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THE PPC
NONPROFIT UPDATE

FEBRUARY 2022, VOLUME 29, NO. 2

IRS Procedural Issues Facing the Exempt Organizations Community

Overview

Procedural and technical obstacles at the IRS have created significant problems and processing delays. Exempt organizations and their service providers have noted several issues.

2019 Tax Filings

Organizations that filed 2019 Forms 990 and 990-T have received multiple requests for "unfiled returns" or have been assessed a late filing penalty despite having filed an extension. Penalty amounts do not always account for the fact that the May 15, 2020, due date was automatically extended to July 15, 2020. Taxpayer responses and abatement letters have not been processed and attempts to contact the IRS have not led to resolution.

Tip: Try calling the IRS on Friday afternoon when the wait times are shortest. File all returns and extension requests electronically rather than on paper.

Automatic Revocations

IRS computers were not updated to reflect the automatic extension for filing from May 15 to July 15, 2020. Delays in processing and posting exempt organization returns that were filed late for 2018 and 2019 has caused some organizations to have their tax-exempt status automatically revoked even though they had not failed to file three consecutive returns. Once the system revokes an organization's exempt status, subsequent Form 990 submissions and extension requests are rejected. The Business Master File continues to list an organization as being revoked after the error is corrected.

Tip: A dedicated fax line (855-247-6123) for the sole purpose of addressing erroneous revocations was created. The IRS has asked that the fax only be used for its dedicated purpose.

Electronic Filing

Electronically filed exempt organization returns have been rejected because of

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errors in the IRS Exempt Organizations Business Master File. Such errors include inexplicable name mismatches, unprocessed name changes, unprocessed year-end changes and the filing of short-year returns, erroneous and uncorrected exemption revocations, and incorrect public charity/private foundation classification. Written correspondence requesting corrections to the Business Master file have not received a response from the IRS.

Name Changes

Exempt organizations that have notified the IRS of a name change, either by checking the "Name Change" box on the annual tax filing or by correspondence with the IRS, have found that the IRS has not updated its Business Master File or its records in Tax Exempt Organization Search (TEOS). Written name-change requests may take more than six months to process. Some organizations have experienced a loss of funding because the new name doesn't appear in the IRS databases. Other organizations have had bank accounts frozen and reimbursements and other payments delayed because the new name does not appear in the database of public charities.

Tip: Check your organization in the IRS Business Master File at least once a year, and send a letter to the IRS if you find errors.

Correspondence

Exempt organizations that have filed a Form 990-series return indicating a change of address have reported that IRS correspondence continues to be received at the former address. Delays in responding to misdirected correspondence have resulted in the imposition of additional penalties and interest.

Tip: File Form 8822-B to notify the IRS of a change in the organization's address prior to filing Form 990. Do not use Form 8822, which is used by individual taxpayers to report a change in the home address. Also use Form 8822-B to report a change in the Principal Officer (*responsible party*) shown in the Header of Form 990.

Exemption Applications

Exempt organizations that use **pay.gov** to electronically file Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code, or Form 1023-EZ, have found that the submitted application doesn't always get transmitted to the IRS. The IRS website indicates when it has assigned applications postmarked after a certain date. After that date, organizations that have called to inquire regarding the status of the application are told that the application is not in the system. IRS internal research queries take 45 days to complete. In some cases, the 45 days will expire without any result, and a second 45-day inquiry is initiated. Taxpayers who send a fax to the IRS are not receiving a response regarding applications that appear to be lost in the system. Additionally, the IRS is often not corresponding with the designated Power of Attorney.

Tip: Call the IRS to inquire regarding the status of the application 90 days after submission to ensure that it has been transmitted to the IRS.

Group Rulings

Since June 17, 2020, the IRS has stopped accepting new group exemption ruling requests while it develops new procedures for obtaining and retaining a group exemption. Preexisting subordinate organizations who are members of a group ruling have received revocation notices even though they were included in the annual supplemental group ruling information (SGRI) letter and included on the group return.

Tip: The central organization in the group ruling should submit the SGRI letter 90 days before the close of the tax year. Once the new procedures are released, begin submitting the SGRI letter 30 days before the close of the tax year. The change is intended to increase the accuracy and completeness of the list.

Announcement 2001-33 Revoked

On December 14, 2021, the IRS released Announcement 2021-18 (2021-52 IRB 910) revoking Announcement 2001-33 (2001-17 IRB 1137), effective for tax years beginning after December 31, 2021.

