D's mission. If Company C had rented the space to another entity instead, Company C would have charged $1,000 per month for the first year of the lease with a 3% annual escalation for each additional year of the five-year term, which is considered to be the market value. For purposes of this example, there is no variable lease cost, no non-lease components, no prepaid rent, no initial direct costs, and no lease incentives. We will assume a 3.5% risk-free rate for the calculation of the lease liability. We will also assume Nonprofit D will use 3.5% as the discount rate for the contribution.

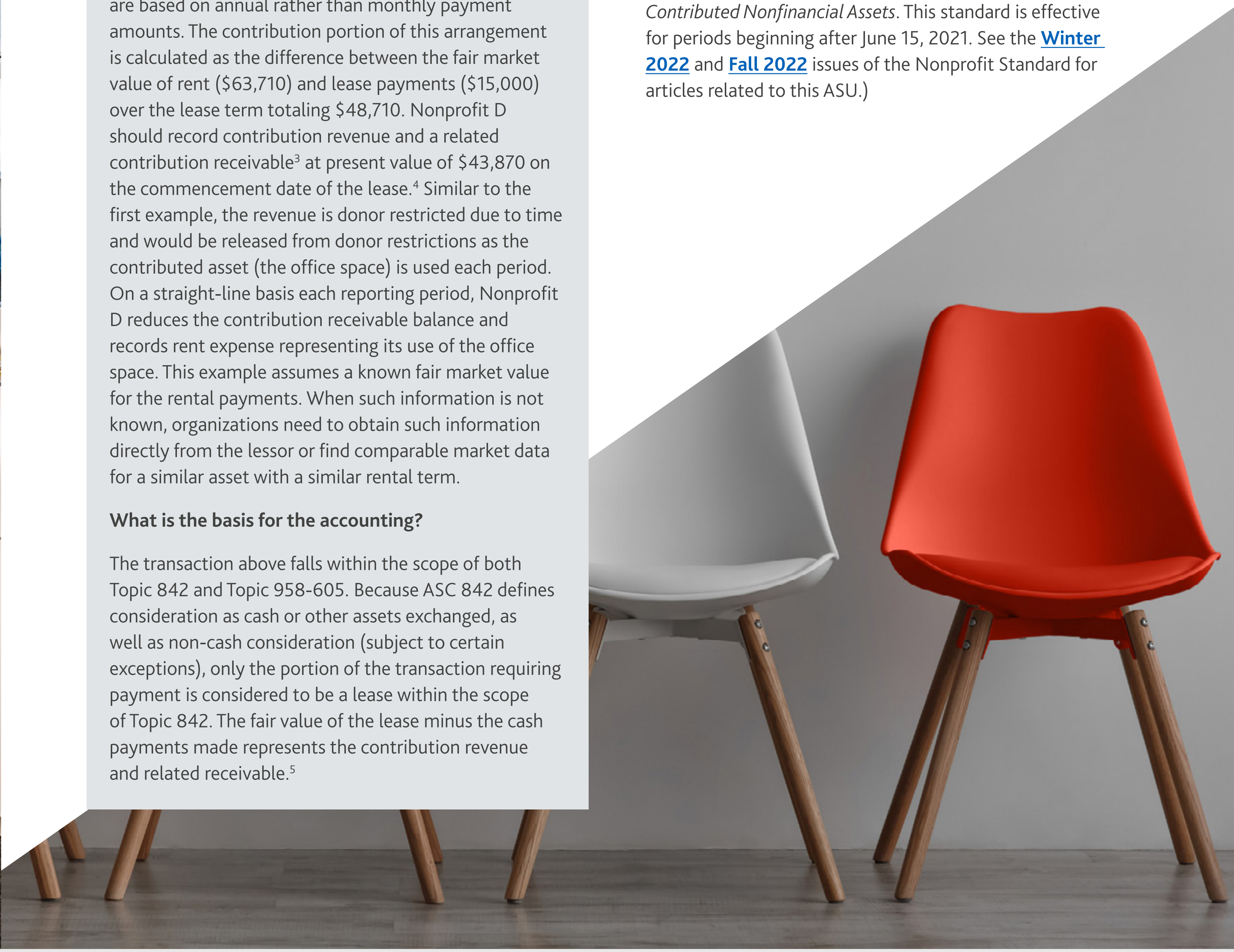
What's the accounting for that?

On the commencement date of the lease, Nonprofit D would record a lease liability equal to the present value of the lease payments totaling $13,550 (rounded) and a right-of-use asset in the same amount. For simplicity purposes, the present value calculations in this example are based on annual rather than monthly payment amounts. The contribution portion of this arrangement is calculated as the difference between the fair market value of rent ($63,710) and lease payments ($15,000) over the lease term totaling $48,710. Nonprofit D should record contribution revenue and a related contribution receivable[3] at present value of $43,870 on the commencement date of the lease.[4] Similar to the first example, the revenue is donor restricted due to time and would be released from donor restrictions as the contributed asset (the office space) is used each period. On a straight-line basis each reporting period, Nonprofit D reduces the contribution receivable balance and records rent expense representing its use of the office space. This example assumes a known fair market value for the rental payments. When such information is not known, organizations need to obtain such information directly from the lessor or find comparable market data for a similar asset with a similar rental term.

What is the basis for the accounting?

The transaction above falls within the scope of both Topic 842 and Topic 958-605. Because ASC 842 defines consideration as cash or other assets exchanged, as well as non-cash consideration (subject to certain exceptions), only the portion of the transaction requiring payment is considered to be a lease within the scope of Topic 842. The fair value of the lease minus the cash payments made represents the contribution revenue and related receivable.[5]

In both of the illustrative examples provided, the contribution of free or reduced-rate office space represents a nonfinancial asset. Nonprofit organizations must consider the revised presentation and disclosure requirements for contributed nonfinancial assets as outlined in Accounting Standards Update (ASU) 2020-07, *Not-for-Profit Entities (Topic 958): Presentation and Disclosures by Not-for-Profit Entities for Contributed Nonfinancial Assets*. This standard is effective for periods beginning after June 15, 2021. See the **Winter 2022** and **Fall 2022** issues of the Nonprofit Standard for articles related to this ASU.)



EMBEDDED LEASES

As nonprofit organizations review their activities and agreements to determine the universe of lease transactions, in both the year of adoption of Topic 842 and in subsequent periods, management should be aware that there may be leases "hiding" within service or other contracts. These types of contracts are referred to as contracts with embedded leases. The following chart provides some examples of service or other contracts where embedded leases may be present:

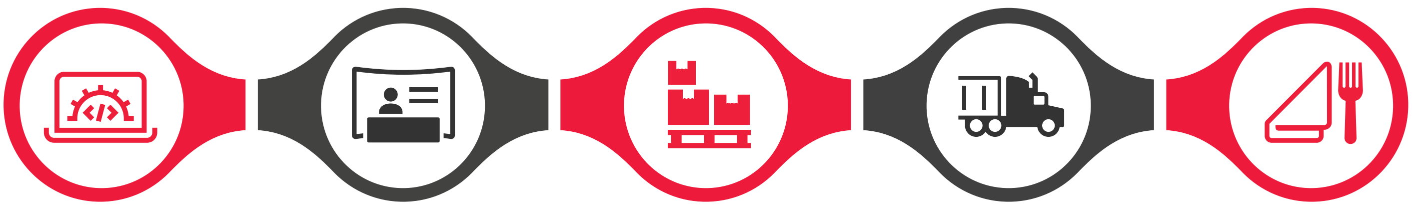
INFORMATION TECHNOLOGY
May contain embedded assets like phones, computers, copies, servers, etc.

ADVERTISING
May contain embedded assets such as the use of a billboard.

INVENTORY MANAGEMENT
Third parties may be engaged to assist a non-profit organization with inventory managment. Use of warehouse space could be an embedded asset.

SHIPMENT OF GOODS OR MATERIALS
Use of a rail car or semi-truck.

FOOD SERVICE
Some organizations provide on-site cafeterias or vending machines. The use of the vending machines, freezers, refrigerators, soft-drink dispensers, etc. could represent an embedded lease.



