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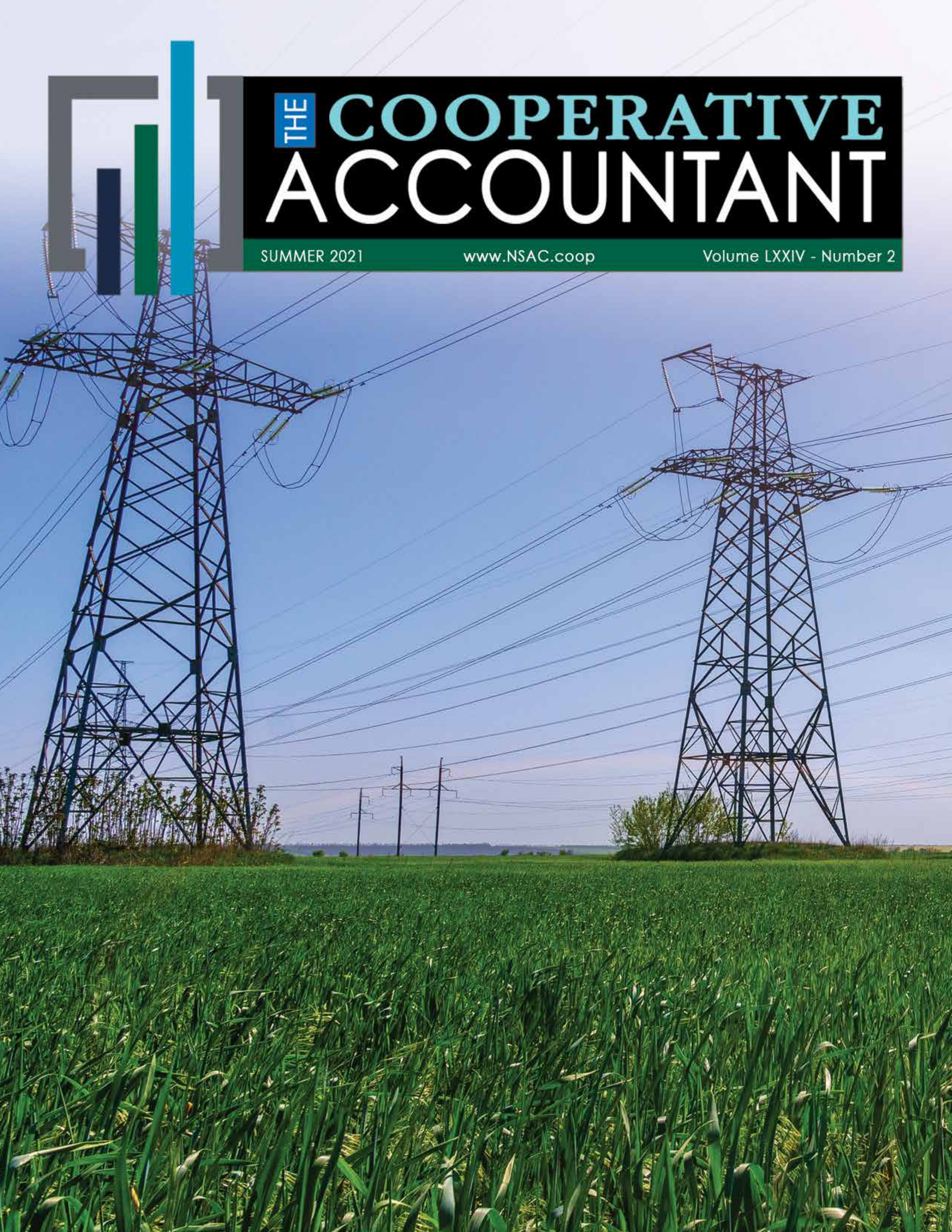

CONTENTS

FEATURES

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As our world is starting to get back to some sense of normality, you can feel the excitement in the air. Disruption does not come without consequences. It can have both negative and positive consequences. Each of us has personally and professionally felt these effects of the last year and a half.

Never before has there been such an enduring need for cooperation. Yet, we continue to not see this much needed cooperation in the political environment. Lack of cooperation causes nothing but problems. Hopefully, the light of cooperation and willingness to work for a common cause will come on before its too late.

Remember, **we too are always looking for you to share your knowledge since you may have some extra time on your hands** (like others continue to do) with us through articles in *The Cooperative Accountant*. Feel free to contact me (fmessina@uab.edu) if you have any ideas or thoughts on a potential article contribution. Sharing knowledge is a wonderful thing for all!!! Knowledge can change our world!

That is why we must remember – "The Past is history; the Future is a mystery, but this Moment is a Gift – that's why it's called the Present."

Positively Yours,
Frank M. Messina, DBA, CPA

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Do the Benefits of Underground Power Lines Outweigh the Costs?

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Overview

America's reliance on electricity has continued to grow. Disruptions in electric service from weather events or natural disasters have tended to repeatedly prompt the seemingly logical next question "does it make sense to underground (UG) power lines to help minimize outages?" Additionally, there has been a continuing trend for the removal of poles and overhead (OH) power lines to improve the aesthetics of a neighborhood or area. While undergrounding power lines may seem on the surface to be a good way to go, the reality is that making the decision to put power lines underground is more complicated, and considerably more expensive. Over the years, electric cooperatives and their regulating agencies or bodies have studied the undergrounding of power lines. The large majority of these studies conclude that the cost of undergrounding is far more expensive than OH power systems. New construction of UG facilities or conversion of existing OH power system facilities are both high cost alternatives for undergrounding. These costs can also vary from location to location, but are considerably higher for UG than OH in all instances. Besides the cost and aesthetics, factors regarding reliability need to be considered. Overall, the question becomes "would the benefits achieved outweigh the costs incurred?"

The Edison Electric Institute (EEI) is the association of shareholder-owned electric companies that represent approximately 70 percent of the U.S. electric power industry. They conducted a 2012 poll of electric customers to determine how willing they might be to pay for undergrounding. The results of their poll showed the following:

The results indicated that 60 percent of electric customers were willing to pay at least 1–10 percent more on their power bills for undergrounding and another 11 percent of customers were willing to pay up to 20 percent more. However, fewer than 10 percent of the customers polled were willing to incur a bill increase of 100 percent to pay the more realistic cost for undergrounding. This information confirms the experience of most utilities and state commissions that the *cost of undergrounding is a very important consideration and that customers have limited tolerance for higher costs for utility services to pay for undergrounding. (Hall, 2013, p. v)*

The cost of undergrounding continues today to remain a challenge for electric cooperatives and their customers who want lines put underground. If UG costs were the same as OH costs, the decision would be an easy one. Despite the higher cost of UG, electric cooperatives do find value in building UG facilities in some instances. For instance, new housing developments in the US are more and more being constructed with UG distribution power lines. But, the construction of new UG transmission lines has been more varied and more rare as UG transmission lines are much more expensive.

Hall (2013) also cites U.S. Energy Information Administration (EIA) data as showing that for all different types of storms or "disturbances", hurricanes/tropical storms, summer storms, and winter storms (ice/snow) make up "more than 97.8 percent of all the events recorded" (p. 14). All events included earthquake, flooding, heat storm, hurricane/tropical storm, summer storm (lightning/high winds), wildfire, and winter storms (ice/snow). The EIA deducted that storms that produce strong winds are the "major cause of warm weather and grid failures" (p. 15). The data further showed that "hurricanes/tropical storms and summer storms cause 80 percent of all major outages and that snow and ice accumulation are the major cause of system outages during the winter" (pp. 15-16). Given this, one might conclude that UG systems would be less susceptible to damage. But, in reality, most underground systems are generally fed electricity by overhead facilities. So, an event that causes overhead line power disruption will inevitably cause disruption to the underground system as well.

The EEI also studied major storm data for a period of nine years to determine trends and impacts these events had on the electric industry. The data was somewhat inconclusive in that storm patterns were increasing, but average outage time per customer declined in some instances. This may have been due to improvements in restoration response time due to increased use of mutual assistance from other electric utility companies. Additionally, UG facilities seemed to have had a slightly better performance than OH facilities in some instances, while a much better performance in others. UG facilities were particularly susceptible to poor performance in areas where flooding occurs.

In order to get an understanding of how to determine the decision to go underground, one needs to understand the benefits and challenges associated with these decisions. The following lists of benefits and challenges is provided directly from the 2012 EEI poll responses (Hall, 2013), and is a comprehensive listing of all aspects surrounding these. Each of these listed may or may not apply to one specific area or company, but instead represent the poll feedback from their association members across the US. Benefits include improved reliability in some instances, aesthetics, and others as listed. Challenges include costs, operation and maintenance, failure issues, and others as listed.

Benefits of Undergrounding

Reliability

- Benefits such as robustness to most weather events and less exposure to wildlife
- Increased reliability during high winds and storms
- Reduced exposure to lightning
- Reduced exposure to outages caused by trees
- Better voltage support
- Decreased tree trimming costs
- Newer UG cable systems, in general, tend to be more reliable and require less maintenance than OH installations

- In very dense urban areas, overhead construction becomes impractical, so the utility benefits by having the option of installing underground network systems in these areas where overhead can't be installed

Aesthetics

- Customers prefer underground construction
- Easier to obtain an easement for underground lines
- Helps with public image
- The primary benefit to an electric utility for an underground system is customer satisfaction
- One of the major benefits is to help create positive community relations by mitigating visual impact

Other

- Transmission - less public EMF concerns
- Transmission - fewer maintenance repairs
- Reduced congestion in high density areas
- Ability to maintain facilities at ground level, rather than from poles and bucket trucks
- Better public safety
- Lower feeder energy losses
- The cost of tree maintenance is removed entirely during the life of underground facilities
- Reduced route congestion near substations
- Increased customer acceptance for new projects
- Less resistance from towns for project approvals
- Significant reduction in right-of-way (R/W) maintenance costs and vehicular caused outages

Challenges of undergrounding

Costs

- Underground systems are normally more expensive to install than overhead systems
- Higher facility replacement costs
- Increased project costs associated with UG systems
- Increased material costs and longer installation timeframes vs. overhead
- Design redundancy/significantly higher capital costs for installation
- Higher operations and maintenance (O&M) cost offsets corresponding reduction in R/W maintenance costs
- Geographic areas with severe frost and rocky conditions can increase costs significantly
- Underground cable mitigation tends to be very expensive compared to other types of equipment repairs/replacements. This is due to the labor intensive nature of locating faults and repairing cable, the need for specialty contractors for replacement or mitigation work, and the need for additional crew resources to restore customers' power when a failure occurs.

Operation and Maintenance

- Older cables are more likely to fail and older tile or fiber duct systems are more likely to collapse when failed cable is pulled
- Repair times for UG construction are substantially higher than for OH construction, driving up maintenance costs and duration-based reliability indices
- Underground facilities experience many dig-ins by those who do not follow proper procedures to identify the location of underground facilities before excavating
- More complex operational needs, such as visual inspection, is impossible, making it more difficult and costly to maintain and repair
- Difficult repair due to frozen ground
- Installation of underground services requires much more coordination between the utility and customer than similar overhead service installations
- Although UG construction eliminates some outage causes, UG systems are still vulnerable to lightning and equipment failure

- Difficulty locating space for padmounted gear
- Increased stray voltage concerns
- Specialized training/equipment for manhole/vault access
- Surface-mounted equipment inspections critical to protect public
- Difficult access for outage restoration in heavy snow areas
- Underground facilities are susceptible to flooding

Failure Issues

- Much of the cable installed in the 1970s and 1980s is reaching the end of its useful life, creating a peak in the need for infrastructure investment
- Customer satisfaction is at risk due to the connected nature of UG feeds. Multiple failures in a segment on a single tap interrupt power to the same set of customers. Customers often become frustrated since it is not visually apparent as to the cause/location and because failures often occur under warm, dry conditions.
- Power outages last longer because damage is more difficult to locate and takes longer to repair
- Outages involving the underground system take more time to resolve as faulted cable/ equipment takes more time to locate and subsequently replace
- Customer perception that undergrounding their service or neighborhood should dramatically improve their reliability, not taking into account exposure of overhead portions of the system upstream

Other

- Submersible transformers, in particular, have created a significant safety hazard for crews attempting to locate and repair failed equipment
- Conflicts with other subsurface construction and utilities
- More specialized skillset and equipment required for installation and repairs (pp. 25-27)

Costs of Undergrounding

The EEI also collected data in it's 2012 survey on cost per mile of UG vs. OH construction. The following tables on the next page represent their findings.

Recovery of costs

The cost of UG facilities is paid by the utility ratepayers. So, the higher cost of UG vs. OH facilities is paid by charging higher utility rates. In many cases, these higher rates can extend for decades. The North American Wood Pole Council (2017) reported the following:

Studies on undergrounding proposals in North Carolina and Florida suggested that placing lines underground would require rate increases of 80 percent to 125 percent annually. Virginia calculated the annual cost of undergrounding lines statewide would equal about $3,000 per customer. These higher rates are not one-time, single year charges. To make them more affordable, these higher rates are planned to extend for a quarter century or more. The City of Anaheim in 1990 voted to underground its entire electrical system. The project is expected to take more than 50 years and it will be funded by a 4 percent surcharge on every electric bill, collected for the duration of the project. (p. 4)

Interestingly, the EEI poll found that no utility indicated that they had a special rate to charge for OH to UG conversion customers or that their state rate regulators had related additional compliance policies.

Another method of paying for UG facilities is through a charge to the individual customer that may be requesting the undergrounding project. These fees, charged as Contribution in Aid of Construction (CIAC), can be expensive to the customer as they would bear the cost as their sole responsibility. In many electric

Table Legend: Urban: 150+ customers per square mile
Suburban: 51 to 149 customers per square mile
Rural: 50 or fewer customers per square mile

Table 6.1 Cost per Mile: New Construction Transmission

	Overhead			Underground		
	Urban	Suburban	Rural	Urban	Suburban	Rural
Minimum	$377,000	$232,000	$174,000	$3,500,000	$2,300,000	$1,400,000
Maximum	$11,000,000	$4,500,000	$6,500,000	$30,000,000	$30,000,000	$27,000,000

For rural electric cooperatives, the survey data suggested that new construction transmission costs at the Minimum level could range 8 times the amount of overhead costs to construct underground facilities while at a Maximum level could range 4 times the amount.