The 1999 Form 990 instructions provided that an organization that paid a third-party entity, such as a management services company, for services provided by an individual including trustees, directors, officers, or key employees ("TDOKEs", including foundation managers for private foundations), must report the direct and other compensation as if the organization had paid the individual directly. The purpose of the requirement was to address the concern that tax-exempt organizations were paying excessive compensation to employees and avoiding disclosure by channeling the compensation through management services companies and other entities. The IRS received comments regarding the new requirement, including concerns that it was too burdensome on tax-exempt organizations because it obliged the organization to obtain detailed information from third-party contractors to complete the tax return accurately and completely.

In 2001, the IRS issued Announcement 2001-33, which determined that an organization has reasonable cause, for purposes of the penalty imposed for failure to file a complete return under IRC Sec. 6652(c)(1)(A)(ii), if it reported in the compensation section of the Form 990 series return the amount paid to the management company (or other third party) for services, rather than reporting the compensation paid to each TDOKE who provided the services to the tax-exempt organization on behalf of that management company.

The 2008 Form 990 was extensively redesigned, including direction to treat management companies as independent contractors reportable on Form 990, Part VII, Section B, and requiring payments from related management companies (but not other management companies) to a current or former TDOKE or highly compensated employee (HCE) to be reported on Form 990, Part VII, Section A, columns (E) and (F), with the individual compensation disclosed separately for each individual.

Throughout the years, the IRS has continued to make revisions to the Form 990-series and instructions, including compensation reporting, based on public feedback. The instructions currently state that if a tax-exempt organization's current or former TDOKEs or HCEs receive compensation from a related management company that provided services to the tax-exempt organization, the tax-exempt organization must report the compensation separately for each individual. In addition, the current instructions provide that if a tax-exempt organization has delegated management duties to a management company (or other third party), then the tax-exempt organization must report the details of the arrangement on Form 990, Schedule O, including the name(s) of any of its current or former TDOKEs and HCEs that were compensated under the arrangement, and the amount(s) received by the management company for the services provided to the tax-exempt organization.

The Department of the Treasury and the IRS have determined that it is no longer appropriate for tax-exempt organizations that file Form 990-series returns to rely on Announcement 2001-33 rather than follow the specific instructions to the Form 990, Form 990-EZ, and Form 990-PF. Organizations no longer have reasonable cause for filing an incomplete return if they fail to provide the required details. Reporting compensation according to the specific Form 990 series instructions will improve transparency and compliance by making it easier for the public and the IRS to understand the financial operations, including compensation arrangements, of tax-exempt organizations that file Form 990-series returns.

Practical Consideration:

It may be necessary for some organizations to obtain and report compensation information differently than in prior years. Since the rules now apply to tax years beginning on or after January 1, 2022, organizations have some time to compile this information.

Tax Brief

Tax Exempt Organization Search (TEOS) Sole Source for Exempt Organizations Data. Effective December 31, 2021, the IRS will no longer update the Form 990-series data on Amazon Web Services (AWS). Publicly available data from electronically-filed Forms 990 in machine-readable format will be available solely through Tax Exempt Organization Search (TEOS) on the Charities and Nonprofits webpage at **www.IRS.gov**.

TEOS provides a wealth of information, including nonprofit organizations' tax-exempt status, determination letters, revocations, and recently filed Form 990-series returns. Documents are available in XML and PDF formatted files, excluding personally identifiable information to prevent identity theft. The IRS, the states, and the general public use the Form 990-series returns as a primary tool to gather and share information about tax-exempt organizations and promote compliance with federal and state tax-law requirements.

AICPA TQA on Accounting for COVID-19 Relief Grants

The AICPA recently issued Technical Question and Answer (TQA) 5270.01, *Recipient Accounting for Shuttered Venue Operators Grants and Restaurant Revitalization Fund Grants Received Under the Small Business Administration COVID-19 Relief Programs* (TQA). The TQA provides guidance on the accounting models to apply to these grants under existing GAAP and applies to both nonprofit and for-profit entities.

These federal grants provide support to eligible entities that suffered revenue losses as a result of COVID-19. The Economic Aid to Hard-Hit Small Businesses, Nonprofits, and Venues Act (passed in December 2020) established the program, and the American Rescue Plan Act (signed into law in March 2021) amended it. The Small Business Association's (SBA) Office of Disaster Assistance administers the grants. Entities receiving these funds may use them only for specific allowable expenses and during certain dates provided for in the grants. Recipients don't have to repay the amounts granted if they used the funds for eligible costs.