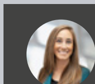
As part of internal policies and procedures related to accounting for leases, management should document, in the year of adoption and annually, how the universe of leases was determined, as well as how management considered the possible existence of embedded leases. While embedded leases may not be material to a nonprofit organization's financial statements, an analysis to determine the relative value of such transactions should be performed nonetheless.

USE OF THE RISK-FREE RATE

As an accounting policy election, Topic 842 permits nonprofit organizations (specifically entities that are not public business entities) to use a risk-free discount rate for leases instead of an incremental borrowing rate, determined using a period comparable with that of the lease term.[6] The use of the risk-free rate may be a more expeditious approach for organizations that do not have a readily available incremental borrowing rate. As a reminder, Topic 842 defines the incremental borrowing rate as "the rate of interest that a lessee would have to pay to borrow on a collateralized basis over a similar term an amount equal to lease payments in a similar economic environment." If an organization has a real estate lease with lease payments totaling $700,000 over the 10-year lease term, it would not be appropriate for the organization to use its $5 million, one-year, line-of-credit borrowing rate as the incremental borrowing rate because the term and amount of the borrowing is not similar.

Organizations wishing to use an incremental borrowing rate that do not have such a rate readily available may need to use external parties such as banks or other lending institutions or valuation professionals to determine an appropriate collateralized rate for certain lease agreements.

In summary, nonprofit organizations should take the time to examine all their agreements to assess whether they have any embedded leases or other arrangements that are subject to lease accounting.



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REFERENCES
1 See ASC 842-10-15-3.
2 See ASC 958-605-25-2 and 958-605-55-24.
3 See ASC 958-605-55-24.
4 See ASC 958-605-24 and 958-605-25-2.
5 See ASC 958-605-55-24.
6 See ASC 842-20-30-3.

The Great Resignation, Talent Shortages, Inflation, Recession … Maybe Bonuses Can Help!

By Mike Conover

It will come as no surprise that bonuses (includes all forms of variable pay for purposes of this discussion) are far more prevalent in the for-profit than the nonprofit sector. For many people, bonuses are believed to be appropriate, or perhaps unavoidable, among for-profits but often viewed as inappropriate or unnecessary for nonprofits. Quite simply, there is a school of thought that nonprofits shouldn't have bonuses or just don't need them to carry out their missions.

Many nonprofit boardrooms have struggled with the "b-word". There's been uncomfortable squirming as they wrestle with "should we, could we, ever pay a bonus?" That kind of uneasiness inhibits many nonprofit organizations from considering a bonus pay-for-performance option in favor of the same old flat percentage across-the-board salary increase for everyone.

Some allege the use of bonuses could distract attention from the organization's good work or, worse yet, motivate staff to maximize bonuses at the expense of the organization's mission. Others mistakenly harbor a belief that nonprofits are not allowed to pay bonuses. Some believe nonprofit status precludes the ability to meaningfully measure performance upon which a bonus could be based. Finally, some board members may just not have enough familiarity with compensation practices to properly consider the use of bonuses.

Contrary to some of the comments above, bonuses of one sort or another are already in use and rather prevalent in several nonprofit sectors. And there is a trend, albeit a slow one, by others to start using them as well.

Hospitals, health systems and professional trade associations were early adopters of bonus plans. Most often the plans covered executive-level positions. Over the years, the prevalence of plans and the award opportunities associated with them have grown as well. This is particularly true among the larger and ever more complex hospitals and health systems. Larger academic institutions, human services and philanthropic organizations have also been instituting bonus plans. No doubt, the competition for executive talent and increasing prevalence of bonus plans among competitors for that talent have, and will, promote adoption of plans by others.

Why limit bonuses to management alone? I believe that a case can be made for considering the use of bonuses not just for executives but other staff positions in nonprofits as well. I am not referring to just the occasional one-off "thanks for the great job" award, I am talking about formally incorporating a bonus plan into the organization's compensation program.

The COVID crisis and related employment and economic disturbances associated with it have negatively impacted many types of organizations and nonprofits are no exception. Mandated shutdowns, work from home requirements, inflation and recession fears have left many nonprofits scrambling to get help, desperately clinging to experienced staff members and fretting over a range of possible recession scenarios.

Organizations have shared stories of valued employees leaving for more compensation elsewhere or the new hires who are "no shows," or worse yet, "short stays!" Not surprisingly, more pay has frequently been viewed as a solution, or at least a partial one, for addressing these tumultuous times.

Budgeting for 2023 compensation expenses has been strained by pressures to respond to competitive pressures in the job market, the highest levels of inflation in 40 years, plus the highest average salary increases in more than a decade. Recession worries raise questions about the advisability of budgeting large payroll increases, especially fixed ones. Year-over-year increases, particularly for those organizations opting to target pay above mid-market levels, build in higher cost for the future. A healthy increase in salary, whether in response to tumultuous times like these or simply a banner year of performance, becomes an ongoing annuity.

This might be an excellent time to consider the adoption of a bonus plan if you do not have one or expanding participation to other staff members if you do. Think of the bonus as replacing all or at least some of the traditional annual increase for positions participating in a plan or even a way of boosting the competitiveness of your pay program.

As a first step, make a determination about the competitiveness of the compensation you now offer your positions. You must know the answer to this to responsibly proceed with exploring the feasibility of offering a plan as a formal part of your compensation program.

Next consider the impact of a bonus on your competitive position. Generally, a minimum of 5% of salary is considered sufficient to impact employee behavior. Reflect on that in relation to the expected 4.25% +/- average salary increase many now project for 2023 (likely for 2024 as well if inflation persists). That 5% amount should allow the organization to maintain its current position in relation to competitive pay levels. Obviously, a higher or lower amount will either improve or erode the relationship to market pay levels. Many would suggest that the bonus target should be set higher than the expected average increase percentage. This offers a higher potential opportunity in return for making it contingent on the organization's performance, a risk adjustment of sorts.

The bonus plan could be added as a formal component of the compensation program to maintain competitiveness and offset cost escalation caused by year-over-year salary increases. Doing so would introduce some elasticity into the organization's compensation costs. The organization's results for the year will determine how much of the bonus is earned and can be paid. As mentioned previously, this may also be a way to improve the competitiveness of your current pay. This also adds a performance-basis component to the compensation program as well.

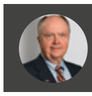
The use of a bonus plan will not preclude the need for periodic salary increases. Competitive pay of covered positions will need to be monitored and adjustments made if the bonus is no longer sufficient to maintain the organization's desired position versus the competitive market. But the year-over-year increase to salaries can be slowed.

If a bonus plan appears feasible, its success will be heavily dependent on effective communication for a number of important topics, including:

- **Overall objective of the plan** (e.g., "will allow us to offer more competitive pay while controlling our expenses," "will allow us to maintain our above-average compensation and carefully manage our costs," etc.)
- **Participation criteria** – levels or positions to be covered by the plan (often introduced at senior-level positions and lower levels later)
- **Eligibility criteria** – minimum employment/position tenure, employed at time of award, etc.
- **Performance factors** – identify the criteria that will be used to determine the decision about payment of the bonus (i.e., yes/no and size of award)
- **Periodic progress reports** – updates to employees on the organization's actual results in relation to the performance factors

This is not an approach that will be appropriate for every organization nor for every position within an organization. The promise of a future bonus does little for employees struggling to manage higher prices now. In the same way, the presence of a bonus opportunity will have marginal ability to overcome a salary that is not competitive.

The presence or absence of a bonus plan is certainly not the sole determinant of a nonprofit's ability to attract and retain executive talent. That said, if two employment opportunities were essentially comparable for an applicant or an employee targeted by a competitor, might a bonus opportunity make a difference? I submit it could, especially among the most capable and sought-after employees. Great talent is always in demand, and this may be a helpful tool in the competition for talent.



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Pay Transparency – Is Your Organization Ready?

By Hannah Boyd

In the past, most discussions about compensation were largely confined to the specific instances of either a job offer or the once-a-year "pay discussion" between manager and subordinate. Outside of these circumstances, the topic was generally not viewed as a subject for polite conversation.