Table 6.2 Cost per Mile: New Construction Distribution

	Overhead			Underground		
	Urban	Suburban	Rural	Urban	Suburban	Rural
Minimum	$126,900	$110,800	$86,700	$1,141,300	$528,000	$297,200
Maximum	$1,000,000	$908,000	$903,000	$4,500,000	$2,300,000	$1,840,000

For rural electric cooperatives, the survey data suggested that new construction distribution costs at the Minimum level could range 3.5 times the amount of overhead costs to construct underground facilities while at a Maximum level could range 2 times the amount.

Table 6.3 Cost per Mile: Converting Overhead to Underground Transmission

	Urban	Suburban	Rural
Minimum	$536,760	$1,100,000	$1,100,000
Maximum	$12,000,000	$11,000,000	$60,000,000

For rural electric cooperatives, the survey data suggested that the cost of converting overhead to underground transmission facilities could range from a Minimum of $1,100,000 per mile to a Maximum of $6,000,000 per mile.

Table 6.4 Cost per Mile: Converting Overhead to Underground Distribution

	Urban	Suburban	Rural
Minimum	$1,000,000	$313,600	$158,100
Maximum	$5,000,000	$2,420,000	$1,960,000

For rural electric cooperatives, the survey data suggested that the cost of converting overhead to underground distribution facilities could range from a Minimum of $158,100 per mile to a Maximum of $1,960,000 per mile. (Hall, pp. 30-31)

cooperatives, policy exists whereby UG facilities are required to be paid by the individual requesting party so that the entire cooperative membership is not burdened by the cost. The prohibitive cost of UG facilities can be a deterrence to individual customers to invest in undergrounding facilities.

Summary

The trend of utilities placing electric services underground is expected to continue in the future. Some of the reason for these decisions are to meet customer demands on aesthetics. But, the growth in new projects requiring distribution or transmission lines, either OH or UG, is anticipated to grow by less than 1 percent a year. While most industry experts contend that wide-spread undergrounding of power infrastructure is not cost-effective, studies have shown benefits in reduced tree trimming costs/needs and reduced restoration costs from severe storms. When the public believes there is a value, they have been willing to pay the additional costs. As long as the cost remains a small percentage of the overall new home cost, new home buyers will likely continue to prefer UG facilities.

Some states and utility companies have developed policies that encourage the utility and local customers to work together to convert "select" OH areas to UG. Some of the reasons this might be encouraged include susceptibility to outages, a large number of customers being served by a power line, and the ability to recover the costs from benefitting customers. No state has, to this date, recommended wholesale undergrounding of a utility's system. Davis (2020) has noted that "Electric utilities can accomplish grid resilience in different ways, but most efforts are focused on either a plan to harden the overhead system or place facilities underground" (para. 3). Any plans to implement UG facilities should be data-driven, using an approach that identifies critical OH equipment as candidates for proactive undergrounding. Davis concludes that "A strategic undergrounding program helps identify the lines most prone to outages and considers undergrounding to improve grid resilience and the total time of restoration of overhead distribution lines" (para. 4).

With the increased occurrence of recent storms, some have been pointing out that there are human, business, and societal costs also associated with power outages. These costs, in the past, have tended to not be included in a utility company's cost vs. benefit analysis. Because utilities aren't required to consider these costs, some believe they may not be considering the complete picture of costs in their decision-making analysis. UT News (2021) cites Ben Leibowicz regarding this point:

Energy Professionals (2021), a consulting firm in the utility industry, reports that power outages "cost an average of about $18 billion to $33 billion per year in the United States" (para. 4). These figures do not include brownout outages, which when included would increase the cost.

"We have a very incomplete picture of the full economic cost of big power outages," said Ben Leibowicz, an assistant professor in the UT Austin Cockrell School's Walker Department of Mechanical Engineering who co-authored the report. "Very relevant to the recent blackouts in Texas, we find that people aren't really estimating the costs borne by electricity customers of being without power for a long period of time." (para. 3)

Energy Professionals (2021), a consulting firm in the utility industry, reports that power outages "cost an average of about $18 billion to $33 billion per year in the United States" (para. 4). These figures do not include brownout outages, which when included would increase the cost. Brownouts are a reduction or restriction in available power by the utility to an area, intended to control electricity supply during periods of high demand to avoid a more severe power interruption. These types of outages

For electric cooperative finance and accounting professionals, it is recommended that you become knowledgeable regarding your electric cooperative's strategic policies regarding undergrounding policies and practices.

can cost businesses in terms of spoiled inventory, and delayed or missed business opportunity. As we see an increased occurrence and intensity of disrupting storm events, there may be increased discussion by the public, regulators, politicians, and the media regarding the human, business, and societal costs that have up until now gone uncaptured in most utility companies strategic policies in UG infrastructure investment decisions.

For electric cooperative finance and accounting professionals, it is recommended that you become knowledgeable regarding your electric cooperative's strategic policies regarding undergrounding policies and practices. Additionally, the cooperative would benefit from an open dialogue and information sharing between the finance/accounting area and the other departments within your organization when formulating decisions on UG investments. The engineering, operations, customer service, regulatory and governance, and public relations/marketing areas could all add value in presenting their expertise and perspectives on "if and how" undergrounding could make sense for your cooperative members. Since the cost of undergrounding is one of the key challenges that has prevented more wide-spread investment in UG infrastructure, adding data-driven financial analysis to key decision-making regarding undergrounding cost vs. benefit analysis would be beneficial to the cooperative members.

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Energy Professionals. (2021). Power Outages on the Rise in the US. Retrieved May 19, 2021 from the following website: https://energyprofessionals.com/power-outages-on-the-rise-in-the-us/

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North American Wood Pole Council. (April, 2017). Technical Bulletin – Undergrounding: Hidden Lines, Hidden Costs. Retrieved May 19, 2021 from the following website: https://woodpoles.org/portals/2/documents/TB_Undergrounding.pdf

UT News. (March 1, 2021). True Cost of Major Power Outages Remains a Mystery, Report Finds. Retrieved May 19, 2021 from the following website: https://news.utexas.edu/2021/03/01/true-cost-of-major-power-outages-remains-a-mystery-report-finds/

Further articles of interest on undergrounding:

Cost-Benefit Analysis of Hardening Utility Lines.
(Report by Public Utility Commission of Texas analyzing costs and benefits of placing utility lines underground.)
10 pages, 03/09
URL: https://woodpoles.org/portals/2/documents/TexasPUC_Hardening.pdf

Cost-Effectiveness of Undergrounding Utility Lines.
(Presentation by Kevin Mara, PE, of HiLine Engineering on the trends and economic costs in placing utility lines underground.)
16 pages, 10/06
URL: https://woodpoles.org/portals/2/documents/Mara_Undergrounding.pdf

Florida Utilities Research: Undergrounding Electric Lines.
(Three-part report analyzing the costs of placing utility lines underground vs. the marginal benefits in protecting distribution systems.)
2007/2008
URL: https://woodpoles.org/portals/2/documents/UndergroundingAssessment_P1.pdf

Life-Cycle 2017.
(Connecticut Siting Council Investigation into the Life-cycle Costs of Electric Transmission Lines, Final Report)
10/18
URL: https://portal.ct.gov/-/media/CSC/Publications/2017LIFECYCLEFINALRptpdf.pdf

Out of Sight, Out of Mind.
(Original 2003-06 Edison Electric Institute study of the costs of undergrounding overhead power lines.)
32 pages, 07/06
URL: https://woodpoles.org/portals/2/documents/OutofSightOutofMind.pdf

Power Outages Often Spur Questions Around Burying Power Lines.
(U.S. Energy Information Administration)
07/12
URL: https://www.eia.gov/todayinenergy/detail.php?id=7250

Technical Bulletin – Hardening of Utility Lines: Implications for Utility Pole Design and Use.
(Despite calls for "hardening" utility systems in response to storms, qualitative evaluations indicate current systems perform as expected and potential actions to harden the system are expensive and offer questionable benefits.)
8 pages, 11/07
URL: https://woodpoles.org/portals/2/documents/TB_HardeningUtilityLines.pdf

Updated! Dirt Report on striking underground utilities.
(Report from Common Ground Alliance on the record 534,151 events in North America where underground utilities were struck or damaged during 2019.)
65 pages, 10/20
URL: https://woodpoles.org/portals/2/documents/DIRT_2019.pdf

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FASB PROPOSES TO IMPROVE AND EXPAND HEDGE ACCOUNTING

On May 5, 2021, the Financial Accounting Standards Board (FASB) issued a proposed Accounting Standards Update (ASU) intended to better align hedge accounting with an organization's risk management strategies. Stakeholders are encouraged to review and provide comment on the proposed ASU by July 5, 2021.

In 2017, the FASB issued a new hedging standard to better align the economic results of risk management activities with hedge accounting. The new standard increased transparency around how the results of hedging activities are presented, both on the face of the financial statements and in the footnotes, for investors and analysts when hedge accounting is applied.

The new standard increased transparency around how the results of hedging activities are presented, both on the face of the financial statements and in the footnotes, for investors and analysts when hedge accounting is applied.

One of the major provisions of that standard was the addition of the last-of-layer hedging method. For a closed portfolio of fixed-rate prepayable financial assets or one or more beneficial interests secured by a portfolio of prepayable financial instruments, such as mortgages or mortgaged-backed securities, the last-of-layer method allows an entity to hedge its exposure to fair value changes due to changes in interest rates for a portion of the portfolio that is not expected to be affected by prepayments, defaults, and other events affecting the timing and amount of cash flows.

Since issuing the hedging standard, stakeholders have told the FASB that the ability to elect hedge accounting for a single layer is useful, but hedge accounting could better reflect risk management activities if expanded to allow multiple layers of a single closed portfolio to be hedged under the method.

The proposed ASU would expand the current single-layer model to allow multiple-layer hedges of a single closed portfolio of prepayable financial assets or one or more beneficial interests secured by a portfolio of prepayable financial instruments under the method. To reflect that expansion, the last-of-layer method would be renamed as the portfolio layer method.

Additionally, the proposed ASU would:

- Clarify eligible hedging instruments in a single-layer strategy
- Provide additional guidance on the accounting for and disclosure of fair value hedge basis adjustments that would be applicable to both the current single-layer model and the proposed multiple-layer model
- Indicate how fair value hedge basis adjustments should be considered when determining credit losses for the assets included in the closed portfolio.

The proposed ASU is available at www.fasb.org.

RECENT ACTIVITIES OF THE PRIVATE COMPANY COUNCIL

The Private Company Council (PCC) met on Tuesday, April 20, 2021. Below is a brief summary of issues addressed by the PCC at the meeting:

PCC Issue No. 2018-01, "Practical Expedient to Measure Grant-Date Fair Value of Equity-Classified Share-Based Awards": The PCC redeliberated issues for the proposed Accounting Standards Update, Compensation—Stock Compensation (Topic 718): Determining the Current Price of an Underlying Share for Equity-Classified Share-Option Awards. The PCC discussed how the practical expedient should reference the Treasury Regulations of Section 409A of the U.S. Internal Revenue Code—by direct reference to specific paragraphs, by a summarization of those paragraphs, or by a combination of those two approaches. The PCC also redeliberated the scope, application, transition method, and effective date of the practical expedient. After redeliberating those issues, the PCC unanimously determined that the practical expedient would achieve the project's intended objectives. At its June 2021 meeting, the PCC will discuss a draft of the final Update and consider whether to recommend that it be subject to the FASB endorsement process.

Agenda Consultation: A PCC member provided a summary of the financial reporting issues that the Board should consider adding to its technical agenda and the priority of those issues, which were discussed during the closed PCC meeting that took place on April 19, 2021. Those issues included debt modifications, troubled debt restructurings, disclosure materiality, liabilities and equity, variable interest entities, and financial performance reporting. PCC members discussed their views with FASB Board members and staff on those potential areas for the Board to prioritize. PCC members also expressed support for the FASB's goodwill and segment reporting projects.

Goodwill—Triggering Event Assessment Alternative for Private Companies and Not-for-Profit Entities: FASB staff highlighted Accounting Standards Update No. 2021-03, Intangibles—Goodwill and Other (Topic 350): Accounting Alternative for Evaluating Triggering Events, which provides an accounting alternative that allows private companies and not-for-profit organizations to perform a goodwill triggering event assessment, and any resulting test for goodwill impairment, as of the end of the reporting period, whether the reporting period is an interim or annual period. This accounting alternative is expected to reduce the complexity for private companies and not-for-profit organizations when performing the goodwill triggering event assessment. The Board thanked the PCC and private company stakeholders for their involvement in developing this standard.

Profits Interests and Their Interrelationship with Partnership Accounting: FASB staff summarized outreach with taxation and valuation specialists that has been conducted since the December 3, 2020 PCC meeting. Key discussion areas with specialists included (1) typical circumstances surrounding the grant of a profits interest award, (2) common terms of profits interests, (3) how the language in Revenue Procedure 93-27 (which defines a profits interest for tax purposes) influences the terms of profits interests, and (4) how valuation techniques used to measure profits interests compare to valuation techniques used to measure other types of equity interests issued as compensation. FASB staff noted that next steps involve performing additional outreach and research focused on some of the key accounting issues on profits interests and analyzing the FASB's agenda criteria as it relates to identified issues. PCC members briefly provided feedback on the research performed so far and next steps.

FASB staff noted that next steps involve performing additional outreach and research focused on some of the key accounting issues on profits interests and analyzing the FASB's agenda criteria as it relates to identified issues.

Current Issues in Financial Reporting: PCC and FASB members discussed practice issues arising from the current business environment under the COVID-19 pandemic. Topics discussed included disclosures related to COVID-19 and Paycheck Protection Program loan classification. The PCC also thanked the FASB for issuing certain educational documents in response to the current environment. Those documents include the FASB Staff Educational Paper, "Topic 470 (Debt): Borrower's Accounting for Debt Modifications," and the FASB Staff Q&A, "Topic 842 and Topic 840: Accounting for Lease Concessions Related to the Effects of the COVID-19 Pandemic."

Revenue—Post-Implementation Review: FASB staff solicited feedback from PCC members on their implementation experience with Topic 606, Revenue from Contracts with Customers, and on the post-implementation review plan for private companies. PCC members commented about their usage of the implementation resources provided by the FASB and discussed challenges and issues related to the adoption of Topic 606.

