

THE PPC NONPROFIT UPDATE

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2021 AICPA Audit Guide on Yellow Book and Single Audits Released



The AICPA recently issued the 2021 edition of its audit guide, *Government Auditing Standards and Single Audits* (GAS/SA Guide), updated as of April 1, 2021. The new edition includes new reporting guidance and illustrations covering SAS No. 134 and related reporting SASs. The GAS/SA Guide is for audits performed in accordance with *Government Auditing Standards, 2018 Revision* (Yellow Book), and Title 2 U.S. Code of Federal Regulations (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance).

The GAS/SA Guide is an interpretive publication. Interpretive publications do not establish auditing standards but instead provide recommendations on applying GAAS in specific circumstances. Auditors are required to consider applicable interpretive publications in planning and performing their audits. If the auditing guidance in an applicable interpretive publication is not applied, the auditor should document how the

GAAS requirements were complied within the circumstances addressed by the guidance.

Purpose and Applicability

Consistent with previous editions, the GAS/SA Guide is organized into two parts: Part I, which discusses considerations for audits performed under the Yellow Book, and Part II, which discusses single audits and program-specific audits performed under the Uniform Guidance.

The 2021 edition of the GAS/SA Guide fully incorporates SAS 134–140 and SAS 141. Because SAS 134–140 are effective for years ending on or after December 15, 2021, the GAS/SA Guide has fully implemented them. Auditors are advised to use the 2020 edition for the auditing guidance and illustrative auditor reporting in effect before implementing SAS 134–140.

The 2021 OMB Compliance Supplement had not yet been issued as of the date of the Guide. Therefore, the information in the GAS/SA Guide is based on the 2020 Compliance Supplement and Addendum.

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Some of the guidance that was considered and included as appropriate in this update includes SAS 143, *Auditing Accounting Estimates and Related Disclosures*; interpretations issued (or reissued) through April 1, 2021; the Single Audit Act Amendments of 1996; *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*; *Government Auditing Standards, 2018 Revision*; and *2 CFR Frequently Asked Questions* published on May 3, 2021.

Highlights

The most notable features of the 2021 GAS/SA Guide are the inclusion of illustrative reports implementing the reporting SASs and information and guidance relating to COVID-19 funding. Highlights include:

- Chapter 2 was updated to provide details of the GAO alert related to three continuing professional education exceptions provided by the GAO in light of the COVID-19 pandemic.
- Chapter 4 was updated to reflect the changes made by SAS 134–140. In addition to new reporting illustrations, updates were made to the basic elements of the auditor’s report on the financial statements to reflect the changes in SAS 134–140.
- The concept of lost revenue applicable to some COVID-19 programs was discussed in Chapters 5, 7, and 12. A link with responses to questions relating to lost revenue was also included in these chapters.
- Several items that may be included in the communication with management when performing an audit under the Uniform Guidance were added in chapter 6. Additionally, several footnotes were added to adapt and apply auditing standards to a Uniform Guidance audit.
- Chapter 8, COVID-19 Considerations section, reminds auditors that all type A programs that were not audited in either of the two most recent audit periods are required to be audited as a major program. Therefore, type A COVID-19 programs must be audited as major programs because they have not been audited in at least one of the two most recent audit periods.
- Chapter 9, COVID-19 Considerations section, suggests that auditors consider internal controls due to new COVID-19 funding and changes in the control environment, such as employees working remotely, layoffs, and furloughs. Auditors should consider these changes when (1) evaluating the design of controls and determining whether controls have been implemented and (2) testing the operating effectiveness of those controls.
- Chapter 13 was updated to reflect the changes made by SAS 134–140, including new reporting illustrations and updated basic elements of the auditor’s report on compliance and internal control over compliance with the Uniform Guidance.

Many other changes were made due to the passage of time, to provide clarification, and to address issues relating to the 2020 Compliance Supplement.