In recent years, society has been pushing organizations to be more transparent when it comes to disclosure of salary information during the job application process or even in the workplace. According to a study conducted in 2022 by Visier 79% of employees want some form of pay transparency, 68% say they would switch employers for greater pay transparency, and 32% want total transparency.

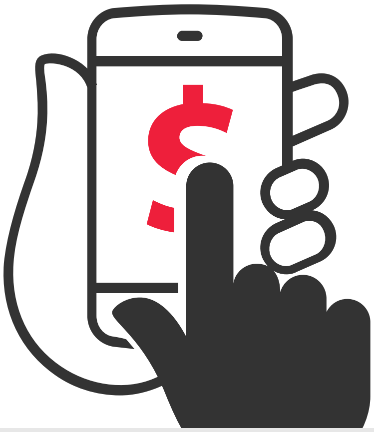
The legal requirement for employer pay transparency was started by the state of Colorado in 2021.

It was the first state to require employers to disclose salary ranges within all job advertisements. Since that time, seven states and six localities have passed legislation establishing pay transparency requirements for employers within their jurisdiction. Additionally, 21 states and 20 localities now have established statewide bans on requesting current salary or salary history from job applicants. This trend will likely grow in the future. (*Please note this information is current as of February 2023. Please stay abreast of changes in the future. State pay transparency laws can be found on state department of labor websites. For localities, the best place to stay up to date would be on each city's official website.*)

The balance of this article outlines the most common pay transparency requirements adopted by various states/localities. Organizations would be well advised to carefully review this information to assess their readiness to comply with the types of information that are being made public.

BAN ON ASKING JOB APPLICANT'S CURRENT SALARY

The first, and most widely established, pay transparency requirement is the ban on requesting salary history. Although all state/local laws have their unique provisions, salary history bans generally prohibit employers from asking job applicants and current employees questions regarding their salary history and/or current salary. Salary history bans have been put in place in hopes of reducing pay disparity and to encourage diversity among workforces.



Below is a list of the states/localities that have current salary history bans in place:

State	Statewide and/or Locality
Alabama	Statewide
California	Statewide & San Francisco
Colorado	Statewide
Connecticut	Statewide
Delaware	Statewide
District of Columbia	District-wide
Georgia	Atlanta
Hawaii	Statewide
Illinois	Statewide & Chicago
Kentucky	Louisville
Louisiana	New Orleans
Maine	Statewide
Maryland	Statewide & Montgomery County
Massachusetts	Statewide
Mississippi	Jackson
Missouri	Kansas City & St. Louis
Nevada	Statewide
New Jersey	Statewide
New York	Statewide, New York City, Albany County, Suffolk County & Westchester County
North Carolina	Statewide
Ohio	Cincinnati & Toledo
Oregon	Statewide
Pennsylvania	Statewide, Philadelphia & Pittsburgh
Rhode Island	Statewide
South Carolina	Columbia & Richland County
Utah	Statewide
Vermont	Statewide
Virginia	Statewide
Washington	Statewide

DISCLOSURE OF PAY RATE TO JOB APPLICANT

Counting Colorado as the first, eight states and six localities have now established unique laws surrounding employer pay transparency. The most common criteria included in these pay transparency laws is the requirement to disclose salary ranges in all job advertisements. This includes, but may not be limited to, disclosing the job's target salary. Some jurisdictions require disclosure of the minimum and maximum salary range amounts or minimum and maximum hourly wage amounts.

Salary transparency and salary disclosures have been put in place to help foster higher levels of trust between employers and job seekers and to show organizational commitment to workplace pay equity. According to the Society for Human Resource Management, "91% of 'employees' who believe that their organization is transparent about how pay decisions are made also said that they trust their organization pays people equally for equal work regardless of gender, race and ethnicity".

Below is a list of states/localities that have salary disclosure requirements along with the states/localities that have established salary minimum and maximum disclosure requirements:

State	Requires Salary Disclosure	Requires Minimum and Maximum Salary Ranges to be Disclosed
California	X	
Cincinnati	X	
Colorado	X	
Connecticut	X	
Ithaca, N.Y.	X	X
Jersey City, N.J.	X	
Maryland	X	
Nevada	X	
New York	X	X
New York, N.Y.	X	X
Rhode Island	X	
Toledo, Ohio	X	
Washington	X	X
Westchester County, N.Y.	X	X

DISCLOSURE OF PAY RATES TO EMPLOYEES

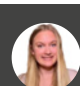
Another commonly included pay transparency requirement is disclosure of salary ranges to current employees. This can include a requirement to disclose salary ranges to employees up for promotion or transfer, and the requirement to disclose current salary ranges to employees who ask for the range for their current position. This internal reporting requirement is intended to encourage transparency at all levels of employment. This allows for employees to be aware of their position's current salary expectations from the perspective of their current employer.

Below is a list of the states/localities that have established internal salary disclosure guidelines:

State	City or State-wide
Colorado	Statewide
Connecticut	Statewide
Nevada	Statewide
New Jersey	Jersey City
New York	Statewide & Ithaca
Rhode Island	Statewide

Of course, these disclosure requirements, regardless of the specific information involved, presume that your organization can readily supply the information and has a formalized program from which this information is secured. It would not be unreasonable to assume that as information is released to the public, there will be occasions where follow-up inquiries are made to provide more information and the process used to develop it. Now would be an excellent time to consider your organization's preparedness for these disclosures or potential inquiries.

More detailed information is available by request from BDO's Global Employer Services team.



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The Inflation Reduction Act of 2022: New Incentives for your College or University

By LaShaun King, CPA, and Drew Norris, CPA

It's not hard for some of us to think back to the lush green lawns and stately buildings of our college and university alma maters. What if we could visualize those hallowed halls enhanced with green technologies that allow administrators to direct more future dollars to academics, athletics or other needs – and fewer dollars to utility bills? Thanks to the **Inflation Reduction Act of 2022** (IRA), colleges and universities now have access to the financial incentives of investing in renewable energy as they renovate existing structures or build new ones. One of the IRA's primary goals is to cut carbon emissions 40% by 2023 while driving domestic clean energy production.

Prior to the IRA's enactment, federal renewable energy credits were promoted via nonrefundable tax credits. Since most nonprofit colleges and universities do not earn taxable income, tax credits were of little benefit to those institutions looking to invest in clean energy projects or implement other energy-efficiency measures.

To address the lack of incentives available to nonprofit organizations, the IRA created a "direct pay" election for tax-exempt entities that allows them to elect to receive a direct refund payment from the IRS for investing in renewable energy projects, clean energy vehicles, electric vehicle (EV) chargers, etc. The direct pay election is in lieu of the incentive tax credits that remain available for tax-paying entities. This is great news for nonprofit entities that want to lower their future energy costs and reduce their carbon footprints.

For example, let's say that the University of Hopes & Dreams (UHD) commenced a renewable energy project to install rooftop solar panels on its campus buildings at an estimated total cost of $100,000. Assuming UHD's project meets the **prevailing wage & apprenticeship** requirements of the IRA (more on that below), UHD will receive an investment tax credit of $30,000, available via the direct payment election.

Or let's say that Sunflower College operates several different vehicle fleets, including campus buses, maintenance vehicles and campus police vehicles. Some of these vehicles are at a point where the administration is weighing replacement options. The IRA includes a **new credit** for tax-exempt entities to receive up to 30% of the cost of qualified commercial clean vehicles placed in service prior to 2033, with credit limits capped based on the weight of the vehicle.

Colleges and universities should also consider that many current and prospective students list climate change as one of their more pressing concerns. A 2020 **Cambridge Global survey** found that 39% of students aged 13 to 19 in the U.S. think that climate change is the biggest issue the world faces today. The Princeton Review publishes an annual list of the **Top 50 Green Colleges** in the United States, while the Environmental Protection Agency has a **Top 30 College & University** list. Taking advantage of this opportunity to invest in more renewable energy sources can help colleges and universities stand out to prospective students.

If this sounds good so far, then let's dive a bit deeper into how the IRA and the clean energy incentives work.