Disclosure of Supplier Finance Programs Involving Trade Payables: FASB staff summarized the features of supplier finance programs, provided an overview of the project, and solicited feedback from PCC members on the use of those programs by private companies. Although PCC members generally had not encountered the arrangements from the perspective of the entity for which the Board is evaluating potential disclosures, certain PCC members discussed their experience in accounting for the programs and with factoring transactions more broadly. The PCC chair offered to perform outreach with private company stakeholders during upcoming PCC Town Halls to further gauge the use of the programs among private companies.

Leases (Topic 842)—Discount Rate for Lessees That Are Not Public Business

Entities: FASB staff provided the PCC with an overview on this FASB project, which was added to the FASB agenda on April 14, 2021. This project seeks to amend the accounting policy election for lessees that are not public business entities to elect to use the risk-free rate as the discount rate by asset class. A PCC member offered preliminary feedback and volunteered to discuss further with the FASB staff at a later date.

Simplifying the Balance Sheet Classification of Debt: FASB staff provided the PCC with an update on this FASB project. At its April 14, 2021 meeting, the Board discussed comments received on and redeliberated the proposed amendments in its January 2017 proposed Accounting Standards Update and its September 2019 proposed Accounting Standards Update (Revised), Debt (Topic 470): Simplifying the Classification of Debt in a Classified Balance Sheet (Current versus Noncurrent). At that meeting, the Board removed this project from the FASB technical agenda.

The next PCC meeting is scheduled for Monday, June 21, and Tuesday, June 22, 2021.

FASB ABANDONS PROJECT TO SIMPLIFY THE BALANCE SHEET CLASSIFICATION OF DEBT

On April 14, 2021, the FASB removed the project to simplify the balance sheet classification of debt from its agenda.

Objective:

The objective of this project was to provide guidance that would reduce the cost and complexity of determining the current versus noncurrent balance sheet classification of debt.

Background:

The project on simplifying the balance sheet classification of debt was added to the technical agenda in August 2014 as part of the Board's Simplification Initiative. The objective of that initiative was to identify, evaluate, and improve areas of generally accepted accounting principles (GAAP) for which cost and complexity could have been reduced while maintaining or improving the usefulness of the information required to be reported by an entity.

Stakeholders told the Board that the guidance on determining whether debt should be classified as a current liability or a noncurrent liability in a classified balance sheet is overly complex. To reduce complexity, the current narrow-scope guidance would have been replaced with principles-based guidance.

On January 10, 2017, the FASB issued the proposed Accounting Standards Update, Debt (Topic 470): Simplifying the Classification of Debt in a Classified Balance Sheet (Current versus Noncurrent). In the 2017 proposed Update, the Board proposed replacing the existing narrow-scope, fact-specific guidance in Topic 470 with an overarching, cohesive principle for debt classification. The due date for comment letters was May 5, 2017.

During re-deliberations on the 2017 proposed Update, the Board added proposed requirements to preclude the consideration of unused long-term financing arrangements and to allow the consideration of grace periods. No other significant changes to the 2017 proposed Update were made. There also were clarifications and revisions made to several aspects of the 2017 proposed Update, including scope, debt settled in equity, debt-covenant waiver conditions, and disclosures.

On September 12, 2019, the FASB issued a revised proposed Accounting Standards Update, Debt (Topic 470): Simplifying the Classification of Debt in a Classified Balance Sheet (Current versus Noncurrent). The purpose of re-exposure was to raise awareness of the revisions with all entities, including private company and not-for-profit organization stakeholders, and to identify unintended consequences of the proposed guidance. The due date for comment letters was October 28, 2019.

Final Project Update:
In April 2021, the Board discussed comments received on and redeliberated the proposed amendments in its January 2017 proposed Accounting Standards Update and its September 2019 revised proposed Accounting Standards Update, Debt (Topic 470): Simplifying the Classification of Debt in a Classified Balance Sheet (Current versus Noncurrent).

Some Board members preferred to move forward with finalizing the project, noting that the proposed classification principle was operable and would have provided decision-useful information to financial statement users. However, the majority of the Board members noted that the proposed amendments would not achieve the objective of the project and would replace the current cost and complexity with new cost and complexity. Therefore, the Board removed the project from its technical agenda.

PROJECTS THE FASB IS WORKING ON RIGHT NOW

As of May 17, 2021, the FASB is working on the following projects:

- Identifiable Intangible Assets and Subsequent Accounting for Goodwill
- Accounting by a Joint Venture for Nonmonetary Assets Contributed by Investors
- Codification Improvements (formerly Technical Corrections and Improvements)
- Codification Improvements (formerly Technical Corrections and Improvements)
- Codification Improvements – Financial Instruments – Credit Losses (Vintage Disclosure: Gross Write-offs and Gross Recoveries)
- Codification Improvements—Hedge Accounting
- Consolidation Reorganization and Targeted Improvements
- Distinguishing Liabilities from Equity Phase 2
- Effect of Underwriter Restrictions on Fair Value Measurements
- Fair Value Hedging—Portfolio Layer Method
- Improving the Accounting for Asset Acquisitions and Business Combinations (Phase 3 of the Definition of a Business Project)
- EITF Issue No. 19-C, "Issuer's Accounting for Certain Modifications of Freestanding Equity-Classified Written Call Options"
- Leases (Topic 842)—Discount Rate for Lessees that are Not Public Business Entities
- Leases (Topic 842): Lease Modifications
- Leases (Topic 842): Lessors—Leases with Variable Lease Payments
- PCC Issue No. 2018-01, Practical Expedient to Measure Grant-Date Fair

Value of Equity-Classified Share-Based Awards

- Recognition and Measurement of Revenue Contracts with Customers under Topic 805
- Reference Rate Reform
- Disclosure Framework—Disclosure Review: Income Taxes
- Disclosure Framework—Disclosure Review: Inventory
- Disclosure Framework: Disclosures—Interim Reporting
- Disclosure Improvements in Response to the SEC's Release on Disclosure Update and Simplification
- Disclosure of Supplier Finance Programs Involving Trade Payables
- Disclosures by Business Entities about Government Assistance
- Financial Performance Reporting—Disaggregation of Performance Information
- Segment Reporting

Details on each project can be found on the FASB's website under the PROJECTS/ Technical Agenda tab at www.fasb.org.

PROPOSED NEW AUDITING STANDARD ENHANCES COMMUNICATION BETWEEN PAST AND POTENTIAL NEW AUDITORS

On February 25, 2021, the American Institute of CPAs (AICPA) Auditing Standards Board (ASB) issued the exposure draft (ED) Proposed Statement on Auditing Standards (SAS) Inquiries of the Predecessor Auditor Regarding Fraud and Noncompliance With Laws and Regulations (NOCLAR) to amend SAS No. 122, as amended, section 210, Terms of Engagement.

The standard requires immediate past auditors and presumed successor auditors, once management consents to the past auditor responding, to communicate about potential NOCLAR situations. Examples of NOCLAR situations include, but are not limited to, noncompliance with tax or pension laws and regulations.

"The Board's overall objective is to help auditors properly understand potential issues in determining whether to accept an engagement," said Jennifer Burns, CPA, AICPA Chief Auditor. "The proposed standard is designed to further the public interest by enhancing communication between past and potential new auditors. A refusal to consent by the client would be a significant red flag that the auditor would consider in determining whether to accept the engagement."

The proposed SAS aligns with the International Ethics Standards Board of Accountants (IESBA) standards which became effective on July 15, 2017. It narrowly amends AU-C section 210 in AICPA Professional Standards to require an auditor, once management approves communication between auditors, to inquire about suspected fraud and matters involving NOCLAR.

Interested parties are encouraged to submit their feedback to the ASB at CommentLetters@aicpa-cima.com by June 30, 2021. Readers are encouraged to also consider and comment on the AICPA Professional Ethics Executive Committee's (PEEC) exposure draft of proposed interpretations and definitions on this topic (comments also due by June 30, 2021).

You can find more information on the NOCLAR ED at www.aicpa.org.

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Continuing Saga of Section 199A(g)

Justin Darisse

Throughout 2020, the National Council of Farmer Cooperatives ("NCFC") continued its concerted effort to have the U.S. Treasury and the Internal Revenue Service ("IRS") follow Congress's explicit intent for the agencies to recreate how "old" Section 199 worked for farmer co-ops when writing rules to implement the fix to the so-called grain glitch.

As you may recall, in 2019 the U.S. Treasury and IRS issued a draft proposal that would limit a co-op's deduction solely to patronage activity. Under the old Section 199, co-ops calculated the deduction on both patronage and non-patronage income, so the proposal directly contradicted Congressional intent in crafting the fix to the so-called grain glitch.

NCFC and its Section 199A Working Group – drawn from NCFC's Legal, Tax & Accounting ("LTA") and Government Affairs Committees – engaged in the early months of the year with key members of Congress to push Treasury and IRS to respect congressional intent.

These efforts seemed to pay off in early March, when both Republicans and Democrats on the House Ways and Means Committee pushed Treasury Secretary Steven Mnuchin on the issue at an oversight hearing. In response to one question, the Secretary said he was "very aware of and very focused on" the issue, and, in fact, "met for one hour on it yesterday." He noted that their job "is to implement the law and not make policy," and planned to meet with the House and Senate tax writing committees to determine what was intended.

Almost immediately after the hearing, the first wave of the pandemic hit the East Coast; the quarantine and the need to implement economic relief passed by Congress meant that across the federal government, including Treasury, work on issues unrelated to the pandemic slowed to a crawl. No follow up meeting as committed to by Secretary Mnuchin ever occurred.

Therefore, NCFC and its allies on the Hill were dismayed when notification appeared that Treasury had sent the proposed regulations – unchanged – to the Office of Information and Regulatory Affairs ("OIRA") within the Office of Management and Budget at the White House. Typically, OIRA gives regulations one final government review to ensure that economic impacts of the regulation have been considered by the drafting agency. Once a regulation returns from OIRA, the next step typically is publication in the Federal Register, after which the regulation becomes final.

NCFC and its members immediately scheduled meetings with OIRA to outline concerns with the regulation, including that Treasury failed to adequately assess the impact that the tax increase caused by the rule. In addition, the members of Congress who made comments at the March hearing reached out directly to Treasury to express their displeasure that Secretary Mnuchin did not fulfill the promise he had made at the hearing.

Though OIRA finished its review and returned the regulation to Treasury late in the summer, the work NCFC and others had done meant that it was not immediately sent to the Federal Register for publication. Working with members of the LTA Committee, NCFC was able to draft a compromise proposal on calculation of the deduction when a co-op has both patronage and non-patronage income. The draft was presented to Treasury in July and was taken into consideration.

Throughout the fall, Treasury stonewalled attempts by NCFC, our members and policy makers from the Hill to discuss the compromise further and failed to even provide updates on Treasury's thinking. Then, just before Christmas, we received notice that Treasury's proposal was back at OIRA for another review. Well-placed sources in the Administration, who had seen the new regulation, said that it was virtually unchanged from the one Treasury had submitted in the summer.

In the first week of 2021, NCFC once again met with OIRA to express cooperatives' concerns and to walk through the compromise proposal. The regulations were returned to Treasury on January 8 and submitted to the Federal Register on January 14 for publication on January 19, just hours before the Trump Administration ended. They did, in fact, get published in the January 19 Federal Register with few changes from the flawed 2018 proposed regulations.

As of mid-April 2021, NCFC continues to seek a solution by reaching out to the Biden Administration as well as to allies in Congress. A bipartisan group of Ways and Means members sent a letter to Treasury Secretary Yellen, asking her to delay of withdraw the regulations for further consideration. USDA Secretary Vilsack has also weighed in with Secretary Yellen, asking that Treasury reconsider the regulations. And NCFC has met with the new tax policy team at Treasury.

The deduction is slated to sunset on December 31, 2025 for fiscal years beginning after that date. And while the regulation controversy is ongoing, recently introduced bills would make section 199A permanent – H.R. 1381 and S. 480, the "Main Street Tax Certainty Act of 2021." It is key that the final regulations are corrected soon, so that any extension of 199A will operate as intended for farmers and their cooperatives.

Final Section 199A(g) Regulations Released

Rebecca Thoune (Smith)

Just over 19 months after the proposed Section 199A(g) regulations for cooperatives and their patrons were issued, the final regulations were published in the *Federal Register* on January 19, 2021. The final regulations specifically provide guidance regarding the application of Sections 199A(a), 199A(b)(7) and 199A(g) to cooperatives and their patrons. While many were hopeful the final regulations would not resemble the proposed regulations, for the most part they do retain the rules and structure of the proposed regulations with some modifications.

The final regulations are broken into six sections, Treas. Reg. sections 1.199A-7 to 1.199A-12. This article will summarize by section the content of the final regulations and include some areas of interest that were discussed in the preamble.

Treas. Reg. section 1.199A-7 – Section 199A(a) Rules for Cooperatives and Their Patrons

This section provides guidance and special rules regarding the deduction for qualified business income (QBI) under Section 199A(a) by patrons of cooperatives to which Part 1 of subchapter T applies. A patron determines their QBI for each trade or business however the cooperative determines the amount of qualified payments of the patron.

When a patron calculates their QBI, it Includes distributions for which the Cooperative is allowed a deduction under Sections 1382(b) and (c)(2) including patronage dividends or similar payments such as money, property, qualified written notices of allocations, and qualified per-unit retain certificates and money or property in redemption of a nonqualified written notice of allocation. The cooperative must determine at its trade or business level whether these distributions include qualified items of income, gain, deduction, and loss. Once the cooperative makes this determination the information must be reported by the cooperative to the patron based on the total net amount of these payments. Consistent with the proposed regulations, a specified cooperative must report any qualified payments and the amount of any qualified items with respect to any non-specified service trade or business (non-SSTB) and any specified service trade or business (SSTB) to the patron on an attachment to or on the Form 1099-PATR, Taxable Distributions Received from Cooperatives, unless otherwise provided by the instructions to the Form. If the cooperative does not report on or before the due date, the amount of distributions that may be included in QBI by the patron is presumed to be zero.