Practical Consideration:

The GAS/SA Guide is available on Checkpoint at [checkpoint.riag.com](https://www.checkpoint.riag.com). *PPC’s Guide to Single Audits* has been updated for the 2021 GAS/SA Guide. The 2022 edition of *PPC’s Guide to Audits of Nonprofit Organizations*, available in spring 2022, will also incorporate the changes. Engagement letters and reports compliant with SAS 134 and related SASs are available now at thomsonreuterstaxsupport.secure.force.com/pkb/pkb_Home.



Planning for Remote Audits

At the start of the COVID-19 pandemic, as nonprofit organizations were forced to curtail their activities and employees worked remotely, nonprofit organizations and their auditors adjusted to what many thought was a temporary situation. Many firms had already begun to implement technologies and cloud-based applications that allowed more flexibility in how and where staff worked.

As the pandemic and social distancing continue, and employees and employers are realizing benefits of working remotely. As a result, many firms are implementing policies to allow working from home on a more permanent basis. Many auditors beginning their planning for the upcoming audit season are incorporating remote work. The audit landscape is very different because of changes in operations and new risks, but auditing standards haven’t changed because of the pandemic and auditors must still comply with them to issue an audit report.

In these uncertain times, to ensure compliance with auditing standards and firm quality control processes, there are important planning considerations for remote audits. Auditors must understand the client’s operations and pressures and perform risk assessment procedures, and the assessment may change during the audit. Obtaining and evaluating required audit evidence, exercising due care and professional skepticism, and documentation continue to be important aspects of every audit, especially because of changes to the economy and client operations as a result of the pandemic.

The following paragraphs discuss some specific planning considerations in a remote environment.

Firm Planning Considerations

Collaboration between Team Members. Firms need to establish a strong infrastructure and culture for remote work so that everyone is productive and employees know what is expected of them. This includes setting regular work hours and general availability, requiring attendance at scheduled video meetings or phone calls, regular use of IM or Microsoft Teams, updating and sharing calendars, and mandatory training. Protocols for using smartphones may also be helpful.

Firm management may need to consider increased monitoring of engagement performance, more interactive engagement team meetings, increased senior staff and partner involvement, and the use of specialists. For all audits, auditing standards require audit planning meetings and supervision of staff, even in a remote environment.

Technology. Staff working remotely need to have the right tools and technology at their workplace, including quality Internet service and network connections, software, adequate data storage and security measures, and video conferencing. There is a greater need for sharing documents and screens and using video conferencing tools to facilitate the audit and communications. Staff may need training to be able to effectively use the new technologies.

Cybersecurity. Whether there are a few staff members or the entire firm working from home, there must be security measures in place to protect sensitive firm and client data. Many firms are already using cloud-based tools, portals, and hosted software applications that ensure data is accessible, safely stored and transmitted, backed up, and recoverable.

Data breaches are a high risk in the current environment for firms and clients of all sizes. Employees need to be aware of firm policies and procedures for information security, especially those related to working remotely. These include using strong passwords, encrypting files and emails, using encrypted VPNs, and avoiding use of public Wi-Fi.

Practical Consideration:

Firms should consider the need to modify their quality control systems to adapt to employees working remotely. This need will vary based on the firm's size and nature of their audit engagements.

Client Planning Considerations

Audit Timing. Because of the pandemic, client deadlines for audited financial statements may have changed and extensions may have been received or can be requested. New deadlines can affect the audit plan. Auditors should also evaluate loan covenant requirements because of COVID-19 effects and should monitor client discussions with creditors about covenants.

Communication with Clients. Auditors need to educate clients on how the remote audit will take place, including clear scheduling of deliverables (client-prepared schedules) and meetings in advance, and agreeing on any preferred communication methods during the audit (for example, email, portal, phone, or in person). Clients will expect the audit to be efficient and that information sharing will be effective wherever the staff is located. It is important for auditors to remember that inquiry alone is not sufficient appropriate audit evidence, despite remote audit conditions, and to educate clients about this as needed.