IRA MAJOR THEMES

The IRA introduces a new incentive structure whereby the tax incentives for renewable energy projects may be eligible for a base rate and a "bonus rate." A college that decided to purchase a 1.5 megawatt (MW) renewable energy project would be entitled to a base rate incentive of 6% of the cost. To qualify for the bonus rate, the project would have to satisfy certain wage and apprenticeship requirements:

- The payment of prevailing wages based on the specific geographic area and job classification; and
- A minimum percentage of total labor hours must be performed by qualified apprentices.

By meeting these additional requirements, the college's 1.5 MW project could qualify for combined base and bonus rates of up to 30% of the cost. Projects under 1 MW are automatically eligible for the bonus rate.

There are additional bonus credit opportunities for projects that are placed in service after Dec. 31, 2022:

- 10% bonus credit for meeting domestic content requirements (e.g., a certain percentage of any steel, iron or manufactured product that is part of the project at the time of completion must be produced in the United States).
- 10% bonus credit for facilities located in energy communities (e.g., a brownfield site, an area with significant fossil fuel employment or a census tract or any immediately adjacent census tract in which, after Dec. 31, 1999, a coal mine has closed, or, after Dec. 31, 2009, a coal-fired electric generating unit has been retired).
- 10% bonus credit for facilities with a maximum net output of less than 5 MW and located in a low-income community or on American Indian land. Unlike the other bonus incentives, the low-income adder bonus must be allocated by the IRS to qualify. Without an IRS allocation, projects may not claim the bonus even if otherwise qualified.

In practice, an organization eligible for an investment tax credit at the 30% rate could expect to see an increased credit value of 40% to 50% of the project cost if applicable bonus criteria are met.

HIGHER EDUCATION FOCAL POINTS

Many campuses have a backlog of deferred maintenance and planned capital projects. With the expanded incentive eligibility, higher education institutions may wonder how to best incorporate these credits into their campus development or renewal strategies.

As mentioned in the examples above, colleges and universities can develop renewable energy projects in many different or combined forms (e.g., solar, fuel cell, small wind, biomass, combined heat and power, etc.) to qualify for the incentives – as long as project construction begins before 2025. In addition, the IRA now also includes energy storage, "dynamic" electrochromic glass and microgrid controllers.

Following the expiration of the historical energy credit, new technology-neutral credits will be available for qualified zero-emission facilities that begin construction after Dec. 31, 2024. The credits begin to phase out the earlier of the calendar year when the annual greenhouse gas emissions from the production of electricity are equal to or less than 25% of the annual greenhouse gas emissions from the production of electricity in the U.S. for calendar year 2022 or 2032.

Additionally, the IRA expands the eligibility for incentives under Section 179D to nonprofit organizations for qualifying energy-saving investments such as energy-efficient interior lighting, HVAC, or the components that make up the building envelope (roofing, walls, etc.).

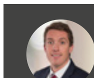
As previously mentioned, the IRA provides incentives for the purchase of clean vehicles from qualified manufacturers. This credit is up to $7,500 for vehicles under 14,000 pounds, or up to $40,000 for all other vehicles.

NEXT STEPS

This may be the ideal time for institutions considering how best to incorporate investments in renewable energy or energy efficiency to have discussions with their boards of directors and other stakeholders. And for any institutions that had not previously considered incorporating renewable energy or energy efficiency into capital development or improvement plans, this is a great time to learn more about how such projects and the benefits in the IRA can help reduce costs now and in the future.

Regardless of where an institution is in the planning process, it is important that they discuss their plans with a trusted tax advisor. Obtaining a project feasibility analysis prior to finalizing plans will help colleges and universities reap the full advantage of the IRA's incentives as well as meeting stakeholder goals.

For more information, contact LaShaun King, Assurance Partner, at lking@bdo.com, or



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Implementation of GASB Statement No. 94, *Public-Private and Public-Public Partnerships and Availability Payment Arrangements*

By Sam Thompson, CPA

Governments are required to adopt the provisions of the Governmental Accounting Standards Board (GASB) Statement No. 94, *Public-Private and Public-Public Partnerships and Availability Payment Arrangements* (GASBS 94 or Statement) for fiscal years ending in 2023. GASBS 94 addresses accounting and financial reporting issues related to public-private and public-public partnerships arrangements (PPPs) as well as availability payment arrangements (APAs). While the Statement incorporates concepts from existing standards, the Statement has the potential to significantly alter a government's financial statements when implemented.

BACKGROUND

In a PPP, a government enters into a partnership agreement with an external entity to transfer the obligation to provide certain public services to the external entity, with the intention that the arrangement will benefit the government and its stakeholders financially or by improving the quality of service, or both. Examples of common PPPs include toll roads and bridges, convention centers and arenas, parking garages, college or university residence halls, and central utility plants. The external entity can be either a private entity or a public entity (i.e., another government).

ACCOUNTING RECOGNITION

GASBS 94 defines a PPP as an arrangement in which a government (the transferor) contracts with an operator to provide public services by conveying control of the right to operate or use a nonfinancial asset, such as infrastructure or other capital asset (the underlying PPP asset), for a period of time in an exchange or exchange-like transaction.

Certain PPPs may meet the requirements of a service concession arrangement (SCA). An SCA is a PPP arrangement that meets all of the following four criteria:

1. The transferor conveys to the operator the right and obligation to provide public services through use and operation of the PPP asset in exchange for significant consideration.
2. The operator collects and is compensated by fees from third parties.
3. The transferor determines or has the ability to modify or approve which services the operator provides and the prices or rates charged.
4. The transferor is entitled to significant residual interest in the service utility of the PPP asset at the end of the arrangement.

In other instances, a PPP may meet the definition of a lease in accordance with GASBS 87. A PPP meeting the definition of a lease must apply the requirements of GASBS 87 if (1) the existing assets of the transferor are the only underlying PPP assets; (2) improvements are not required to be made by the operator to the existing PPP assets; and (3) the PPP does not meet the definition of an SCA.

Transferor Accounting

A transferor should recognize the following for a PPP that *does not meet the definition of an SCA*:

- A receivable for installment payments in relation to the PPP
- A receivable for any new underlying PPP asset purchased or constructed to be received when the asset is placed into service
- An asset for improvements, if any, made by the operator to an existing PPP asset, when the asset is placed into service
- A deferred inflow of resources equal to:
    - any receivable for installment payments or a new PPP asset to be received when the asset is placed into service
    - payments received from the operator at or before commencement of the PPP term
    - asset improvements made by the operator when the improvements are placed into service

A transferor in a PPP *meeting the definition of an SCA* should recognize the following:

- A receivable for installment payments in relation to the PPP
- An asset for the purchased or constructed underlying PPP asset when placed into service
- A deferred inflow of resources equal to:
  - any receivable for installment payments
  - payments received from the operator at or before commencement of the PPP term
  - the amount of the initial measurement of the underlying PPP asset

If the underlying PPP asset is an existing asset of the transferor, the PPP asset should continue to be measured at its carrying value. If the underlying PPP asset is a new asset purchased or constructed by the operator, the PPP asset should be measured at acquisition value when placed into service. The PPP asset should be depreciated unless the PPP arrangement requires the operator to return the PPP asset in its original condition. Improvements made by the operator to the PPP asset should be recognized at acquisition value when placed into service.

Receivables for installment payments should be measured at present value. The receivable balance should include all fixed payments, index or rate-based variable payments (initially measured using the index or rate at the beginning of the PPP term), variable payments fixed in substance and residual value guarantees fixed in substance. Variable payments based on future performance criteria or other variable factors besides an index or rate should not be included in the measurement of the receivable. The discount rate used for future PPP payments should be the interest rate the transferor charges the operator, which may be an implicit interest rate. The receivable discount should be amortized in subsequent periods and reported as an inflow of resources (e.g., interest revenue) for the period.

The receivable should be remeasured in subsequent periods for changes in the PPP term, interest rate charged by the transferor, or for resolution of a contingency upon which some or all of the variable payments to be received over the remainder of the PPP term are based on if the changes, individually or in the aggregate, are expected to significantly affect the measurement of the receivable. If the receivable is remeasured for any of the forementioned reasons, or if there is a change in the PPP term or interest rate charged by the transferor, the receivable should be adjusted for any change in an index or rate used to determine variable payments if that change is expected to significantly affect the receivable amount.