Consistent with the proposed regulations and the statute, the final regulations retain the rule that patrons of a specified cooperative that receive a qualified payment are required to reduce their Section 199A(a) deduction by the amount, if any, under Section 199A(b)(7). (Treas. Reg. section 1.199A-7(f)). This reduction applies whether the specified cooperative passes through all, some, or none of the Section 199A(g) deduction to the patron in the taxable year.

Treas. Reg. section 1.199A-8 – Deduction for Income Attributable to Domestic Production Activities of Specified Agricultural or Horticultural Cooperatives

This section contains the rules relating to the deduction for income attributable to domestic production activities of a specified agricultural or horticultural cooperative (Specified Cooperative). Consistent with the proposed regulations, a Specified Cooperative is a cooperative to which Part 1 of subchapter T applies and which manufactures, produces, grows or extracts (MPGE) in whole or significant part within the U.S. any agricultural or horticultural product, or is engaged in the marketing of agricultural or horticultural products that have been MPGE in whole or significant part within the U.S. by its patrons. The regulations define two types of Specified Cooperative, an exempt which is a cooperative who qualifies as a farmer's cooperative organization under Section 521 and a nonexempt which is a cooperative not qualified under Section 521.

A key element of this section, besides the actual computation, is the definition of an agricultural or horticultural product. The final regulations retained reference to the Cooperative Marketing Act of 1926 (non-tax law definition). However, they did accept a portion of NCFC's alternative definition by providing several nonexclusive examples of items that qualify. The regulations define an agricultural or horticultural product as follows:

- Agricultural, horticultural, viticultural, and dairy products, livestock and the products thereof, the products of poultry and bee raising, the edible products of forestry, and any and all products raised or produced on farms and processed or manufactured products thereof within the meaning of the Cooperative Marketing Act of 1926, 44 Stat. 802 (1926)
- Aquatic products that are farmed
- Fertilizer, diesel fuel, and other supplies (for example, seed, feed, herbicides, and pesticides) used in agricultural or horticultural production that are MPGE by a Specified Cooperative

The final regulations specifically do not include intangible property other than when incorporated into a tangible agricultural or horticultural product.

The other key element of this section is the computation of the deduction for a nonexempt and exempt specified cooperative. The computation for a nonexempt cooperative is generally the most controversial item in the final regulations as a nonexempt cooperative cannot compute a deduction on nonpatronage income which is a clear reversal of Section 199. For a nonexempt cooperative the deduction is computed as follows (Treas. Reg. section 1.199A-8(b)):

Step 1: Identify patronage and nonpatronage gross receipts and related cost of goods sold (COGS), deductible expenses, W-2 wages, etc. and allocate them between patronage and nonpatronage

- Can only use patronage gross receipts and related deductions to calculate QPAI, oil related QPAI, the W-2 wage limitation, or taxable income
- Nonpatronage gross receipts and related deductions cannot be used to calculate a Section 199A(g) deduction
- Gross receipts = Receipts for the taxable year that are recognized under the Specified Cooperative's method of accounting used for federal income tax purposes for the taxable year
    - Total sales net of returns and allowances
    - All amounts received for services
    - Any income from investments and from incidental or outside sources
    - Interest, Dividends, Rents, royalties, and annuities

Step 2: Determine patronage gross receipts that are domestic production gross receipts (DPGR)

Step 3: Calculate qualified production activities income (QPAI)

- DPGR for the taxable year less COGS that are allocable to DPGR less other expenses, losses, or deductions that are properly allocable to DPGR
- Exclude the section 199A(g) deduction or any deduction allowed under Section 1382(b)
    - Patronage dividend, per-unit retain allocations

Step 4: Calculate deduction

- 9% of the lesser of
    - QPAI for the taxable year <u>or</u>
    - Taxable income for the taxable year
- Deduction is limited to 50% of the patronage W-2 wages attributable to DPGR for the taxable year

An exempt specified cooperative must

calculate two separate Section 199A(g) deductions, one patronage sourced and the other nonpatronage sourced. The patronage sourced calculation is computed the same as the nonexempt specified cooperative above. The nonpatronage sourced calculation is also calculated as above however using only nonpatronage gross receipts and related nonpatronage deductions. The taxable income is limited to taxable income and related deductions from nonpatronage sources and excludes any Section 199A(g) deduction or any deduction allowable under Section 1382(c). The nonpatronage deduction cannot be allocated, it has to be used against cooperative nonpatronage net income.

In the case of an exempt or nonexempt cooperative, the deduction cannot create or increase a NOL or the amount of NOL carryover or carryback. Any deduction not used in the tax year (or passed through to patrons) is lost.

In addition, for any patronage deduction created by an exempt or nonexempt cooperative, the cooperative is permitted to pass through an amount equal to the portion of the cooperative's Section 199A(g) deduction that is allowed with respect to the portion of the cooperative's QPAI that is attributable to the qualified payments the cooperative distributed to the patron during the taxable year and identified on the notice required in Treas. Reg. section 1.199A-7(f)(3). The cooperative must identify in a written notice the amount of the Section 199A(g) deduction being passed through to the patron and the notice must be mailed to the patron no later than the 15th day of the ninth month following the close of the taxable year of the cooperative. In addition to the written notice to the patron, the cooperative must also report to the patron the amount passed through in the notice on an attachment to or on the Form 1099-PATR. Just reporting on Form 1099-PATR the amount of the pass-through does not fulfill the notice requirement.

The final regulations did provide some much-needed clarification from the proposed regulations with respect to the pass through of the deduction. Consistent with the proposed regulations a specified cooperative may pass through all, some, or none of its patronage Section 199A(g) deduction. The key difference in the final regulations is the cooperative can pass it through to all patrons. The phrase "to all patrons" is key as it puts the burden on the patron not the cooperative to determine if it is an eligible taxpayer as only eligible taxpayers may claim the deduction that is passed through. An eligible taxpayer is a Specified Cooperative or a patron other than a C Corporation. If a Specified Cooperative is able to determine a patron is not an eligible taxpayer, then the Specified Cooperative may retain, at its discretion, any of the patronage Section 199A(g) deduction that would have gone to the ineligible taxpayer.

Treas. Reg. section 1.199A-9 – Domestic Production Gross Receipts

This section provides guidance to determine what gross receipts are DPGR. It is consistent with the proposed regulations. DPGR is defined as gross receipts that are derived from any lease, rental, license, sale, exchange, or other disposition of an agricultural or horticultural product that is MPGE by the Specified Cooperative or its patrons in whole or significant part within the U.S. Gross receipts derived from services, guaranteed payments (for partners in a partnership), and gross receipts from the lease, rental, license, sale, exchange, or other disposition of land are not DPGR, unless a de minimis or other exception applies.

In order to determine if a gross receipt is DPGR it is important to understand two additional definitions – "MPGE" and "in whole or significant part." MPGE includes the following:

- Manufacturing, producing, growing, extracting, installing, developing,

improving, and creating agricultural or horticultural products
- Making agricultural or horticultural products out of material by processing, manipulating, refining, or changing the form of an article, or by combining or assembling two or more articles
- Cultivating soil, raising livestock, and farming aquatic products
- Storage, handling, or other processing activities (other than transportation) within the U.S. related to the sale, exchange, or o ther disposition of agricultural or horticultural products but only if the products are consumed in connection with or incorporated into the MPGE of agricultural or horticultural products, whether or not by the Specified Cooperative

The Specified Cooperative or patron must have the benefits and burdens of ownership of the products under Federal income tax principles during the period the MPGE activity occurs. Items that do not qualify as MPGE are (a) packaging, repacking, or labeling agricultural or horticultural products and engaging in no other MPGE activity with respect to those products and (b) installation of agricultural or horticultural products and engaging in no other MPGE activity with respect to the products.

An item will be treated as MPGE in whole or significant part in the U.S. if the MPGE of the agricultural or horticultural products by the Specified Cooperative within the U.S. is substantial in nature taking into account all the facts and circumstances, including the relative value added by, and relative cost of, the MPGE within the U.S., the nature of the agricultural or horticultural products, and the nature of the MPGE activity that the Specified Cooperative performs within the U.S. If the direct labor and overhead of such Specified Cooperative to MPGE the product within the U.S. accounts for 20% or more of the Specified Cooperative's COGS of the product, or, in a transaction without COGS, accounts for 20% or more of the Specified Cooperative's unadjusted depreciable basis in property, the definition is meet.

With respect to a marketing cooperative, a Specified Cooperative will be treated as having MPGE in whole or significant part any agricultural or horticultural product marketed by the Specified Cooperative which its patrons have so MPGE within the U.S.

Allocating gross receipts between DPGR and non-DPGR should be done by using a reasonable method based on all the facts and circumstances. The method must be consistently applied from one taxable year to another and books and records maintained for gross receipts must be consistent with any allocations.

The final regulations did provide some additional relief by altering the de minimis rule. Specifically, all receipts are treated as DPGR if <10% of the total gross receipts are non-DPGR. The inverse also applies for non-DPGR.

Treas. Reg. section 1.199A-10 – Allocation of COGS and other deductions to DPGR

This section describes how COGS and other deductions should be allocated to DPGR and is reflective of the proposed regulations.

COGS is determined under the methods of accounting used to compute taxable income and does not include any payment made, whether during the taxable year, or included in beginning inventory, for which a deduction is allowed under Section 1382(b) and/or (c). Consistent with gross receipts, COGS is allocated between DPGR and non-DPGR by using a reasonable method based on all the facts and circumstances and the method must be consistently applied from one taxable year to another.

The other deductions are allocated by using either the Section 861 method, the simplified production method (if eligible), or the small business simplified overall method (applies only to qualifying small Specified Cooperatives).

Treas. Reg. section 1.199A-11 – Wage Limitation for the Section 199A(g) Deduction

The wage limitation in the final regulations is most consistent with the Section 199 regulations. Some consistent items to note are as follows:

- Use Form W-2 issued for the calendar year ending during the taxable year of the cooperative
- Employee = Officers and employees of a taxpayer under the common law rules
- Wage Limitation – 50% of W-2 wages attributable to DPGR
  - Allocable to DPGR using a reasonable method based on facts and circumstances
  - Consistently applied from year to year
- Wage definition = wages, elective deferrals, compensation deferred under section 457, and designated Roth contributions
- Methods for calculating W-2 wages (provided for in Rev. Proc. 2021-11)
- Specific rules apply for acquisitions, dispositions, and short taxable years

-

Treas. Reg. section 1.199A-12 – Expanded Affiliated Groups

This section discusses how members of an expanded affiliated group (EAG) compute the deduction. Unfortunately, the final regulations maintained the rule that members of an EAG that are not Specified Cooperatives are not included in computing the deduction for the group. This may be problematic for controlled groups where C corporation subsidiaries are doing manufacturing and distribution of the product.

An EAG is an affiliated group with one or more chains of includable corporations connected through stock ownership with a common parent corporation which is an includable corporation but only if (1) the common parent owns directly stock in at least one of the includable corporations, and (2) stock in each of the includable corporations (except the common parent) is owned directly by one or more of the other includable corporations. With respect to stock ownership, one must own stock which possesses more than 50% of the total voting power of the stock of such corporation and has a value equal to more than 50% of the total value of the stock of such corporation.

When computing the deduction, each nonexempt Specified Cooperative that is a member of an EAG computes its own taxable income or loss, QPAI, and W-2 wages from patronage sources. Then the income or loss, QPAI, and W-2 wages from each member of the EAG is aggregated. The deduction is computed on the aggregated amounts, and then the deduction is allocated among members of the EAG in proportion to each nonexempt Specified Cooperative's patronage QPAI regardless of whether the member has patronage taxable income or W-2 wages.

Treas. Reg. section 1.1388-1(f) – Patronage and Nonpatronage Definition

Despite multiple comments that a definition of patronage and nonpatronage is not necessary, the final regulations largely retained the definitions as in the proposed regulations, with some clarification. This regulation provides that whether an item of income or deduction is patronage or nonpatronage sourced is determined by applying what it refers to as the "directly related use test." The final regulations state:

"If the income or deduction is produced by a transaction that actually facilitates the accomplishment of the cooperative's marketing, purchasing, or services activities, the income or deduction is from patronage sources. … If the transaction producing the income or deduction does not actually facilitate the accomplishment of the cooperative's marketing, purchasing or services activities but merely enhances the overall profitability of the cooperative, being merely incidental to the association's cooperative operation, the income or deduction is from nonpatronage sources."

The definition in the final regulations applies to all Subchapter T cooperatives, not just Specified Cooperatives who are eligible for a Section 199A(g) deduction. The preamble to the final regulations clarified that the directly related use test is intended to follow Rev. Rul. 69-576 and to be consistent with Farmland Industries, Inc. v. Commissioner, 78 T.C.M. 846 (1999).

Effective/Applicable Date

The final regulations were "effective" January 14, 2021, and "applicable" to taxable years beginning after January 19, 2021. Therefore, for a taxpayer that has a year-end other than January, the regulations will be applicable for their tax year ending in 2022, for a taxpayer with a January year end, the regulations will be applicable for its 2023 tax year.

CARES Act and Consolidated Appropriations Act, 2021 - Temporary Changes to Charitable Contributions Limitation

George W. Benson

Cooperatives that make significant charitable contributions often find the historic corporate "10% of taxable income limitation" on charitable deductions to be constraining. See, Section 170(b)(2)(A). After exclusions/ deductions for per-unit retain allocations and patronage dividends, many cooperatives have little taxable income and thus cannot deduct all they contribute. There is a special definition of "taxable income" for this purpose contained in Section 170(b)(2)(D). That definition lists several adjustments to ordinary taxable income in determining "taxable income" for purposes of the limitation. But there is no adjustment permitting cooperatives to add back per-unit retain allocations or patronage dividends as there is in the statute for DPAD purposes. Nor is there a delegation of authority to Treasury to make other exceptions as there was in Section 163(j). As a result, while strong policy/equity arguments can be made that cooperatives should be permitted to add back patronage dividends, Section 170(b)(2)(D) probably needs to be amended to allow that to be done.

Having said that, the CARES Act temporarily increased the corporate limitation for certain "qualified contributions" from 10% to 25% of taxable income and for contributions of food inventory from 15% to 25%. For this purpose, "qualified contributions" are cash contributions to most charitable organizations made during calendar 2020 which the taxpayer elects to have covered. Also included are contributions of "food inventory" covered by Section 170(e)(3)(C).