Technology. Auditors also need 24/7 access to the firm's core applications and data, along with client data and applications, to share information with clients in a secure environment. Accounting firm IT departments may need to work with client IT staff to make sure this can happen and evaluate any revisions needed either at the client or the firm. As client information will be arriving in new ways, auditors need to consider security and privacy controls.

Consultations and Independence. Firms should emphasize the importance of consultations with their staff. Because there are more uncertainties and areas of higher risk, firms may require additional consultation areas.

Auditor independence is always an important part of planning. Because of changes in client operations and internal controls, auditors should be especially mindful of the requirements to be independent of clients both in fact and appearance. These include pre-approval of significant nonattest/nonaudit services, not assuming the role of management, and timely communications with audit committees about independence matters.

Upcoming Additional Guidance

A future edition of *The PPC Nonprofit Update* will feature an article on additional remote auditing considerations once the audit begins.



Inflation-adjusted Amounts for 2022

The following inflation-adjusted amounts apply for 2022 [Rev. Proc. 2021-45 (2021-48 IRB 764)].

Low-cost Articles

Charitable organizations normally can distribute low-cost articles in connection with a fundraising campaign without fear that the IRS will treat the activity as an unrelated business activity [IRC Sec. 513(h)(1)(A)]. A low-cost article is an item that costs the organization no more than \$11.70 in 2022 (up from \$11.30 in 2021).

Insubstantial Benefits

The deductible portion of a donor's contribution normally must be reduced by the value of anything received in return. However, an insubstantial benefit can be ignored, therefore allowing a full deduction, if the gift otherwise meets the requirements for claiming a contribution. The following alternative limitations are used to determine if benefits are insubstantial:

1. The fair market value of all benefits received is not more than the lesser of \$117 for 2022 (up from \$113 in 2021) or 2% of the contribution.
2. The contribution is at least \$58.50 for 2022 (up from \$56.50 in 2021), and the cost of the benefits received is no more than the low-cost article value of \$11.70 for 2022 (up from \$11.30 for 2021).
3. In connection with a fund-raising campaign, the benefits are distributed free to potential donors who neither requested nor expressly consented to receiving them, and their cost is no more than the low-cost article value of \$11.70 for 2022.

Lobbying Expenditures

If a Section 501(c)(4) social welfare organization, a Section 501(c)(5) agricultural or horticultural organization, or a Section 501(c)(6) organization has any lobbying expenditures, it normally must notify members of the portion of their dues that is nondeductible because of these expenses [IRC Sec. 6033(e)(1)(A); Rev. Proc. 98-19 (1998-1 CB 547)].

However, Section 501(c)(4) and (c)(5) entities are exempt from the notification requirements if (1) more than 90% of the annual dues comes from certain other tax-exempt entities, or (2) more than 90% of the dues comes from members who annually pay \$124 or less for 2022 (up from \$120 for 2021).

Agricultural or Horticultural Organization

The dues and similar income of an agricultural or horticultural organization are not subject to unrelated business income tax, regardless of the benefits or privileges to which the entity's members are entitled, if the annual dues do not exceed \$178 for 2022 (up from \$173 in 2021) [IRC Sec. 512(d)(1)].

Penalty Provisions

Some of the penalty provisions under IRC Sec. 6652 are adjusted for inflation. Those that apply to tax-exempt organizations or their managers are summarized as follows.

Failure to File Return under IRC Sec. 6033(a)(1).

Exempt organizations can be assessed penalties for failure to file returns. The penalties listed below (not all inclusive) are for returns required to be filed in 2023.

| Scenario | Daily Penalty | Maximum Penalty |
|--|---------------|--|
| Organization with gross receipts of \$1,129,000 or less | \$20 | Lesser of \$11,000 or 5% of the organization's gross receipts for the year |
| Managers | \$10 | \$5,500 |
| Public inspection of annual returns | \$20 | \$11,000 |
| Public inspection of exemption applications and notice of status | \$20 | No limit |

For a tax-exempt entity with gross receipts over \$1,129,000, the daily penalty is \$110, with a maximum penalty of \$56,000.