A receivable for the underlying PPP asset should be measured at the operator's estimated carrying value of the PPP asset as of the expected date of the transfer in ownership from the operator. The receivable should be remeasured for any PPP modifications or terminations.

A transferor should report initial direct costs incurred as outflows of resources (e.g., expenses) in the period incurred. A transferor subsequently should recognize the deferred inflow of resources as an inflow of resources (e.g., revenue) in a systematic and rational manner over the PPP term.

Operator Accounting

An operator should recognize a liability for installment payments to be made, offset to a right-to-use asset. The liability should be measured at present value of PPP payments expected to be made during the PPP term. The liability should include all fixed payments, index or rate-based variable payments (initially measured using the index or rate at the beginning of the PPP term), variable payments fixed in substance, amounts reasonably certain of being required to be paid under residual value guarantees, certain penalty payments for terminating the PPP, and other payments that are reasonably certain of being required. Variable payments based on future performance criteria or other variable factors besides an index or rate should not be included in the measurement of the liability.

The discount rate used for future PPP payments should be the interest rate the transferor charges the operator, which may be an implicit interest rate. The discount on the liability should be amortized in subsequent periods and reported as an outflow of resources (e.g., interest expense) for the period. The liability should be remeasured in subsequent periods for changes in the PPP term, interest rate charged by the transferor, changes in the likelihood of a residual value guarantee being paid, a change in the estimated amounts for payments already included in the measurement of the liability, or for resolution of a contingency upon which some or all of the variable payments to be made over the remainder of the PPP term are based on if the changes, individually or in the aggregate, are expected to significantly affect the measurement of the liability. If the liability is remeasured for any of the aforementioned reasons, or if there is a change in the PPP term or interest rate charged by the transferor, the liability should be adjusted for any change in an index or rate used to determine variable payments if that change is expected to significantly affect the liability amount.

An operator should measure the right-to-use asset as the sum of the initial measurement of installment payments liability, payments made to the transferor at or before commencement of the PPP term, the cost of improvements to an existing PPP asset, the cost of the purchased or constructed underlying PPP asset (if the PPP meets the definition of a SCA), and initial direct costs that are necessary to place the right-to-use asset into service. The right-to-use asset should be amortized in a systematic and rational manner over the shorter of the PPP term or useful life of the asset. Amortization should be recognized as an outflow of resources (e.g., amortization expense).

An operator should recognize a liability for any requirement to transfer the PPP asset to the transferor during or at the end of the PPP term, measured at the estimated carrying value of the PPP asset as of the expected date of the transfer in ownership.

Availability Payment Arrangements (APAs)

An APA is an arrangement in which a government compensates an operator for services that may include designing, constructing, financing, maintaining or operating an underlying nonfinancial asset for a period of time in an exchange or exchange-like transaction. APAs in which ownership of the asset transfers at the end of the contract should be treated as a financed purchase.

PPP Recognition in Financial Statements Prepared Using the Current Financial Resources Measurement Focus

In the governmental fund financial statements, a transferor should recognize a receivable for installment payments and a deferred inflow of resources. The initial measurement of the deferred inflow of resources should be equal to the initial value of the installment payment receivable, plus amounts for payments received at or before commencement (such as up-front payments) associated with the PPP. In subsequent periods, the transferor should recognize the deferred inflow of resources as inflows of resources (e.g., revenue), if available, in a systematic and rational manner over the PPP term.

An operator should recognize an expenditure and other financing source in the period the PPP is initially recognized. Subsequent PPP payments should be accounted for following the principles for debt service payments for long-term debt.

KEY CONSIDERATIONS

Multiple Components

A PPP arrangement may contain multiple components, such as a contract with both a PPP and a non-PPP component, or a PPP with multiple assets. A transferor or operator should account for PPP and non-PPP components as separate arrangements unless the contract does not include prices for individual components and it is not practicable to determine a best estimate for price allocation for some or all components in the contract, or if prices are included, the prices appear to be unreasonable. In such cases, those components should be accounted for as a single PPP. Transferors and operators should account for multiple PPP assets with different terms as separate PPP components, unless it is not practicable to do so. If multiple components are accounted for as a single PPP, the accounting for the single PPP should be based on the primary component's terms.

Prices for individual components included in the contract should be used first to allocate the contract price to different components unless the price allocation appears unreasonable, followed by professional judgment, taking into consideration the use of observable information as much as possible.

Discount Rates

Installment payments should be measured at the present value of PPP payments expected to be received or made during the PPP term. The discount rate used should be the interest rate the transferor charges the operator. In some agreements, the rate may not be stated. The operator should use its estimated incremental borrowing rate when the interest rate charged by the transferor cannot be readily determined.

Modifications and Terminations

PPP arrangements may be amended. Amendments may include the changing of the price of the arrangement, the length of the PPP term, adding or removing PPP assets, or changing the index or rate used for variable payments. Amendments can take the form of either a modification or termination. An amendment in which the operator's right to use the underlying PPP asset does not decrease is a modification.

A modification should be accounted for as a separate PPP arrangement by both a transferor and operator if the modification gives the operator additional PPP assets not included in the original PPP arrangement and the increase in PPP payments does not appear unreasonable. If the modification does not result in a separate PPP, a transferor should account for the modification by remeasuring the installment payment receivable and underlying PPP asset receivable, if applicable. Deferred inflow of resources should be adjusted for the difference between the receivable balance pre- and post-modification. An operator should account for the modification by remeasuring the installment payment or underlying asset liability. The right-to-use asset should be adjusted for the difference in liability pre- and post-modification.

An amendment decreasing the operator's right to use the PPP asset is a partial or full termination. A transferor should account for a partial or full termination by recognizing a gain or loss equal to the sum of any reduction in the carrying value of deferred inflows of resources. Operators should account for a partial or full termination by recognizing a gain or loss equal to the sum of any reduction in the carrying value of the right-to-use asset.

SIMILARITIES WITH GASBS 87 AND GASBS 96

Many of the core principles of GASBS 94 are shared with GASBS 87, *Leases,* and GASBS 96, *Subscription-Based Information Technology Arrangements*. All three standards require the presence of a contract that conveys control of the right to use another party's asset as specified in the contract for a period of time in an exchange or exchange-like transaction. Similarities between the standards can also be found relating to recognition and measurement of financial statement amounts, selection and application of discount rates, and criteria for amending or remeasuring the underlying agreements.

ASC 853 CONSIDERATIONS

In many PPP arrangements, the operator will be a non-governmental entity reporting under generally accepted accounting principles (GAAP) as promulgated by the Financial Accounting Standards Board (FASB) and will account for the arrangement as a service concession arrangement. FASB guidance for service concession arrangements is found in Accounting Standards Codification (ASC) 853.

IMPLEMENTATION CONSIDERATIONS

Effective Date and Transition

GASBS 94 is effective for fiscal years beginning after June 15, 2022, and all reporting periods thereafter. Changes required by the Statement should be applied retroactively by restating financial statements for all prior fiscal years presented, as practicable. Governments should recognize and measure PPPs using the facts and circumstances that existed at the beginning of the fiscal year of implementation. If more than one year is presented in the financial statements, a government should recognize and measure PPPs using the facts and circumstances for the beginning of the earliest fiscal year restated.

Preparation for Implementation

While implementation of GASBS 94 is primarily the responsibility of accounting personnel, successful implementation requires the involvement of the entire organization. Timely communication with all stakeholders is essential as arrangements potentially meeting the requirements of GASBS 94 may currently exist or subsequently be entered into without communication to or consultation with accounting personnel.

Governments should perform a complete inventory of contractual arrangements with other parties engaged to provide services to a government's constituents, as well as for any arrangements in which the government provides services to other governments. Each arrangement should be evaluated against the requirements of GASBS 94 to determine whether the arrangement should be recognized as a PPP or APA. Criteria to consider in this evaluation includes (but is not limited to):

- Whether the contract conveys control of the right to operate or use a nonfinancial asset for a period of time
- Whether the transaction meets the definition of an exchange or exchange-like transaction
- Whether the transaction meets the existing definition of a service concession arrangement under GASBS 60, *Accounting and Financial Reporting for Service Concession Arrangements* or a lease in accordance with GASBS 87

To help ensure successful implementation and adherence to requirements in future periods, governments should evaluate their internal processes, procedures and controls, and make changes where relevant.