The Consolidated Appropriations Act, 2021 ("CAA") extends the CARES Act relaxation of the corporate limitation to include contributions made during calendar 2021.

Separately, the CAA provides a special 100% limitation for "qualified disaster relief contributions." This special limitation is also elective. "Qualified disaster relief contributions" are defined as contributions "for relief efforts in one or more qualified disaster areas." They must be made during the period beginning 1/1/2020 and ending "on the date which is 60 days after the date of enactment of this Act." The CCA was signed by the President on December 27, so 60 days after the date of enactment ran on February 25, 2021.

In IR-2021-27 (January 29, 2021), the IRS provided further guidance as to the scope of this 100% limitation. The information release states:

"Under the new law, qualified disaster areas are those in which a major disaster has been declared under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act. This does not include any disaster declaration related to COVID-19. Otherwise, it includes any major disaster declaration made by the President during the period beginning on Jan. 1, 2020, and ending on February 25, 2021, as long as it is for an occurrence specified by the Federal Emergency management Agency as beginning after Dec. 27, 2019, and no later than Dec. 27, 2020." (emphasis added).

The donor must follow the usual recordkeeping requirements that apply to charitable contributions, including obtaining a contemporaneous written acknowledgment ("CWA") from the charity prior to the due date for its return. The statute also requires affirmation from the charity that the contributions was used, or is to be used, for relief efforts in one or more qualified disaster areas (a "disaster relief statement"). Having said that, because the provision was not enacted until the end of December and guidance was not released until the end of January, IR-2021-27 states that the IRS "will not challenge a corporation's deduction of any qualified contribution made before Feb. 1, 2021, solely on the grounds that the corporation's CWA does not include the disaster relief statement."

The IRS Extends the Filing Date for Individual Returns for 2020

George W. Benson

In mid-March the Treasury Department and Internal Revenue Service ("IRS") announced an extension of the due date for individual federal income tax returns for 2020 from April 15 to May 17. See, IR-2021-59 (March 17, 2021). The extension was limited to only the due date of the returns. The IRS did not extend the April 15 due date for the first installment of estimated tax payments for individuals. The extension did not, of course, extend the due date for state income tax returns, though most states have followed the federal lead.

The authority for this action is contained in Section 7508A which generally gives the Secretary of the Treasury authority to postpone certain deadlines in the event of a federally declared disaster.[1] The Treasury has delegated this authority to the IRS. The Section 7508A authority is discretionary (though see the discussion below). The IRS can choose which federally declared disasters warrant relief, and it can then tailor the relief to the situation. The deadlines that can be extended are listed in Section 7508(a)(1).[2] Relief can include many other things that just extending return filing deadlines as was illustrated by the COVID-19 notices last year. The length of any extension is generally up to the IRS (though see the discussion below), but may not exceed one year.

A list of disaster relief declarations in recent years can be found on the IRS website at https://www.irs.gov/newsroom/tax-relief-in-disaster-situations. A typical disaster relief declaration specifies the covered disaster, the

1 – Section 7508A cross-references the definition of "federally declared disaster" in Section 165(i)(5)(A). An individual in a federally declared disaster area who suffers an uninsured or unreimbursed disaster related loss is permitted by Section 165(i) to elect to deduct the loss either on the return for the loss year or on the return for the prior year. In contrast to Section 7508A, the application of Section 165(i) does not depend upon the discretion of the IRS. There are many unanswered questions as to the extent to which Section 165(i) may apply to COVID-19 losses. See, comments submitted to the IRS by the Section on Taxation of the ABA, available at https://www.americanbar.org/content/dam/aba/administrative/taxation/policy/2020/091420comments.pdf. While "guidance under § 165(i) on COVID-19 losses" is included in the IRS 2020-2021 priority guidance plan, nothing has yet been released.

2 – In Rev. Proc. 2018-58, 2018-50 I.R.B. 990, the IRS lists over 250 deadlines that may be extended under Section 7508A. The revenue procedure "does not, by itself, provide any postponements under section 7508A. In order for taxpayers to be entitled to a postponement of any act listed in this revenue procedure, the Internal Revenue Service (IRS) generally will publish a notice or issue other guidance (including an IRS News Release) providing relief with respect to a federally declared disaster, or a terroristic or military action." Section 1.02. The list includes the payment period limitation for patronage dividends. If a situation should ever arise where a cooperative affected by a federally-declared disaster declaration was unable to timely pay patronage dividends because of the disaster, the cooperative should consider reaching out to try to convince the IRS to include an extension of the payment period in any relief that is granted.

covered disaster area, the affected taxpayers and the scope of the relief. See, for example, LA-2021-01 (February 17, 2021), for a declaration related to tax relief for Hurricane Zeta victims in Louisiana. The covered disaster relief area may be narrower than the area covered by the FEMA declaration for the disaster. The deadlines extended normally include only a subset of the deadlines described in Section 7508(a)(1).

Historically, most extensions have followed natural disasters (floods, fires, hurricanes or other severe weather, etc.). The extensions that have been granted for this year and last year related to the COVID-19 pandemic were issued pursuant to an emergency declaration made by the President on March 13, 2020 under section 501(b) of the Stafford Act.

Recently, there has been a renewed focus on Section 7508A and what can (and must) be done under that section.

On December 20, 2019 (just before the COVID-19 outbreak in the U.S. and unrelated to that outbreak), the Section 7508A was amended by adding what is now section (d).[3] The language of this new section is vague, and its legislative history is sketchy. The section appears to be an attempt to address taxpayer complaints arising from the time between FEMA disaster declarations and IRS announcements of relief. It seems clear that Congress intended to reduce the IRS discretion so that taxpayers know sooner that deadlines will be extended. However, extent to which IRS discretion has been reduced is not clear.

The Ways and Means Committee described the purpose of the new section as follows:

"The Committee believes that the certainty and additional time provided by an automatic extension of filing deadlines for taxpayers affected by Federally declared disasters will ease the burden of tax compliance for taxpayers dealing with the hardship of disaster recovery."[4]

The report then stated:

"The provision provides to qualified taxpayers in the case of a Federally declared disaster a mandatory 60-day period that is disregarded in determining whether the acts listed above were performed in the time prescribed…"[5]

In a floor statement, the sponsor of the provision, Representative Tom Rice, described what he thought the provision did:

"This provision provides disaster related tax relief to those who are victims of a natural disaster. Specifically, this provision allows for people to receive a 60-day extension to file their taxes if there is a federally declared disaster. I want to clarify that this extension is not limited to the current Internal Revenue Service (IRS) policy of extending a declaration for FEMA Individual Assistance or FEMA Public Assistance, but may be triggered by any federal assistance under the Robert T. Stafford Disaster Relief and Emergency Assistance Act…"[6]

However, in proposed regulations released on January 13, 2021, the Treasury/IRS has taken the position that the scope of Section 7508A(d) is very narrow – namely, that it does not change the IRS discretion to determine which federally-declared disasters will get relief and what deadlines will be extended. In their view, the only limitation is to require that any extensions granted

3 – Section 7508A(d) was added by Section 205 of the Taxpayer Certainty and Disaster Tax Relief Act of 2019, enacted as Division Q of the Further Consolidated Appropriations Act, 2020.

4 - H.Rep. No. 116-379 (116th Cong., 2d Sess.) (January 21, 2020), at 99.

5 - Id., at 99. The reference to the "acts listed above" was to a laundry list of activities, not just to the return filing date.

6 - *Congressional Record* (December 17, 2019), at H10599.

must be for at least 60 days beginning "on the earliest incident date specified in a disaster declaration for a Federally declared disaster and [ending] on the date that is 60 days after the latest incident date specified in the disaster declaration." Prop. Treas. Reg. § 301.7508A-1(g)(3)(i). If a declaration does not specify an incident date (as in the case of the COVID-19 declaration), "there is no mandatory postponement period under section 7508A(d). In such cases, the only postponement period will be the period determined by the Secretary under 7508A(a)." Prop. Treas. Reg. § 301.7508A-1(g)(3)(ii)(B).[7]

But not all agree. Arguably, the Treasury/IRS position effectively renders Section 7508A(d) meaningless. In the past, it is unlikely that there ever were cases where the relief granted, when the IRS decided to grant relief, was shorter than the 60-day period. The perceived problem was the uncertainty experienced by affected persons while waiting to see whether the IRS would choose to grant relief and the scope of the relief granted.

Several comment letters argue that the purpose of Section 7508A(d) was to make extensions mandatory for all federally-declared disasters.

"As we understand that 2019 legislation, Congress intended to create a new mandatory and automatic deadline extension for taxpayers who have been affected by federally-declared disasters. The U.S. Treasury Department and Internal Revenue Service (IRS) have long had the authority to postpone these same deadlines on a discretionary basis. However, the unpredictable nature of those discretionary extensions results in inefficiencies and uncertainty when there is a delay between the onset of a disaster and the IRS announcement of deadline extensions. Under this existing framework, some affected taxpayers do not know whether they will be eligible for relief until weeks after a disaster has occurred, and in some cases, well after the relevant tax deadline has passed. Thus, to eliminate those inefficiencies and uncertainties, Congress created a new mandatory and automatic deadline extension for taxpayers who have been affected by federally-declared disasters."[8]

See also the comment letter by the law firm Ivins, Phillips & Barker dated March 14, 2021, https://www.ipbtax.com/assets/htmldocuments/Comments%20on%20Section%207508A%20Proposed%20Regulations%20IPB.pdf.

It will be interesting to see how this plays out.

There are at least two cases pending in Tax Court on motions to dismiss involving taxpayers who filed their petitions late and are asking for relief based in part on Section 7508A(d).[9] The Tax Court may be required to express its view on the scope of Section 7508A(d) in dealing with those cases.

My suspicion is that the IRS will not back down from the position taken in the proposed regulations. If Section 7508A relief is to be made more certain, Congress may have to try again with language that strikes a clearer and more balanced approach between taxpayer certainty and IRS discretion.

7 – The preamble to the proposed regulations explains the reasoning behind the Treasury/IRS position. An article by two law professors analyzes why what the Treasury/IRS have proposed makes sense from a policy perspective. See, "Predicting the 'Whether' of Section 7508A(d)," by Bryan T. Camp and T. Keith Fogg, Tax Notes Federal (April 19, 2021).

8 - See, comment letter of the American Benefits Council dated March 9, 2021.

9 - See, *Lowe v. Commissioner*, Tax Court Dkt. No. 4629-20S and *Abdo v. Commissioner*, Tax Court Dkt. No. 5514-20.

New Regulations Address TCJA Changes to the All Events Test and to the Treatment of Advance Payments

George W. Benson

As part of the Tax Cuts and Jobs Act of 2017 ("TCJA"), Congress modified the accrual "all events" test and adopted new rules for advance payments received by accrual basis taxpayers. Final regulations implementing these changes were publicly released on December 21, 2020 and published in the *Federal Register* on January 6, 2021. See, T.D. 9941, 86 FR 810 (January 6, 2021).

Change to the "all events" test

The TCJA amended Section 451(b) to provide that, for accrual method taxpayers, "the all events test for an item of gross income (or portion thereof) shall not be treated as met any later than when such item (or portion thereof) is taken into account as revenue in (i) an applicable financial statement of the taxpayer, or (ii) such other statement as the Secretary may specify for purposes of this subsection." New Treas. Reg. § 1.451-3 provides guidance for implementing this new rule (referred to in the regulations as the "AFS income inclusion rule").

The AFS income inclusion rule applies to accrual basis taxpayers with an applicable financial statement ("AFS") as defined in Treas. Reg. § 1.451-3(b)(5). Generally, an AFS is a financial statement prepared in accordance with GAAP or IFRS. Also included are certain other financial statements (other than a tax returns) filed with the federal or a state government or agency or a self-regulatory agency. The final regulations contain rules dealing with more complex situations, such as situations where an AFS covers groups of entities and where a taxpayer's financial accounting year is different than its taxable year. See, Treas. Reg. § 1.451-3(j).

As a general matter, under the AFS income inclusion rule, "the all events test … for any item of gross income, or portion thereof, is met no later than when that item, or portion thereof, is taken into account as AFS revenue…" This brings the recognition of income for tax purposes more in line with the recognition of income for financial statement purposes. There are some important exceptions to this rule:

- It does not apply to taxpayers that do not have an AFS.

- It does not apply to mortgage servicing contracts.
- It does not apply "if the timing of income inclusion for that item, or portion thereof, is determined using a special method of accounting." Treas. Reg. § 1.451-3(b)(13) contains a nonexclusive list of special methods of accounting for this purpose. Examples of methods on the list include the crop method of accounting, methods of accounting provided in Sections 453 to 460, mark-to-market accounting under Section 475, etc. While not on the list, the method of accounting for patronage dividends and per-unit retain allocations provided in Section 1385 should be regarded as a special method of accounting for this purpose.

The final regulations state that the AFS income inclusion rule does not "change the treatment of a transaction or the character of an item for Federal income tax purposes. Treas. Reg. § 1.451-3(g). So, for instance, the fact that a transaction is treated as a sale or as a financing for AFS purposes does not affect the timing of the recognition of income from the transaction if it is treated as a lease, license or similar transaction for federal income tax purposes.

In addition, the final regulations state that the AFS income inclusion rule is intended to affect the time at which the all events test is treated as satisfied "and therefore does not change the applicability of any exclusion provision, or the treatment of non-recognition transactions." See, Treas. Reg. § 1.451-3(h) and examples illustrating this limitation. So the AFS income inclusion rule would not be triggered by financial statement recognition of income upon the forgiveness of a Payroll Protection Program loan. Nor would it be triggered if income is recognized for financial statement purposes upon an exchange of real properties which qualifies for nonrecognition purposes under Section 1031.

However, the final regulations do not provide additional guidance as to the distinction between recognition and realization.

"Practitioners were hoping for better examples of income realization for tax purposes and a clear definition of something that would not be realized for tax purposes but might be recognized for financial statement purposes.