Failure to File Disclosure Required under IRC Sec. 6033(a)(2).

The daily penalty is \$110, with a maximum penalty of \$56,000.

Failure to File Return under IRC Sec. 6043(b). Terminated exempt organizations and their managers can be penalized. This list is not all inclusive.

| Scenario | Daily Penalty | Maximum Penalty |
|--------------|---------------|-----------------|
| Organization | \$10 | \$5,500 |
| Managers | \$10 | \$5,500 |

Other Penalty Provisions. There are several other penalty provisions (both taxpayer and preparer) that are adjusted annually for inflation, but they are not specific to tax-exempt organizations. See Rev. Proc. 2021-45 (2021-48 IRB 764), for additional inflation-adjusted amounts for various penalties.



Restaurant Meals Deduction

Background

Organizations are allowed to deduct 50% of food and beverage that are ordinary and necessary business expenses under IRC Sec. 162(a) and meet all of the following criteria [Reg. 1.274-12(a)(1)]:

1. The expense is not lavish or extravagant under the circumstances.
2. The taxpayer, or an employee of the taxpayer, is present when the food and beverages are provided.
3. The food and beverages are provided to the taxpayer or a business associate. A business associate is a person with whom the employee could reasonably expect to engage or deal in the active conduct of the employer's trade or business, such as a customer, client, supplier, employee, agent, partner, or professional advisor, whether established or prospective [Reg. 1.274-12(b)(3)].

100% deduction if provided by a restaurant. A temporary provision under IRC Sec. 274(n)(2)(D), allows a 100% deduction (instead of 50% under the general rule) for meal expense paid or incurred after December 31, 2020 and before January 1, 2023 that were *provided by a restaurant*. The IRS clarified in Notice 2021-25 (2021-17 IRB 1118) that a restaurant, for this purpose, is a business that prepares and sells food or beverages to retail customers for immediate consumption, regardless of whether the food or beverages are consumed on the business's premises (i.e., take-out or delivery allowed). However, a restaurant does not include a business that primarily sells pre-packaged food or beverages not for immediate consumption (e.g., a grocery store, specialty food store, drug store, convenience store, or kiosk).

Recent Development

Per diems. The IRS recently provided guidance regarding the effect of the temporary 100% deduction for food or beverages from restaurants to taxpayers applying the rules of Revenue Procedure 2019-48 (2019-51 IRB 1392). Taxpayers may treat the full meal portion of a per diem rate or allowance as being attributable to food or beverages from a restaurant beginning January 1, 2021, through December 31, 2022. [IRS Notice 2021-63 (2021-49 IRB 835), News Release IR-2021-225]

Practical Consideration:

See Section 6.05 of Revenue Procedure 2019-48 to determine the portion of a per diem rate or allowance attributable to meals which is 100% deductible if paid or incurred in 2021 or 2022.



Tax Treatment of Forgiven PPP Loan Amounts

When the Paycheck Protection Program (PPP) was first created, the CARES Act specified that no part of a forgiven PPP loan is included in taxable income. For a tax-exempt organization, the amounts of forgiven PPP loans are reported as contributions from a government unit (on Form 990, Part VIII, line 1e) in the year that the amounts are forgiven. In addition, these amounts may be included on line 1 of Schedule A, Parts II or III in the public support tests as contributions from a governmental unit in the year forgiven.

The tax treatment of the expenses paid by forgiven PPP loans has been less clear. The IRS released Notice 2020-32 (2020-21 IRB 837), indicating no deduction would be allowed for any expense if paying that expense resulted in PPP loan forgiveness. Rev. Rul. 2020-27 (2020-50 IRB 1552) followed providing that a taxpayer incurring otherwise deductible expenses could not deduct those expenses if, at the end of the tax year, they reasonably expected those expenses would be reimbursed in the form of a forgiven PPP loan. The IRS reasoned that the loan forgiveness resulted in tax-exempt income and those expenses paid with tax-exempt income could not be deducted because it would provide a double tax benefit.