Governments are strongly encouraged to reflect on the recent implementation of GASBS 87 and incorporate the successful elements from adoption and to learn from and improve upon the areas that were difficult or problematic.

ITEMS TO COMMUNICATE TO THOSE CHARGED WITH GOVERANCE

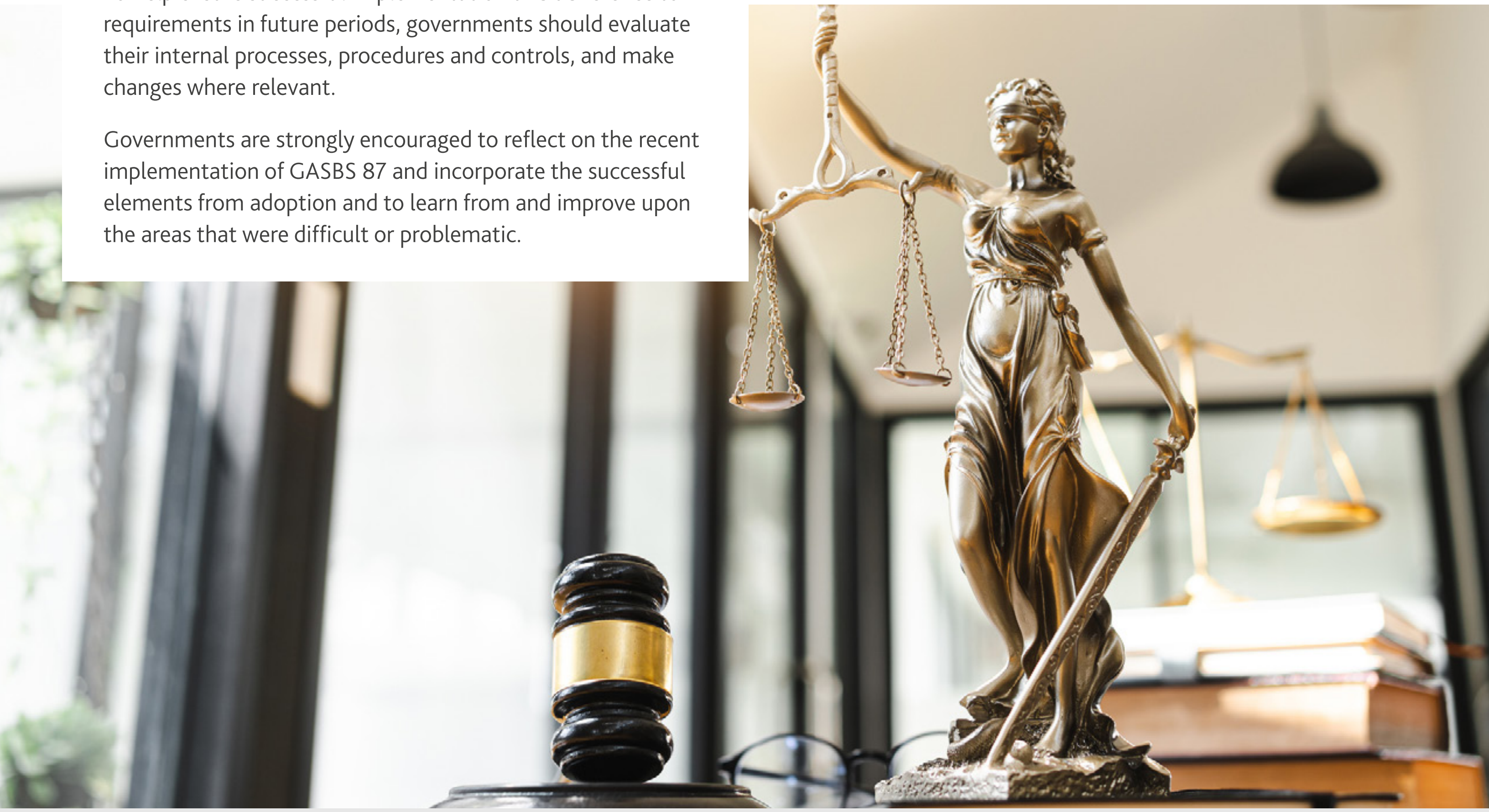
PPPs and APAs are increasingly common. The size and duration of many arrangements significantly impact a government's financial position. Users of the financial statements are interested in the exposure a government has to PPPs and APAs.

In conclusion, implementation of GASBS 94 will improve the financial reporting of PPPs and APAs through the establishment of consistent definitions and guidance on accounting and financial reporting for related transactions. Specifically, more consistent measurement and recognition of assets and liabilities associated with PPPs, along with improved disclosures, will assist users in better comprehending the current and future financial statement impact resulting from PPPs.

Successful implementation will require management to proactively devote substantial time and energy.

Those charged with governance should be made aware of the possibility of significant changes to the financial statements upon adoption of GASBS 94 and any impact on debt covenants or key operating measures used.

For more information, contact Sam Thompson, Professional Practice Director - Government, at sthompson@bdo.com.



Updated Guidance: Federal Perkins Loan Closeout

By Andrea Taylor

The Perkins Program has expired, with no new disbursements permitted after June 30, 2018. The U.S. Department of Education's Federal Student Aid Office issued updated guidance related to the conclusion of the Perkins Program. This guidance includes certain actions that higher education institutions must take. The due date for these actions, which was originally June 30, 2022, has now been extended through June 30, 2023 as a result of delays brought about by the COVID-19 pandemic.

The federal Perkins Loan Program (Perkins Program), which was first authorized by Congress in 1957, provided low-interest federal student loans for undergraduate and graduate students who demonstrated exceptional financial hardship. Loans under the Perkins Program featured a fixed 5% interest rate and, at nine months, a longer repayment grace period than other federally funded student loan programs. The Perkins Program is unique in that it is funded with aid from the federal government and matched with institutional contributions and loan recipients could also qualify for flexible repayment terms. Given that a portion of each loan disbursed through the Perkins Program was funded through institutional resources, student borrowers who graduated, withdrew or fell below half-time status, were required to repay their loans directly to the institution (typically through a third-party administrator), with the returned funds then used to issue additional loans in future periods.

Due to budgetary issues, the federal government began to phase out the Perkins Program in 2015, but later extended it until 2017 in the hope that the budgetary constraints would be resolved. Those who were in favor of continuing the Perkins Program believed that it was important to preserve low-cost options for the neediest student borrowers, while opposition hoped that allowing the Perkins Program to expire would simplify and centralize the federal student loans process. However, the Perkins Program was not renewed after Sept. 30, 2017, with no further disbursements under the program permitted after June 30, 2018.

Though no new loans are being made from the Perkins Program, participating institutions have been expected to continue to service any outstanding loans, returning the federal share of repayments. In August 2021, the Department of Education's (ED) Federal Student Aid Office issued guidance related to the conclusion of the Perkins Program, with revised guidance issued May 2022 extending the deadline for institutions to either:

- Assign the loans that have been in default for more than two years to the ED while holding onto the active loans and continuing collection efforts; or
- Liquidate the entire program, which includes assigning all loans back to the ED whether or not they are in default.

Accounts that are in default for more than two years must be assigned to the ED before the end of the current reporting period, which is now defined as June 30, 2023, unless the institution has documentation that borrowers are actively making payments toward the loans.

Given this requirement, institutions are facing a decision regarding the best course of action for their remaining Perkins portfolio. When assessing which of the two options outlined above is most appropriate for an institution, an analysis should be performed to consider the potential return for continuing to service the portfolio against the related costs, such as:

- The cost of continuing to operate the Perkins Program, including the cost of using a third-party administrator and outside debt collection agency as well as the related payroll cost associated with the administrative burden of overseeing the program; and
- The cost associated with liquidating the Perkins Program, which can be determined by evaluating each outstanding loan by:
  - Segregating loans by age; the older the loan is, the less likely collection will be successful.
  - Making a realistic assessment of what amount the institution may be able to realize after other parties, such as collection agencies and the ED, receive their share.
  - Realistically assessing the cost and benefit of continuing to hold and collect the loans versus the cost to liquidate the Perkins Program.