For example, practitioners are unsure what to do in the case of 'unbilled revenue' or 'unbilled receivables' for the provision of goods, in which someone may perform a service for a single deliverable that takes a while to complete… In that situation, the company may record revenue for AFS purposes but it's not earned until it completes the deliverable…

Previously, the company didn't need to realize that income for tax purposes because it wasn't fixed and determinable, but the new AFS rule could require recognition in that situation…" [10]

When an AFS income inclusion is required, the amount to be included is not always the amount of revenue reported on the AFS. See, Treas. Reg. § 1.451-3(c)(2) The revenue reported on the AFS is increased by the amount of any "(1) cost of goods sold and liabilities that are required to be accounted for under other provisions of the Code such as section 461, including liabilities for allowances, rebates, chargebacks, rewards issued in credit card transactions and other reward programs, and refunds…" and "(2) amounts anticipated to be in dispute or anticipated to be uncollectable." Unless the taxpayer chooses to apply what is described as the "alternative AFS revenue method," the AFS revenue is reduced by any amount the taxpayer would not have a legal right to retain if the customer were to terminate the contract on the last day of the taxable year (the "unenforceable rights exception"). Also, the AFS revenue should be adjusted to exclude a financing component if the contract had a significant financing component. (As noted below, these exclusions also apply for taxpayers with applicable financial statements under the new advance payment rules.)

Note that the unenforceable rights exception is the default rule. The alternative AFS revenue method requires an election, which, once made, requires IRS approval to change. Commentators have pointed out difficulties of applying the unenforceable rights exception:

"The AFS income inclusion rule generally requires taxpayers to exclude from AFS revenue amounts that they do not have an enforceable right to collect at the end of the tax year. However, the application of this rule requires a detailed understanding of the facts of the transaction resulting in the revenue, as well as a comparison of the AFS standard used to report that revenue and a legal analysis of whether the taxpayer

10 – "Realization Punt in Final Biz Accounting Regs May Risk Audits," by Amy Lee Rosen, Law360 (February 17, 2021).

11 – "The Unenforceable Rights Exception to AFS Income Inclusion," by Scott H. Rabinowitz and David A Schneider, *Tax Notes Federal* (February 22, 2021).

has an unenforceable right to that revenue (taking into account potential equitable recoveries)." [11]

The alternative AFS revenue method allows taxpayers to avoid this complication, but it comes at a cost. It may require a taxpayer to include in income amounts to which it does not yet have a legal right.

The Treasury/IRS recognized that the application of the AFS income inclusion rule to sales of inventory could result in mismatches of revenue and expense. The final regulations provide for an "AFS cost offset method." If advance payments are also involved, the taxpayer must also use the "advance payment cost offset method." The rules applicable to these methods are contained in Treas. Reg. § 1.451-3(d) and -8(e). While some taxpayers have observed that the AFS cost offset method is better than nothing (which is what the proposed regulations provided), they are disappointed that final regulations did not go further towards full book/tax conformity by allowing an offset for estimated expenses.

Special rules are provided for contracts with multiple performance obligations (Treas. Reg. § 1.451-3(e)) and for multi-year contracts (Treas. Reg. § 1.451-3(f)).

New rules for advance payments

Accrual basis taxpayers are, as a general rule, required to include advance payments in income in the year of receipt even though accrual might not otherwise make sense under the all-events test. Realizing that the general rule can result in a significant mismatch of revenue and expense, before the TCJA the IRS permitted taxpayers to defer recognition of advance payments in certain situations. See, Rev. Proc. 2004-34, 2004-1 C.B. 991, and Treas. Reg. § 1.451-5.

The TCJA changed that. Now advance payments are governed exclusively by new Section 451(c), which, in pertinent part, provides:

"(1) In General. – A taxpayer which computes taxable income under the accrual method of accounting and receives any advance payment during the taxable year, shall –

(A) except as provided in subparagraph (B), include such advance payment in gross income for such taxable year, or

(B) if the taxpayer elects the application of this subparagraph with respect to the category of advance payments to which such advance payment belongs, the taxpayer shall –

(i) to the extent that any portion of such advance payment is required under subsection (b) [the "AFS income inclusion rule"] to be included in gross income in the taxable year in which such payment is received, so include such portion, and

(ii) include the remaining portion of such advance payment in gross income in the taxable year following the taxable year in which such payment is received."

As part of T.D. 9941, the Treasury promulgated new Treas. Reg. § 1.451-8 (advance payments for goods, services and certain other items). This new regulation is applicable to taxable years beginning on or after January 6, 2021. A taxpayer can choose to apply the rules contained in the regulations to prior taxable years provided that it does so in their entirety and in a consistent manner.

The term "advance payment" is defined in Section 451(c)(4) and Treas. Reg. § 1.451-8(a)(1). It includes any payment received by the taxpayer if "(A) the full inclusion of the payment in the gross income of the taxpayer for the taxable year of receipt is a permissible method of accounting, without regard to this section; [and] (B) any portion of the payment is taken into account as AFS revenue for a subsequent taxable year, or, if the taxpayer does not have an applicable financial statement … any portion of the payment is earned by the taxpayer in a subsequent taxable year." For this purpose, the definition of "AFS" follows that used in new Treas. Reg. § 1.451-3 described above.

Advance payments are payments for services, the sale of goods, the use of intellectual property, eligible gift card sales, memberships in an organization and certain other things. Advance payments do not include rent, insurance premiums, payments with respect to financial instruments, and certain other things.

The final regulations begin by providing that, as a general rule, "an accrual method taxpayer shall include an advance payment … in gross income no later than in the taxable year in which the taxpayer receives the advance payment." Treas. Reg. § 1.451-8(b).

However, they then provide that taxpayers with an AFS may elect the "deferral method." Under that method a taxpayer "must (i) include the advance payment, or any portion thereof, in gross income in the taxable year of receipt to the extent taken into account as AFS revenue as of the end of such taxable year…; and (ii) include the remaining portion of such advance payment in gross income in the taxable year following the taxable year in which such payment is received (next succeeding year)." Treas. Reg. § 1.451-8(c). There are special adjustments to what is reported for financial purposes for determining what is "taken into account as AFS revenue" that that are similar to those described above for the new all-events test.

Taxpayers without an AFS, are eligible to use the "non-AFS deferral method." Under that method, a taxpayer "includes the advance payment in gross income for the taxable year of receipt to the extent that it is earned in that taxable year and includes the remaining portion of the advance payment in gross income in the next succeeding year." Treas. Reg. § 1.451-8(d)(3). For this purpose, a payment is deemed earned when the all-events test is met, without regard to when the payment is received by the taxpayer.

The regulation allows taxpayers to adopt the "advance payment cost offset method" for advance payments from the sale of inventory. Under this method, a taxpayer is permitted to reduce what it otherwise would have included in income for a taxable year prior to the year the inventory is transferred "by the cost of goods in progress offset for the taxable year." This method does not permit taxpayers to include costs that will be incurred in the subsequent year in the offset. As noted above, if the taxpayer adopts the advance payment cost offset method, it must also adopt the AFS cost offset method.

There is a special carve-out from the advance payment rules for payments received for goods two years or more in advance of delivery (the "specified good exception") unless the taxpayer elects the "specified good section 451(c) method."

The final regulations contain a number of examples illustrating the application of the rules. The examples address such things as the sales of gift cards, sales of products or services where the customer earns miles or other rewards, sales of products where the customer receives a discount voucher for future purchases, etc. Special rules apply to contracts with multiple performance obligations. The regulations provide that "any payments received under the contract are allocated to the corresponding item of gross income in the same manner as such payments are allocated to the performance obligations in the taxpayer's AFS." Treas. Reg. § 1.451-8(c)(8).

Effective date

Generally, the final regulations are effective for tax years that start on or after January 1, 2021, but there are options for adopting the rules earlier.

Implications of Book versus Tax Based Patronage in Agricultural Cooperatives

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Introduction

A book tax difference (BTD) is the difference between book income and taxable income in a given period. BTDs arise from various accounting items that are recognized differently depending on the income basis in consideration. Taxable income represents the amount of income that is subject to taxation in accordance with IRS tax code and other statutes. Book basis income refers to the income resulting from revenues and expense are calculated in accordance with Generally Accepted Accounting Principles (GAAP). Because book income and taxable income having differing regulatory standards, some accounting items are recognized differently on a book or tax basis. BTDs can be temporary or permanent depending on the accounting item. Temporary BTDs results when an accounting items is recognized within both book and tax methods but the recognition of that item occurs at different times. A temporary BTD reverses itself once full recognition has happened on both book and taxable income basis. Permanent BTDs occur due to special accounting items that are only recognized on either a book income or taxable income basis. BTDs can also be classified as favorable or unfavorable. A favorable BTD increases the amount of a deductible expense and decreases taxable income.

BTDs occurring within investor-owned firms have been examined for a variety of reasons. BTDs are considered to be informative on current and future earnings of a firm (Hanlon, 2005). BTDs can also signal information like the accounting conservativism or aggressiveness of a firm. Much research has considered the relationships between BTDs and earnings management, quality, and forecasts in relation to investor-owned firms (Atwood, 2011). The relationships between BTDs and earnings are a part of a broader discussion surrounding the idea of book-tax conformity. There is still an on-going debate as to how BTDs effect the quality of earnings reporting (Atwood, 2011).

While there has been research about BTDs in relation to investor-owned firms, we are unaware of any consideration for BTDs within cooperative business structures. BTDs could be particularly important in cooperatives since book-based patronage can differ significantly from tax-based patronage. BTDs can also shift income, and thus patronage, temporally which could result in benefits being distributed to different sets of members. The Tax Cuts and Jobs Act of 2017 (TCJA) has resulted in higher potential BTDs in agricultural cooperatives. That makes it particularly important to examine the implications of book or tax-based patronage in agricultural cooperatives.

The most apparent potential BTDs in agricultural cooperatives are accelerated depreciation, the receipt of non-qualified equity patronage and the Section 199 deduction. Depreciation on a book basis is based on the matching principle in accounting and is typically calculated on a straight-line basis over the life of the asset. Tax depreciation refers to the amounts reported on the company's income tax returns and in the U.S. the tax depreciation is based on the regulations of the Internal Revenue Service (IRS). The tax regulation allows for accelerated depreciation (such as modified accelerated cost recovery system MACRS) which shifts the largest portion of the depreciation expense to the earliest years of an asset's life. Accelerated depreciation methods create a favorable temporary BTD since it reduces income and patronage in the more current years and increases income and patronage in later years.

Many agricultural farm supply and marketing cooperatives are members of regional cooperatives and receive cash and equity patronage from those firms. Due in part to the reduction in the corporate tax rate from the TCJA, some regional cooperatives have distributed non-qualified equity patronage. This creates another potential BTD for the local cooperative. If the local cooperative calculates patronage on a book basis the regional non-qualified patronage would become part of the local cooperatives income in the year the equity patronage was issued. Local cooperatives calculating patronage on a tax basis would not include the regional non-qualified equity as patronage in the year the equity was issued but would instead recognize the income when the equity was redeemed by the regional cooperative.

A final common BTD effecting agricultural cooperatives is the Section 199 deduction which was part of the TCJA. While the nuances of the Section 199 deduction are complex it basically allows many agricultural cooperatives to deduct a portion of their income, subject to a limitation based on W-2 wages (KPMG, 2019). While Section 199A reduces taxable income, it is not recognized by GAAP and has no effect on book income. Section 199 therefore creates a permanent favorable BTD.

In this research, we used two tools to examine the impact of tax or book-based patronage on agricultural cooperatives and their members. A cooperative simulation model developed by Oklahoma State University Kenkel (2015) was used to model the effects at the cooperative level and the overall membership. The simulation program creates a 30-year time series of pro-forma financial statements. The long period for projections is necessary to reflect the impacts of revolving equity and the member's lifetime return from the cooperative. In addition to pro-forma profit and cash flow projections, the members' net present value (NPV) is calculated based on after tax portion of cash patronage and equity revolving payments. The calculated member NPV can be used to analyze the impact of alternative profit distribution, equity management structures and, in this case, the choice of book or taxed based patronage.

The simulator results were further enhanced by creating a profile of patronage by age using data on the market value of agricultural products sold by age category that was obtained from the USDA 2010 Census of Agriculture (USDA, 2012). The profile of patronage by age was used to determine the NPV of member benefits of patronage and equity retirement benefits by beginning patron age over the 30-year simulation period. More information on the profile of patronage by age is available in Kenkel (2020).

Case Study Cooperatives

The first example cooperative was based on a Midwestern farm supply and marketing cooperative with $58M in annual sales and $99M in total assets. The cooperative marketed 35M bushels of grain and supplied 57,000 tons of fertilizer and 8M gallons of petroleum products. The cooperative had $44M of net fixed assets, a fixed asset/total asset ratio of 45% and a debt to asset ratio of 53%. Personnel expense represented 37% of the cooperative's gross margin and regional patronage represented 20% of farm supply margins.

The second example cooperative was based on a Southern Plains wheat marketing and farm supply cooperative with $42M in sales and $46M in total assets. The cooperative marketed 28M bushels of grain (primarily wheat) and supplied 38,000 tons of fertilizer and 10M gallons of petroleum products. The cooperative had 17M in net fixed assets, a fixed asset/total asset ratio of 37% and the debt to asset ratio was also 37%. Personnel expense represented 28% of gross margin while regional patronage represented 40% of farm supply margins.

While these cooperatives were typical for their regions and also fairly similar to each other they provide some reasonable variation in key BTDs variables (Table 1). When measured as a percentage of earnings before interest, taxes, depreciation and amortization (EBITDA) the Midwestern cooperative had higher BTDs from depreciation, Section 199 and regional non-qualified patronage. That observation suggests that BTDs likely vary across cooperatives.