However, the non-deductibility of these expenses became moot when the COVID-related Tax Relief Act (COVIDTRA), enacted in December 2020, clarified that a taxpayer is allowed a deduction for otherwise deductible expenses paid with PPP loan proceeds or an Economic Injury Disaster Loan (EIDL) grant. It does not matter if a PPP loan has been, or is expected to be, forgiven. Additionally, a taxpayer will not recognize taxable income on PPP loan forgiveness or receipt of an EIDL grant. The tax basis and other attributes of the taxpayer's assets are not reduced because of the loan forgiveness or nontaxable receipt of the grant. This was welcome relief. However, some returns were filed for the 2020 tax year without deducting these now allowable expenses.

Amend 2020 or Deduct Expenses in 2021

Rather than filing an amended return for their tax year ended after March 26, 2020 and before 2021 (their 2020 tax year), a safe harbor announced in

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April 2021 allows *covered taxpayers* to deduct original eligible expenses (expenses that qualified for PPP loan forgiveness under the program before it was expanded) on their return for the first tax year following the 2020 tax year. Covered taxpayers are taxpayers that (1) received a PPP loan from February 15, 2020 through December 31, 2020, (2) paid or incurred original eligible expenses during their 2020 tax year that were not deducted on their tax return for that year because the expenses resulted in forgiveness (or expected forgiveness) of a PPP loan, and (3) timely filed (including extensions) their return before December 28, 2020.

To elect the safe harbor, the covered taxpayer must attach a statement to its timely filed (including extension) return for its first tax year following its 2020 tax year in which the original eligible expenses were paid or incurred [Rev. Proc. 2021-20 (2021-19 IRB 1150)]. The statement must be titled "Revenue Procedure 2021-20 Statement" (and named RevProc2021-20.pdf for e-file attachments) and include the following:

- The covered taxpayer's name, address, and TIN.
- A statement that the covered taxpayer is applying the safe harbor provided by Section 3.01 of Revenue Procedure 2021-20 (2021-19 IRB 1150).
- The amount and date of disbursement of the taxpayer's original PPP covered loan.
- A list, including descriptions and amounts, of the original eligible expenses paid or incurred by the Covered Taxpayer during the 2020 taxable year that are reported on the return for the first taxable year following the 2020 taxable year.

Caution: Only expenses for which an original PPP loan could receive forgiveness are eligible for the safe harbor. Additionally, second draw PPP loan expenses are not covered by the safe harbor.

Practical Consideration:

The tax treatment for PPP loan proceeds has been fluid but the results are taxpayer favorable.



Tax Briefs

IRS Will Not Acquiesce in *Mayo Holding*. The IRS announced that it will not acquiesce in an Eight Circuit decision in *Mayo Clinic* [127 AFTR 2d 2021-2013 (8th Cir.)], discussed in the July 2021 edition of this newsletter, invalidating the requirement that the primary function of an educational organization described in IRC Sec. 170(b)(1)(A)(ii) must be the presentation of formal instruction [AOD 2021-04 (2021-47 IRB 725)].

Retroactive Termination of the Employee Retention Credit (ERC). The Infrastructure Investment and Jobs Act (IIJA), signed into law on November 15, 2021, retroactively ended the ERC after September 30, 2021 (rather than December 31, 2021, as previously provided) unless the employer is a recovery startup business. In addition, the definition of a recovery startup business was expanded by the IIJA. In the fourth quarter, a recovery startup business is one that (1) began operating after February 15, 2020, and (2) has average annual gross receipts of less than \$1 million. The pre-IIJA requirement that a recovery startup business must not have otherwise met the requirements for an eligible employer qualifying for the ERC, (i.e., experienced a significant decline in gross receipts or been subject to a full or partial suspension under a government order) no longer applies. These provisions apply to calendar quarters beginning after September 30, 2021 (IRC Sec. 3134).