Perkins Program Liquidation Process

STEP 1: Notify the Department of Education of intent to liquidate

STEP 2: Assign outstanding loans to the Department of Education

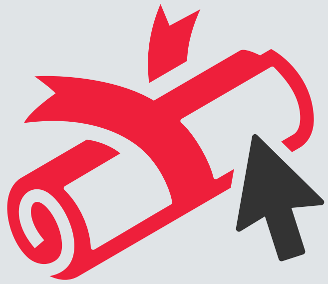
STEP 3: Repurchase loans that are not accepted for assignment by the Department of Education

STEP 4: Remit federal share to the Department of Education

STEP 5: Submit Fiscal Operations Report and Application to Participate (FISAP) including Perkins Program closeout data

STEP 6: Complete closeout audit

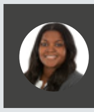
If the ED rejects a loan for assignment, a reason for the rejection is required to be provided to the institution. The institution can then choose to resolve the issue, if possible, and resubmit the loan for assignment. Otherwise, the institution would have to repurchase the loan.



A Perkins Program closeout audit is required as part of the liquidation process. Institutions must schedule the closeout audit and provide a copy of the audit report to the ED when it is available. The focus of this audit is to account for every borrower under the program. To do this, the institution must show the loans that were paid in full, assigned or repurchased, with the total coming to zero. Nonprofit institutions that qualify and report annually under the Single Audit Act may elect to have an independent Perkins closeout audit done, or instead include the closeout audit with the institution's next scheduled annual federal compliance audit.

Additionally, institutions that elect to take advantage of the Perkins Program liquidation extension will be required to provide an explanation as to why they were unable to meet the original June 30, 2022 deadline. ED has also reminded schools that although the Perkins Program is winding down, they remain obligated to ensure all collection procedures, outlined in the regulations, are being followed.

ED provides guidance on the Perkins loan assignment process in the **Perkins Assignment and Liquidation Guide**.



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Endowment Woes! Navigating The Nuances With Endowments

By Orynthia Wildes, CPA

An endowment is a pool of funds donated or set aside to be preserved over time in order to support an organization's mission. Nonprofits establish endowments for a variety of reasons, usually as part of their long-term strategic plan. Donors may contribute assets, such as cash and securities, and make pledges for future contributions to a nonprofit for creating an endowment.

While an endowment is a great idea for long-term planning and may provide continuous funding for charitable activities, it comes with some nuances that must be carefully navigated to ensure it is successfully managed and fulfills the intended purpose for the organization.

The main types of endowments are as follows:

Type	Period	Description
Perpetual (donor restricted)	Perpetuity	Principal (corpus) preserved perpetually, while earnings may be expended based on donor stipulations.
Term (donor restricted)	Varies	Principal preserved for a specified period or until the occurrence of an event, specified by the donor.
Board designated	Varies	Principal usually retained, while earnings may be expended. Principal may be utilized upon board approval.

POTENTIAL CHALLENGES

- **Understanding what they are and how to account for endowments**
  "I received an endowed gift. Now what?" Nonprofits that never had an endowment may not know where to start. Endowments are governed by guiding documents, which may come in various forms such as a trust instrument, other written agreements from the donor or a board resolution. Identifying the right key words in these documents becomes crucial to ensuring that endowments are set up and accounted for correctly. Additionally, recognizing the type of endowment is also important to ensure the appropriate accounting guidance is applied.

- **Stipulations plus governing laws**
  Endowment operations are not only governed by the gift instruments but also by state law. Nonprofits may not appropriately prioritize these. The Uniform Prudent Management of Institutional Funds Act (UPMIFA) is a uniform act that provides guidance on investment decisions and endowment expenditures for nonprofit and charitable organizations. Except for Pennsylvania, all states and the District of Columbia have enacted their version of UPMIFA. Pennsylvania has its own endowment law not based on UPMIFA. Nonprofits may not realize that the donor's stipulations take precedence over UPMIFA, albeit at times the donor stipulations are not explicit enough to override UPMIFA. This can create confusion.

- **Unclear donor intent**
  It is not uncommon for donor agreements to be vague when it comes to conveying the intent and purpose of the gift. These documents can be written by various persons who are not accountants, which can create challenges when determining the appropriate financial statement classification and operating mechanics of the endowment.

- **Managing endowments**
  Endowment management can be complex and time consuming without proper resources and knowledge. Nonprofits need to track endowment activity in detail, and retain adequate supporting documentation for all gifts and any investment returns. Funds are often commingled in investment pools, which can create allocation challenges for nonprofit accounting teams. Various levels of expertise and strong internal controls are required for effective management.

- **Donor changes**
  Over time, donors can submit modifications to their original gift instruments that are not correctly applied on a prospective basis. Nonprofits need to retain support from donors who make modifications to their endowment agreements as a record for any changes made to the accounting and treatment of an endowment from a donor.

- **Balancing the objectives**
  Under UPMIFA, applying prudence to the fund to preserve value is the goal, not just retention of the dollar amount of the initial corpus. This is due to the time value of money. A gift of $100 in 1990 is not worth the same today; thus, to preserve the purchasing power of the fund's principal, prudent investment and spending policies must be applied, while considering the donor's stipulations for the fund's use. Funds with deficiencies (where the fund value drops below the corpus) require special considerations related to spending and estimating future recovery.

Many of these challenges also apply to a board-designated endowment fund. A board-designated endowment fund is created by a nonprofit organization's governing board by designating a portion of its net assets without donor restrictions to be invested to provide income for a long but not necessarily specified period. Proper management and investment tracking are also applicable to this type of endowment fund. The board of the organization establishes the purposes for the endowment fund and this should be documented in the board minutes.

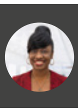
NAVIGATING THE CHALLENGES

To effectively manage endowments, nonprofits need to be proactive, sophisticated and careful. They must be willing to make the required investment to educate their team and put the right processes and controls in place. Here are some tips to help organizations navigate the challenges discussed above:

- Adopt formal gift acceptance, endowment and investment policies. Policies should clearly address how funds are to be invested, spent and used (purpose).
- Use consistent templates for gift/endowment agreements to standardize the language and avoid misinterpretation. It is important to have personnel from various areas of the organization review and approve these templates including legal, finance, operations and the board.
- When in doubt, clarify intent! Reach out to donors or their representatives, especially for unusual gifts that come into the organization from trusts and bequests.
- Maintain detailed documentation for all gifts. Accurate and detailed recordkeeping is crucial to the success of endowment operations. Documentation should include certain key information on the donor, assets transferred, specified use, spend rate, investment policy and any modifications.
- Monitor endowment assets regularly and compare to donor agreements often.
    - At minimum, organizations should analyze investment returns, spending rates and fund balances throughout the year to ensure funds are being managed in accordance with the gift instrument and state law, if applicable.
    - Organizations can go back to donors and discuss modifications, if needed. Seek legal advice before any significant changes are considered and obtain written approval from donors.
    - Be mindful that the goal is to preserve the overall purchasing power of the endowment over time. Deficient funds should be tracked separately and monitored more frequently. Elevate these to the board or investment committee for review and a plan of action.

- Nonprofits should consider short- and long-term needs when accepting gifts to ensure it is the right strategic decision. Some organizations may need more short-term liquidity to fulfill their mission; thus, it may not be wise to accept endowments that must be maintained in perpetuity and do not generate adequate income for operations. Overly large endowments have been likened to hoarding in the public eye in some cases. Readers of financial statements may not understand how endowments work and see the large balances and question why the entity needs additional resources. Nonprofits may want to consider more flexibility to ensure the immediate needs of the organization are being met. Outside of perpetual endowments, nonprofits can consider term/quasi endowments or include variance power language in their agreements. This will grant the organization some flexibility in redirecting the use of the assets.
- Proper internal controls are imperative to ensure accuracy and completeness of endowment funds. Nonprofit finance personnel should stay abreast of the latest accounting guidance through research and training.
- Before establishing endowments, nonprofits should examine and quantify the costs to manage an endowment, in terms of time and resources. This may be in the form of investment managers, bank charges and other fees, and additional staff time required to reconcile and track activity.