Table 1: Beginning Proportions of BTD Items to EBITDA

	Book	Tax
Section 199A Deduction:		
Midwestern	0.00%	12.21%
Southern Plains	0.00%	7.49%
Depreciation Expense:		
Midwestern	28.68%	40.98%
Southern Plains	12.87%	18.19%
Regional Non-Qualified Equity:*		
Midwestern	13.67%	0.00%
Southern Plains	8.79%	0.00%

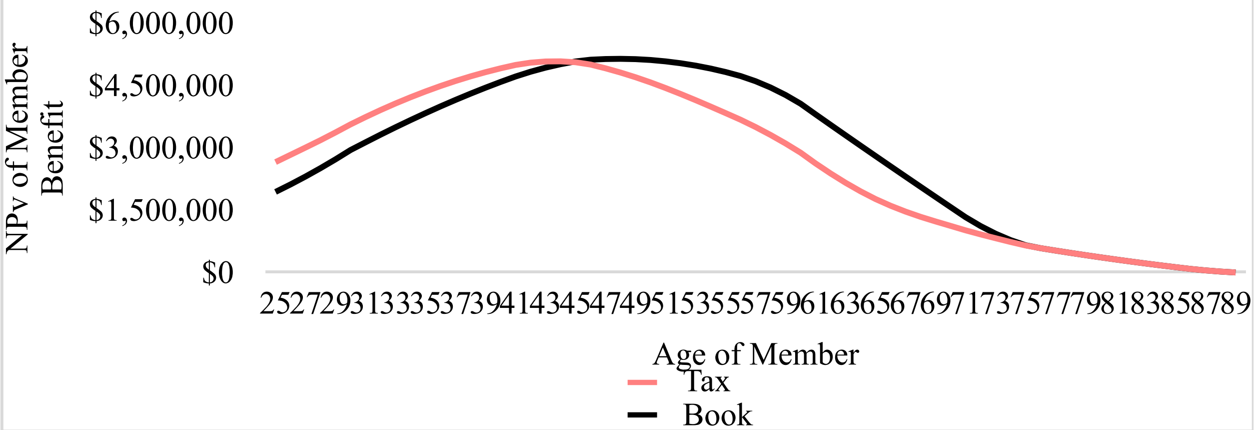
**Book uses issued equity while tax uses redeemed equity*

The case study cooperatives were analyzed under two scenarios. In the first scenario each cooperative's growth rate was maintained at the rate allowed by the book-based cash flows. The additional cash flow from tax-based patronage was simply retained as unallocated retained earnings. In the second scenario the cooperatives' growth rates under tax-based patronage were based on available cash flows and thus exceeded the book-based growth rates. This procedure separated the initial effect of tax-based patronage in reducing and delaying patronage from the secondary effect of growing the cooperative and thus generating additional future patronage. Under book-based patronage, the growth rates of the Midwestern cooperative were 1.36% and 2.15% for the Southern Plains cooperative. Under tax-based patronage those growth rates increased to 3.85% and 3.06% for the Midwestern and Southern Plains cooperatives respectively. The Midwestern cooperative had a greater growth effect from tax-based patronage due to the higher level of BTDs.

Results:

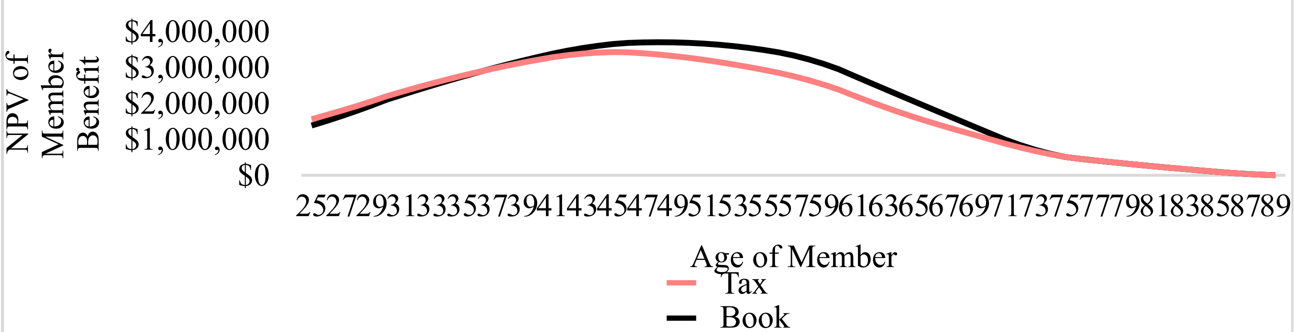
In the normalized growth rate scenarios, the aggregate member NPVs were higher for book patronage for both cooperatives. That result is not surprising. Our tax-based patronage calculation involved temporary BTDs that moved patronage to future years and permanent BTDs that reduced patronage. The results are more interesting when analyzed by member age. While, in aggregate, the member's NPV from the cooperative is higher under book-based patronage, younger members have slightly higher NPV with tax-based patronage. Younger members have fairly-low business volume and thus the younger age groups

Figure 1: Midwestern Cooperative NPV of Member Benefit by Age Normalized Growth

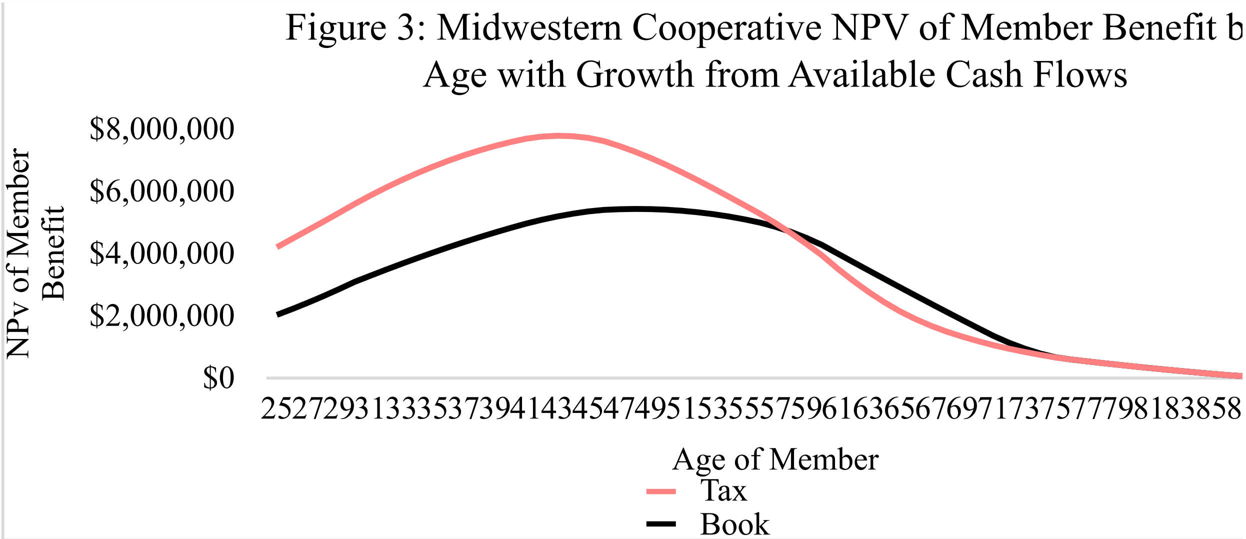


Aggregate Member NPV	
Book	Tax
$186,772,479	$171,177,690

Figure 2: Southern Plains Cooperative NPV of Member Benefit by Age Normalized Growth



Aggregate Member NPV	
Book	Tax
$135,278,202	$124,193,097



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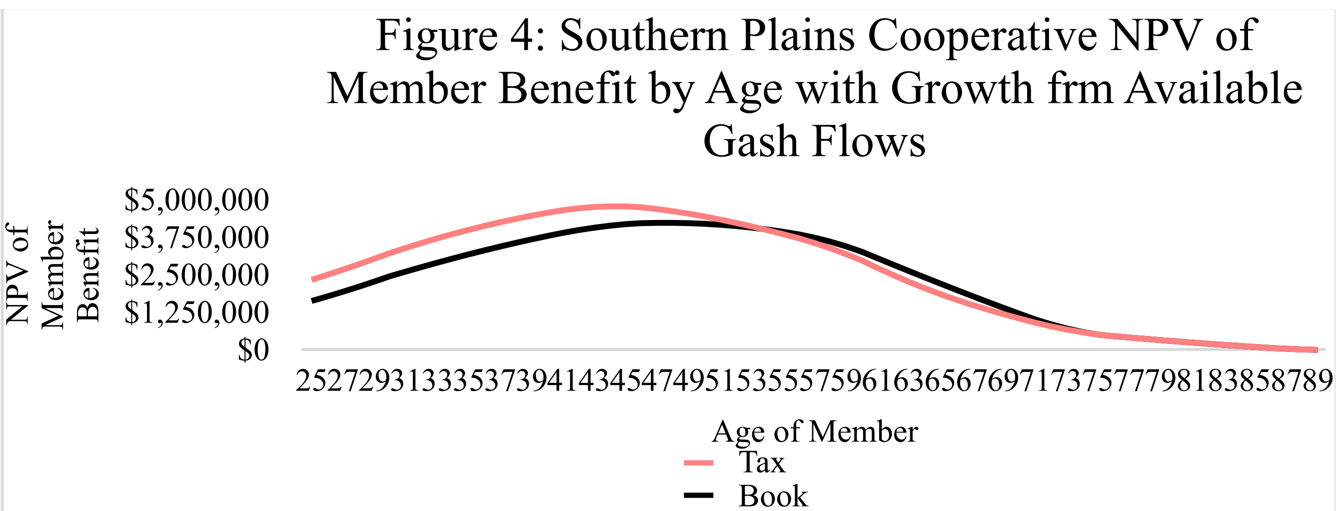
Aggregate Member NPV	
Book	Tax
$195,472,810	$255,920,236



Aggregate Member NPV	
Book	Tax
$152,680,914	$166,387,499

receive a small share of total patronage. The patronage percentage for those younger age groups will increase over time and thus those members are benefited when the cooperative moves income and patronage into future years. In contrast, older members will have lower patronage in future years or may have discontinued using the cooperative. Older members are disadvantaged when patronage is moved into future years.

Under the growth scenario the aggregate member NPV was higher under tax-based patronage for both cooperatives. In aggregate, the benefits of growing the cooperative and increasing future income and patronage outweighed the disadvantages of delaying or avoiding some patronage due to BTDs. When the results are analyzed by member age, differential impacts were even more apparent. While it was still the case that younger members were advantaged by tax-based patronage and older members were advantaged by book-based patronage, the relative advantage of tax patronage for younger members increased and the member age at which book-based patronage was preferred increased. Younger members will increase their patronage over time, have a longer patronage lifespan with the cooperative and receive more benefit from a cooperative's growth. All of those effects contribute to their advantage from tax-based patronage.

Implications and Discussion:

The choice of book or tax-based income calculations impacts the level and timing of patronage payments and has significant impact on the member's return. It can also affect the cooperative's cash flows and its potential growth rate. Our results were based on a financial simulation model and case study grain cooperatives with the cash patronage rate held constant. We found that tax-based patronage had the direct effect of reducing member benefit by reducing and delaying patronage. However, that direct effect was offset if the cooperative is able to use the additional cash flows generated from tax-based patronage to grow the cooperative. That result is predicated on an individual cooperative's ability to generate additional revenues from its reinvested cash flows in its market area.

The patronage calculation method has differential impacts on members of different ages. Younger members are more likely to be advantaged by tax-based patronage because their share of total patronage will increase over time and because they have a longer timeframe to benefit from the cooperative's growth. That could have implications for cooperatives who are trying to attract younger members.

BTDs varied across our two representative cooperatives and likely vary significantly across cooperatives. Growth opportunities are also firm specific. Many cooperative boards of directors have not considered how the choice of book or tax-based patronage impacts their cooperative and the members. Our research suggests that boards should work with their auditors to better understand this issue. The choice or book or tax-based patronage deserves the same attention and consideration as the more familiar decisions on cash patronage rates or equity revolving periods.

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DISASTER **RECOVERY**

Published January 23, 2017

Too many companies aren't prepared to handle a disaster or business continuity event. Rather than putting it off indefinitely, companies need to make an effort to get a disaster recovery plan in place. The list below offers a series of steps that can be taken to reinforce the ability to bounce back from anything that may become a disaster – whether it's a broken water pipe or a full-blown natural disaster.

1 Protect your data. If you don't have your data, it's all over. Even if you don't have a formal recovery plan, backing up your data is one of the quickest and easiest ways to protect your coop. There are now backup appliances available from over a hundred vendors that allow you to save your data every 15 minutes or so, with one appliance on-site and another in a remote location, for a relatively reasonable price. Companies can also save their data in the cloud, either through dedicated backup providers, or through individual cloud-based software applications. Companies might consider a mutual aid arrangement, where two companies in different locations host backup facilities for each other.

Whatever your method, you'll want to make sure that you're backing up everything at your company, from individual PCs and portable devices up to multi-location networks. And picking a method is only the beginning. You need to test it on a regular basis. This can range from spot checks to see that individual documents have been saved, up to full "bare metal restores" of all of your data and applications.

Without double-checking the backups, firms may find themselves in the same shoes as the accountant who provided a favorite quote about a failed system: "Our backup was working perfectly – we just can't restore from it." Until the backups are restored, you won't know if you have data or not.

2 Write the plan. Get something in writing – if it's not in writing, it doesn't exist. A number of companies were able to weather the 9/11 attacks because they were able to dust off and execute disaster recovery plans that they had set up for Y2k.

There are variety of sample Disaster Recovery plans available online, but as part of the process you should review the critical elements of your business and diagram your workflows (most firms have around 40). Once you know what your company looks like pre-disaster, you can start deciding which operations you need to have back in service first -- not all emergency restorations will support 100 percent of company operations right away. Have a categorized list of what you'll restore first, second and so on. It's better to decide this when you're not in the heat of battle.

As part of your plan, you'll want to know where licenses, product key information and user policies are stored, and have an inventory of all systems, workstations and storage devices. This will be valuable for a variety of purposes, not least for insurance claims: Unless you can document what you had, the insurance policies won't come across.

You'll also want lists of employees, customers, vendors, as well as critical contracts, certificates and policies – and you'll want them printed out, because in many cases you may not have power.

3 Have a risk management officer. This person will be responsible not just for taking the lead in the event of a disaster, but also for keeping the plan up to date and making sure everyone's trained and ready to execute. It is recommended that it not be your controller or chief technologist.

4 Create an emergency response team (ERT) and assign specific responsibilities. If your company has multiple locations, you'll want to have people at each location who can handle those responsibilities. It is important to emphasize the importance of training and education: You need to train your ERT. The top fault in companies is the lack of training. You can never have too much extra training on the Emergency Response Team, so they know what to do.

Among other things, a group of people need to know how to handle a data restore.

5 Test and revise the plan on a regular basis. Besides frequent tests of your data backup, there needs to be a quarterly read-through of the overall disaster recovery plan, an annual physical test, with a debriefing afterward so you can fix what didn't work and be ready for the next time.