Nonprofit organizations aren't eligible for Restaurant Revitalization Fund (RRF) grants. RRF grants provide emergency assistance to businesses, including restaurants, bars, caterers, food concessions, and others that serve food or drink, which suffered revenue losses due to the COVID-19 pandemic. Publicly traded entities aren't eligible for either the RRF or Shuttered Venue Operator Grants (SVOG).

Shuttered Venue Operators Grants (SVOG)

SVOG provide relief to entities that suffered revenue losses because of closures due to restrictions on public gatherings resulting from COVID-19. The $16 billion program commenced in April 2021, and applications for supplemental SVOG awards began in August. Applicants that qualify may receive amounts under initial SVOG equal to 45% of gross earned revenues, up to a $10 million maximum grant. Examples of eligible nonprofit entities include operators of live performing arts organizations, museums, zoos, aquariums, and movie theatres; operators or promoters of live venues; and theatrical producers. The grant program has eligibility criteria for each type of entity.

The program specifies eligible uses for the SVOG money. These include payroll costs, rent, utilities, scheduled mortgage and certain debt payments, state and local taxes and fees, insurance, maintenance, payments to independent contractors, and other ordinary and necessary business expenses. Grant recipients can't use SVOG dollars to buy real estate or make investments, among other prohibitions.

Accounting for SVOG by Nonprofit Organizations

Government grants are accounted for as contributions received based on FASB ASC 958-605, *Not-for-Profit Entities—Revenue Recognition*. This standard requires entities to first determine whether a contribution is conditional or unconditional.

The TQA indicates the SVOG payments are conditional because there are conditions for receiving and keeping the funds. The entity must have incurred eligible expenses, and noncompliance with terms and conditions of the grant is grounds for returning the funds to the SBA. As a result, the entity shouldn't recognize the grant as contribution revenue until it substantially meets the conditions, or the government explicitly waives them.

The organization recognizes contribution revenue only to the extent it has incurred eligible expenses. At each reporting date, grant payments received in excess of revenue that can be recognized are recorded as a refundable advance liability, which is reversed and recorded as contribution revenue in subsequent periods when the entity incurs eligible expenses.

FASB ASC 958-605 also requires consideration of whether the government has imposed restrictions on the use of the funds. Because entities can only use SVOG funds for eligible expenses, they are considered to be donor-restricted when applying FASB ASC 958-605. Because the entity will likely satisfy the restrictions at the same time it meets the conditions for receiving the funds, it reports any contribution revenue recognized as an increase in donor-restricted net assets with a reclassification to net assets without donor restrictions. If the entity elects the accounting policy option at FASB ASC 958-605-45-4A and -4B to "simultaneously release" donor-restricted contributions whose restrictions are met in the same reporting period, it can report contribution revenue directly as support within net assets without donor restrictions.

Practical Consideration:

The TQA is available at **www.aicpa.org/content/dam/aicpa/interestareas/frc/downloadabledocuments/tqa-sections/tqa-section-5270-01.pdf**.

Nonprofit Audit Request for Proposals Tips

The request-for-proposal (RFP) process is the way a nonprofit organization can find the audit firm that best meets its needs. It is used for initial audits but also for changing auditors. Management and the governing board, or the audit committee when there is one, should decide on the criteria that is important to the organization before issuing RFPs. These include the organization's activities and services, accounting and reporting, financial situation, and regulatory environment. By making this determination in advance, they can narrow their search, save time, and better identify the audit firm size, experience, and resources they need to address their specific needs.

Nonprofit organizations should specify in their RFPs all their needs and resources, along with their expectations of their auditor. They should provide guidelines for submitting the proposals, administrative information about their organization, and their timing, work, and reporting requirements.

Designing an Efficient and Well-executed RFP Process

Following are tips for the organization to consider when designing their RFP process:

- Provide clear audit scope and objectives, along with other needs outside of audit and tax. This includes specifying if a Yellow Book and/or Single Audit will be needed.
- Get recommendations on firms and how to evaluate them from other nonprofit organizations, bankers, attorneys, insurance agents, investment advisors, state CPA societies, or nonprofit associations.
- Limit the request to no more than three to six firms. Those firms should be ones the entity has evaluated and thinks will be best qualified to meet its needs.
- Meet with interested firms to interact with them, evaluate the ability to work together, share information, and answer questions. It is critical to the audit for the entity and the auditor to have a positive working relationship, respect, and trust in each other. The RFP process is also a way for the accounting firm to evaluate and get to know the entity and decide whether it should accept the engagement.
- Consider providing the firm the opportunity to meet with management before the firm proposes, to share prior year audited financial statements and discuss matters like internal controls, operating units, information technology, and internal auditors that could affect the external audit. Management should be honest about the audit hours and fees paid in prior years to help the proposing firm evaluate what it will take for them to do the audit.
- Evaluate the firm's experience and industry knowledge. The audit output is more than a signed audit opinion. Auditors should be able to identify risks and opportunities to management and the board based on their knowledge of the entity and the industry and make recommendations about business practices and internal controls that add value to the organization.
- Ask the firm for references and contact them.
- Inquire about outliers when RFPs are received. If one firm's fees or time estimates are out of line with other firms' responses, the entity should understand why the estimates are different and consider the expected time by staff level. The price may not be the most important consideration, and the lowest fee may not be the best outcome.

Requesting Information

RFPs usually include a list of questions. Organizations should consider including non-routine questions to help them find the best firm for them. The following is an overview of suggested information a nonprofit entity should include in an RFP to meet its goals:

Administrative:

- Contact person(s) at the organization overseeing the RFP process and who can answer questions.
- Number of paper or electronic copies needed.
- Date the firm should return the proposal and when the decision will be made.
- How proposals will be evaluated, and whether there will be in-person interviews or virtual meetings.

The Organization:

- Mission or purpose, and history of its founding and development.
- Management structure and corporate governance.
- Finance function, including location, staffing and qualifications, technology used, and internal controls over financial reporting.
- Financial statement overview, including assets, revenues, expenses, liquidity, and accounting issues.
- Budget and forecasts.
- Regulation, including tax status, regulatory reviews, and audits in process.

Qualifications of the Auditor:

- Firm size, including staff and revenues.
- Licensing by state.
- Financial solvency and length of time in business.

The PPC Nonprofit Update is published monthly by Thomson Reuters/Tax & Accounting, P.O. Box 115008, Carrollton, Texas 75011-5008, (800) 431-9025.

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- Service offerings and unique experience or qualifications that differentiate the firm from other audit firms in general (not specifically other firms taking part in the RFP).
- Experience with not-for-profit industry, accounting and reporting, tax requirements, and federal single audits.
- Firm thought leadership in the industry (webinars, publications, industry and trade organization representation) and reputation.
- Philosophy, values, and ethics.
- Audit approach, quality control process, and use of technology.
- Geographic locations, whether audit will be staffed from local or out-of-town offices, and whether auditors are working remotely and the firm's virtual approach.
- Qualifications, experience, and training of individuals to be assigned to the audit and other key personnel providing services.
- Any disciplinary actions against the firm by regulators or professional associations, litigation history, and recent peer review reports.
- Firm's independence from the organization, including any conflicts of interest with the entity's management or board.
- Firm's relationships with attorneys, bankers, and regulators.
- Commitment to diversity and social responsibility.

Services Required from the Auditor and Fees:

- Scope of work and deliverables.
- Estimated hours to complete the audit in total and by each level of audit staff.
- Use of any subcontractors or specialists and their qualifications.
- Nonattest/nonaudit services to be provided.
- Fees for multiple years, along with any expected one-time costs in the first year of the audit.
- Conditions that would result in additional fees in the first or subsequent years audited.
- How fees will be billed and how reports will be provided by the auditor.

Practical Consideration:

The AICPA has a sample RFP for not-for-profit audit services on its website in the Not-for-Profit Member section.

Auditing Brief

OMB COMPLIANCE SUPPLEMENT ADDENDUM 1 RELEASED. Because of the timing of development and approval of the Compliance Supplement changes and the evolving nature of the COVID-19 pandemic and related legislation and programs, the 2021 Compliance Supplement, issued in August 2021, did not contain new COVID-19-related programs that resulted from the American Rescue Plan Act of 2021 (ARP). In December 2021, OMB released the first of two expected addenda to the 2021 Compliance Supplement. Addendum 1 adds Part IV guidance to the 2021 Compliance Supplement for two programs funded by ARP: (1) Coronavirus State and Local Fiscal Recovery Funds (Assistance Listing 21.027); and (2) Education Stabilization Fund (ESF) (Assistance Listing 84.425). (Note that ESF was included in the 2021 Compliance Supplement, but Section 1 of the program was not updated for the implications of the ARP. Addendum 1 provides ESF Section 1 updates.) You can access Addendum 1 at **www.cfo.gov/2021-addendum-1/**. Addendum 2 is expected in early 2022.