Over the past three years, nonprofits have had to navigate some turbulent times with the disruption of the world's economic and political environments due to the COVID-19 pandemic, inflation, and political unrest. Endowments and other reserves may be an opportunity for nonprofits to boost liquidity and permanently support their philanthropic goals and survive in an unstable economic climate. Nonprofits should weigh the benefits and costs of establishing and running an endowment. Organizations should also be mindful of the nuances described above and plan how to navigate these. With proper planning and the right resources, nonprofits can avoid improper classification of gifts and financial statement errors when it comes to accounting for endowments. Nonprofits can also lower reputational risk by ensuring compliance with applicable state law and donor stipulations.



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ESG: An Opportunity for Nonprofits

By Karen Baum, CPA, CFE, and Corey Eide

In the for-profit world (and particularly among SEC-regulated companies), environmental, social and governance (ESG) planning has largely focused on compliance and risk mitigation. Given the mission-based orientation of nonprofits, ESG can be approached as an opportunity to grow their mission and impact in a rapidly changing world. The integration of environmental and social sustainability principles into nonprofits' operational lifecycles will be key to ensuring donor retention and programmatic success for years to come.

THE RISE OF ESG STANDARDS AND REPORTING

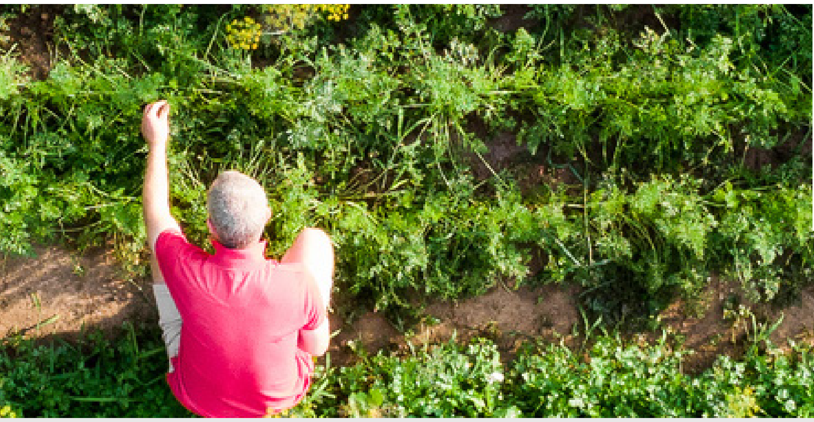
Over the past few years, multiple global ESG frameworks and standards have emerged to encourage sustainability strategies and provide guidance on sustainability reporting and disclosure. In the for-profit space, ESG reporting is often used to inform investment decisions, comply with regulations and/or give a company a competitive edge. At present, there is no universally followed standard in place, but there is movement toward consolidation of frameworks and standards. The International Sustainability Standards Board (the ISSB) recently merged with the Sustainability Accounting Standards Board (SASB). In addition, the Global Reporting Initiative (GRI) is a leading framework guiding corporate ESG transparency. Together, they are collaborating in an attempt to establish universal metrics for reporting greenhouse gas emissions, human rights protections, diversity, equity and inclusion (DEI) progress, and linkages to the United Nations Sustainable Development Goals.

In a few short years, the private sector has evolved beyond the early adopters who have expanded their corporate social responsibility efforts into broader ESG reporting. Today, companies understand the risk of being left behind if they do not adopt comprehensive ESG programming. ESG reporting is becoming the new normal, even for entities not beholden to SEC regulations. In the corporate space, ESG adoption is often a reactive response to the demands of investors, customers and other stakeholders. That said, nonprofit organizations will ultimately face demands from their stakeholders; however they are uniquely positioned to leverage ESG to enhance their mission and brand.

THE SOCIAL LICENSE AND INCREASING CALL FOR TRANSPARENCY

Nonprofit organizations exist to serve individuals and communities where gaps in the market are unaddressed by the private sector or government. Their social license to operate comes with the benefit of tax exemption in exchange for providing services and transparency (e.g., IRS Form 990). As the nonprofit industry has evolved, so have reporting expectations. In addition to reporting to the IRS, nonprofits self-report an ever-increasing amount of impact and operational data to third-party evaluators such as Charity Navigator, GuideStar and Candid. ESG reporting is the next evolution of transparency reporting for nonprofits.

As nonprofit organizations are adept at reporting financials and an increasing amount of impact data, they must now navigate the evolving expectations related to ESG stakeholders. For stakeholders focused on the bottom line of mission impact, it must not come at the expense of unaddressed (or uncalculated) negative environmental impacts. For example, stakeholders expect nonprofits to understand their environmental footprint and develop strategies to mitigate it. BDO's Nonprofit Benchmarking Report shows that 18% of nonprofits surveyed report evaluating their vendors, partners and/or funders for their alignment to ESG policies and actions. If that expectation has not been set for an organization today, it is only a matter of time before corporate donors or other stakeholders will expect to see disclosure and alignment. Donors who are accustomed to evaluating their own investments utilizing ESG indexes will be asking questions about the investment portfolios for endowments that fund a nonprofit organization's programs. Foundations are increasingly aligning their endowments to ESG metrics utilizing the Global Impact Investing Network's (GIIN) IRIS+ for measuring, managing, and optimizing their impact. Lastly, stakeholders who expect an organization to embody expectations of DEI will also expect reporting on established metrics that demonstrate evidence of progress.



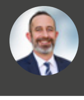
AN OPPORTUNITY TO GROW THE MISSION

As nonprofit executives examine the industry landscape and their organization's opportunity to thrive in the future, sustainability must become a key focus in all aspects of management. From attuning to evolving stakeholder priorities to ensuring continued access to donations and capital, and amplifying the impact of their mission, the integration of ESG principles into all facets of the nonprofit lifecycle will contribute to continued success. Indeed, leading industry organizations such as the American Red Cross have exhibited this imperative by incorporating formal ESG programs into their strategic plans.

Establishing ESG expectations at the leadership level can also drive adoption throughout the organization. Program staff can seize the opportunity to further integrate ESG elements and frameworks into program design, delivery and measurement. Development professionals can utilize ESG reporting to articulate insights attractive to individual, corporate and foundation donors. Communication and marketing professionals can tell a truly holistic story of impact. Finance leaders can ensure that their investments reinforce the organization's mission.

Article adapted from the Nonprofit Standard blog.

For more information, contact Karen Baum, Sustainability & ESG Advisory Services Leader, at kbaum@bdo.com, or



Corey Edie, Managing Director, Community Resilience, at ceide@bdo.com.

BDO Professionals in the News

BDO professionals are regularly asked to speak at various conferences due to their recognized experience in the industry. You can hear BDO professionals speak at these upcoming events:

APRIL

Norma Sharara is part of a panel presenting the topic "Tax Treatment of Employee Benefits" at the Georgetown University Law School's 40th Annual Representing and Managing Tax-Exempt Organizations conference in Washington, D.C. on April 27 and 28.

MAY

Norma is participating in two panels at the AICPA Employee Benefit Plan Conference in Denver, Colo. on May 10:

- Testing Your Limits in Qualified Plans
- The Great Sand Dunes: Pitfalls in Plans M&A/Mergers, Spinoffs and Terminations

JUNE

Amy Guerra is presenting a session entitled, "Single Audit Approach - What to do when the Program is Not in the Matrix" at the Illinois CPA Society's Advanced Not-For-Profit Conference on June 1 in Chicago.

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For more information on BDO USA's service offerings to this industry, please contact one of the following national practice leaders who will direct your inquiry to the appropriate partner in your market:

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For 100 years, BDO has provided services to the nonprofit community. Through decades of working in this sector, we have developed a significant capability and fluency in the general and specific business issues that may face these organizations.

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The Institute offers both live and local seminars, as well as webinars, on a variety of topics of interest to nonprofit organizations and educational institutions. Please check BDO's web site at **www.bdo.com/nonprofit** for upcoming local events and webinars.

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