In the end, the important thing is to get started. Many people have had this on their calendar for a long time, but it keeps getting pushed aside. You can do a really simple plan or a really complex plan – the one that doesn't work is the one that doesn't get done.

(Source: AccountingToday - Accounting Technology - October 30)

NATIONAL SOCIETY OF ACCOUNTANTS FOR COOPERATIVES

FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2020 AND 2019

GOLDSHOT, LAMB & HOBBS, INC.
CERTIFIED PUBLIC ACCOUNTANTS
3066 KETTERING BLVD
DAYTON, OHIO 45439

Goldshot, Lamb & Hobbs, Inc.

Certified Public Accountants

Business Advisors

INDEPENDENT AUDITOR'S REPORT

Board of Directors
National Society of Accountants for Cooperatives
Dayton, Ohio

We have audited the accompanying financial statements of National Society of Accountants for Cooperatives (a non-profit organization), which comprise the statements of financial position as of December 31, 2020 and 2019, and the related statements of activities, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of National Society of Accountants for Cooperatives as of December 31, 2020 and 2019, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Goldshot, Lamb & Hobbs, Inc.

June 4, 2021

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NATIONAL SOCIETY OF ACCOUNTANTS FOR COOPERATIVES

STATEMENTS OF FINANCIAL POSITION

DECEMBER 31, 2020 AND 2019

ASSETS

	2020	2019
CURRENT ASSETS		
Cash and Cash Equivalents	$ 442,803	$ 163,315
Investments	1,289,602	1,397,044
Accounts Receivable	-	4,582
Prepaid Expenses	8,216	14,359
TOTAL	$ 1,740,621	$ 1,579,300

LIABILITIES AND NET ASSETS

	2020	2019
CURRENT LIABILITIES		
Accounts Payable	$ 15,805	$ 5,516
Chapter Dues Payable	11,045	5,065
RDU Seminar Deposits	19,639	19,639
Deferred Income	36,750	56,400
ECC Funds Held for Chapter	66,389	-
Total Current Liabilities	149,628	86,620
NET ASSETS WITHOUT RESTRICTIONS	1,590,993	1,492,680
TOTAL	$ 1,740,621	$ 1,579,300

The accompanying notes are an integral part of these financial statements.

NATIONAL SOCIETY OF ACCOUNTANTS FOR COOPERATIVES

STATEMENTS OF ACTIVITIES

YEARS ENDED DECEMBER 31, 2020 AND 2019

	2020	2019
REVENUES		
Membership Dues	$ 230,875	$ 243,025
Revenues from Events:		
Conference	107,403	175,426
Seminars	2,609	3,006
Publications	500	920
Investment Income	59,833	200,406
Total Revenue	401,220	622,783
EXPENSES		
Program Services:		
Conference	20,098	145,171
Publications	45,653	51,504
Seminars	2,032	14,721
Member Engagement	32,543	33,252
Committee Expenses	30,355	44,176
Total Program Services Expenses	130,681	288,824
Administrative Services:		
Member Services	47,355	33,594
Management Fee	117,060	116,776
Meetings and Travel	1,016	40,680
Investment Fees	6,795	7,167
Total Administration Services Expenses	172,226	198,217
Total Expenses	302,907	487,041
CHANGE IN NET ASSETS	98,313	135,742
NET ASSETS WITHOUT RESTRICTIONS - BEGINNING OF YEAR	1,492,680	1,356,938
NET ASSETS WITHOUT RESTRICTIONS - END OF YEAR	$ 1,590,993	$ 1,492,680

The accompanying notes are an integral part of these financial statements.

NATIONAL SOCIETY OF ACCOUNTANTS FOR COOPERATIVES

STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2020 AND 2019

	2020	2019
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in Net Assets	$ 98,313	$ 135,742
Adjustments to Reconcile Change in Net Assets to Net Cash Provided (Used) by Operating Activities:		
Net Realized and Unrealized (Loss) Gain on Investments	(71,877)	(142,516)
Accounts Receivable	4,582	(3,890)
Prepaid Expenses	6,143	(2,523)
Accounts Payable	10,289	(518)
Chapter Dues Payable	5,980	(1,459)
Deferred Income	(19,650)	(2,350)
ECC Funds Held for Chapter	66,389	-
Net Cash Provided (Used) by Operating Activities	100,169	(17,514)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from Sales of Investments	442,409	484,395
Purchase of Investments	(263,090)	(793,166)
Net Cash Provided (Used) by Investing Activities	179,319	(308,771)
NET CHANGE IN CASH AND CASH EQUIVALENTS	279,488	(326,285)
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR	163,315	489,600
CASH AND CASH EQUIVALENTS - END OF YEAR	$ 442,803	$ 163,315

The accompanying notes are an integral part of these financial statements.

NATIONAL SOCIETY OF ACCOUNTANTS FOR COOPERATIVES

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2020 AND 2019

1. NATURE OF ORGANIZATION:

The National Society of Accountants for Cooperatives (NSAC) is a not-for-profit membership organization originally incorporated in Minnesota in 1936. NSAC serves the cooperative accounting community through education programs and professional publications. NSAC's principal revenue sources are its membership dues, and conference fees.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Basis of Presentation

The financial statements of the have been prepared in accordance with U.S. generally accepted accounting principles, which require the organization to report information regarding its financial position and activities according to the following net asset classifications:

Net Assets without Donor Restrictions: Net assets that are not subject to donor-imposed restrictions and may be expended for any purpose in performing the primary objectives of the organization. These net assets may be used at the discretion of NSAC management and the board or directors.

Net Assets with Donor Restrictions: Net assets subject to stipulations imposed by donors, and grantors. Some donor restrictions are temporary in nature; those restrictions will be met by actions of NSAC or by the passage of time. Other donor restrictions are perpetual in nature, where by the donor has stipulated the funds be maintained in perpetuity.

Donor restricted contributions are reported as increases in net assets with donor restrictions. When a restriction expires, net assets are reclassified from net assets with donor restrictions to net assets without donor restrictions in the statements of activities.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Cash and Cash Equivalents

For purposes of the Statement of Cash Flows, cash and cash equivalents consist of checking, savings, and money market funds. NSAC considers all investments with maturities of three months or less to be cash equivalents.

Accounts Receivable

Accounts receivable are stated at the amount management expects to collect from outstanding balances. Management provides for probable uncollectible amounts through a provision for bad debt expense and an adjustment to an allowance account based on its assessment of the current status of individual accounts. An allowance was not considered necessary as it was immaterial to the financial statements.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

Revenue Recognition

Revenue from contracts with customers is derived primarily from dues income, events, and other income. Revenue is recognized upon transfer of control of the promised products or services (performance obligations) contained in the customer contract in an amount that reflects the consideration NSAC expects to receive from satisfying the performance obligations. Prior to recognizing revenue, NSAC identifies the contract, performance obligations, and transaction price, and allocates the transaction price to the underlying performance obligations.

NSAC's revenues from contracts with customers are from performance obligations satisfied over time and at a point in time. Revenue from contracts with customers that are satisfied over time is derived from contracts with an initial expected duration of one year or less. Prices are specific to a distinct performance obligation and do not consist of multiple transactions.

Membership dues are billed to members annually on their anniversary date. Membership dues received in advance of a membership year are reported as deferred income. Deferred income also includes sponsorships and registration fees received in advance of the annual conference.

Event revenue is comprised of various fees charged for events hosted by NSAC for both members and non-members. NSAC hosts educational and social events for which attendees purchase a ticket or pay a course fee. Revenue is recognized as each performance obligation is satisfied at a point in time.

Other revenue is recognized over time and at a point in time as the related performance obligations are satisfied.

Investments

NSAC carries investments in marketable securities with readily determinable fair values at their fair values in the Statement of Financial Position. Unrealized gains and losses are included in the change in net assets in the accompanying Statement of Activities.

Income Taxes

NSAC is exempt from federal income taxes under Section 501(c)(6) of the Internal Revenue Code. However, income from activities not directly related to an organization's tax-exempt purpose is subject to taxation as unrelated business income. For the years ended December 31, 2020 and 2019, NSAC had not engaged in activities deemed unrelated to its exempt purposes.

NSAC determines the recognition of uncertain tax positions, if applicable, that may subject the organization to unrelated business income tax necessary by applying a more-likely-than-not recognition threshold and determines the measurement of uncertain tax positions considering the amounts and probabilities of the outcomes that could be realized upon ultimate settlement with tax authorities.

Currently, the tax years ended December 31, 2019, 2018 and 2017 are open and subject to examination by taxing authorities.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

Expense Allocation

The costs of providing various programs and other activities have been summarized on a functional basis in the Statement of Activities. Expenses that can be identified with a specific program or supporting service are charged directly to that program or supporting service. Costs common to multiple functions have been allocated based on management's estimate of how the resource has been consumed.

ECC Funds Held for Chapter

ECC Funds Held for Chapter represent cash held by the Organization on behalf of an unrelated entity. These funds will be returned to the entity upon their request.

3. CONCENTRATIONS OF CREDIT RISK:

NSAC maintains cash balances with Fifth Third Bank and Morgan Stanley Smith Barney. The balances at Fifth Third Bank are insured by the Federal Deposit Insurance Corporation up to $250,000. At December 31, 2020 and 2019, there were no uninsured cash balances. NSAC also maintains investments at Morgan Stanley Smith Barney. These funds are insured under the Securities Investor Protection Corporation which protects the investor only in the event of fraudulent broker activity. At December 31, 2020 and 2019, uninsured investment balances totaled $1,289,602 and $1,397,044, respectively.

4. INVESTMENTS:

Investment values as of December 31, 2020 and 2019 were as follows:

	2020		
	Fair Value	Cost Value	Unrealized Gain (Loss)
Mutual Funds	$ 312,530	$ 279,083	$ 33,447
Exchange-Traded and Closed-End Funds	279,550	236,177	43,373
Common Stocks	120,710	80,000	40,710
Government Securities	576,812	579,161	(2,349)
Total	$ 1,289,602	$1,174,421	$ 115,181

	2019		
	Fair Value	Cost Value	Unrealized Gain (Loss)
Mutual Funds	$ 1,258,049	$1,206,046	$ 52,003
Exchange-Traded and Closed-End Funds	18,795	19,398	(603)
Common Stocks	103,110	80,000	23,110
Government Securities	17,090	15,964	1,126
Total	$ 1,397,044	$1,321,408	$ 75,636

4. INVESTMENTS (Continued):

The following schedule summarizes the investment income in the statement of activities for the years ended December 31, 2020 and 2019:

	2020	2019
Interest, Dividends and Capital Gain Distribution	$ 131,710	$ 57,890
Net Realized and Unrealized Gains (Losses)	(71,877)	142,516
Total Investment Income (Loss)	$ 59,833	$ 200,406

5. RELATED PARTY TRANSACTIONS AND MANAGEMENT CONTRACT:

A management services company, Advanced Management Concepts, Inc. (AMC), serves NSAC under a formal management agreement which was in effect through March 31, 2013. The agreement now automatically renews annually unless terminated by either party. Management fees were $117,060 and $116,776 for the years ended December 31, 2020 and 2019, respectively.

NSAC also reimburses AMC on a monthly basis for administrative costs such as postage, telephone, printing and reproduction. The Executive Director of NSAC is an employee and part owner of AMC.

6. SUPPLEMENTARY CASH FLOW INFORMATION:

No cash was paid for interest or income taxes for the years ended December 31, 2020 and 2019.

7. AVAILABILITY AND LIQUIDITY:

The following represents the Organization's financial assets at December 31, 2020 and 2019:

	2020	2019
Financial assets at year-end:		
Cash and Cash Equivalents	$ 442,803	$ 163,315
Investments	1,289,602	1,397,044
Accounts Receivable	0	4,582
Total Financial Assets	1,732,405	1,564,941
Less amounts not available to be used within one year:		
Net assets with donor restrictions	0	0
Less net assets with purpose restrictions to be met in Less than a year	0	0
Financial assets available to meet general expenditures Less than a year	$1,732,405	$ 1,564,941

7. AVAILABILITY AND LIQUIDITY (Continued):

NSAC's goal is to generally to maintain financial assets to meet 90 days of operating expenses. As part of its liquidity plan, excess cash is invested in short-term investments, including money market accounts and various publicly traded exchange-traded and closed-end funds, commons stocks, government securities, and mutual funds.

8. FAIR VALUE MEASUREMENTS:

Fair value is defined as the price that would be received to sell an asset in the principal or most advantageous market for and assets in an orderly transaction between market participants on the measurement date. Fair value should be based on the assumptions market participants would use when pricing an asset. The modified cash basis of accounting establishes a fair value hierarchy that prioritizes investments based on those assumptions. The fair value hierarchy gives the highest priority to quoted prices in active market (observable inputs) and the lowest priority to an entity's assumptions (unobservable inputs). NSAC groups assets at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

- Level 1 inputs are unadjusted quoted market prices for identical assets or liabilities in active markets as of the measurement date.
- Level 2 inputs are other observable inputs, either directly or indirectly, including quoted prices for similar assets/liabilities in active markets; quoted prices for identical or similar assets in non-active markets; inputs other than quoted prices that are observable for the asset/liability; and, inputs that are derived principally from or corroborated by other observable market data.
- Level 3 are unobservable inputs that cannot be corroborated by observable market data.

NSAC has determined that the only material financial assets or liabilities that are measured at fair value on a recurring basis and categorized using the fair value hierarchy are investments. For such investments, fair value measurement is based upon quoted prices. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. All investments at December 31, 2020 and 2019 are measured at Level 1 inputs.

9. SUBSEQUENT EVENTS:

Management has evaluated subsequent events through June 4, 2021, the date the financial statements were available to be issued.

The COVID-19 pandemic is having a substantial impact on the economy and normal operations of most entities. The severity of the financial impact of this pandemic on the financial position and long-term operations of NSAC is not know at this time; however, management is taking actions to mitigate any impact of the outbreak to the organization.

2021

TAX, FINANCE & ACCOUNTING CONFERENCE FOR COOPERATIVES

AUGUST 2–4

VIRTUAL

NSAC
NATIONAL SOCIETY OF ACCOUNTANTS FOR COOPERATIVES

NRECA
America's Electric Cooperatives

NTCA
THE RURAL BROADBAND ASSOCIATION