CPAS / ADVISORS

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April 30, 2019

Board of Directors
Indiana Association of REALTORS®, Inc.
Indianapolis, Indiana

Dear Members of the Board:

We have audited the consolidated financial statements of Indiana Association of REALTORS®, Inc. (the Organization) for the year ended December 31, 2018, and have issued our report thereon dated as of the date of this letter.

This letter is not required by professional standards. However, we want to inform you about issues of importance to the not-for-profit (NFP) community in order to assist you in continuing to proactively plan for the future of the Organization. The purpose of this letter is to inform you about the status of certain emerging developments that will affect NFP organizations.

NFP MANAGEMENT FOR THE LONG-TERM THROUGH GOOD TIMES AND BAD

The length of the current economic expansion, coupled with recent volatility in the economy and the financial markets serve as a reminder that organizations need to keep a long-term view as they strive to continue fulfilling their missions.

Charitable Giving Trends and Your Donor Base

The impact of the 2017 Tax Cuts and Jobs Act on charitable giving remains uncertain. On the positive side, charitable giving has continued on an overall upward trend over the past few decades. Statistics suggest that 70% of individuals give to charity, while only about 30% have itemized their deductions on their tax returns. This indicates that a large portion of the population gives to charity at some level without receiving any tax deduction for their donations. With the increase in the standard deduction and the limitation on deductions for state and local taxes under the Tax Cuts and Jobs Act, it is anticipated that the percentage of individuals who will itemize their deductions will drop to 10%. Will this impact charitable giving in a significant way? Time will tell.

Regardless of the impact of tax laws and economic cycles on giving, NFPs should continue to be proactive in understanding, growing and communicating with their donors. Steps to consider include:

- Develop a keen understanding of your donor base
- Tailor fundraising to generational differences
- Identify what economic conditions affect your donors
- Share your stewardship story effectively with your donors
- Maintain a strong base of unrestricted giving
- Strengthen relationships with key donors
- Don’t remain overly dependent on a few donors over time

Financial and Operational Management

Maintaining strong financial and operational management is critically important to long-term sustainability. Challenge yourself to maintain best practices such as:

- Prepare timely and accurate monthly financial statements
- Measure actual performance against budget
- Monitor your organization's financial trends over a multi-year period
- Increase financial discussions among management and the board
- Utilize a rolling multi-year financial plan
- Maintain adequate liquidity by determining reserve levels appropriate to the timing of your income streams and your operating cycles, and then monitor reserves on a monthly basis
- Maintain the purchasing power of your endowment
- Utilize debt sparingly
- Keep fixed costs low
- Consider what revenues are most vulnerable to change and diversify revenue sources where possible
- Measure your own outcomes and the cost of those outcomes
- Challenge the effectiveness of each program
- Understand the true costs of each of your programs (considering both direct and indirect costs)
- Consider utilizing outsourcing to streamline staff and increase efficiency

Maintain Strong Organizational Leadership

NFPs are facing the same wave of retiring baby boomers as the economy as a whole. Do not avoid investing in leadership development and planning for the succession of key roles:

- Plan for leadership succession without threatening current leaders
- Invest in strategic planning
- Recruit generationally diverse board members with a broad range of talents and experiences
- Keep the board focused on the big-picture and not on the day-to-day operations
- Monitor industry trends and determine how they will affect your organization

These are just a few topics that we suggest you consider as you plan for the continued success of your organization. Keeping these steps in mind, you'll be on your way to building and maintaining sustainability to continue to achieve your organization's mission.

EFFECTIVELY MANAGE GOVERNANCE POLICIES

Donors and stakeholders continue to have increased expectations as to how their donations and dues are spent, as well as how efficiently and effectively NFP organizations are operated. As a result, many boards are reviewing their internal policies and keeping oversight consistently at top of mind. With other obligations and tasks constantly battling for management's attention, the process of reviewing and continuously updating policies can seem daunting. On October 9, 2018, the American Institute of

Certified Public Accountants released this useful summary of key steps to formalizing internal policies for NFP organizations. Those steps are as follows:

1. *Inventory the policies that are currently in place*

This may require some digging if you don't have a central repository for your policies; it also may include reviewing past board member meeting minutes. As you identify the policies; create an index that lists all of them in one place. Include the date the board originally approved the policy and any subsequent dates they were reviewed and/or updated. The index can help you identify the policies that haven't been reviewed recently and finalize those that were never approved by the board.

2. *Consider what policies should be in place and what they should include*

Once you've identified the policies the organization has in place, consider what might be missing. Policies that an organization may wish to consider having in place include the following:

- Designation of funds policy
- Delegation of authority policy
- Conflict of interest policy
- Document retention policy
- Gift acceptance policy
- Information security policy
- Investment policy
- Endowment policy
- Operating reserve policy
- Social media policy
- Whistleblower policy
- Ethics policy

3. *Create a process for updating policies*

Once you have a comprehensive list of policies, it's important to plan for periodic reviews. The frequency and time frame for review may be different for each policy. For instance, some organizations review their investment policies annually, and review other specific policies every three years. Establishing a policy review schedule will help to ensure that policies reflect the organization's standards and are being adhered to by staff. It is good practice to stagger the reviews, so you are not trying to look at them all at one time. In addition, consider establishing a consistent practice of having the board and/or board committees review and approve policies.

4. *Establish a means of effectively communicating policies*

For board members to comply with organizational policies, they need to understand them. It's not enough to distribute policies to board members and ask them to sign a statement saying they have reviewed and understand them. Formal training on the policies is necessary for board members to fully understand the need for the policies and the ramifications to the organization of not following

them. Consider offering comprehensive training on policies as part of the board orientation, augmented by an abbreviated policy training at each board meeting.

5. Ensure that policies are consistently enforced

The fastest way for policies to lose their effectiveness is to enforce them inconsistently or not at all, so it's important to make sure that management and the board take consistent action. Just like the board, organizational staff need to understand the policies in order to comply with them. Formal policy training for staff is recommended during new hire orientation, augmented by abbreviated policy training during staff meetings.

6. Consider when exceptions may be acceptable

Of course, there will be times when a policy exception is necessary. Exceptions should be made only after thoughtful consideration, and they should be documented. To assist management and the board in determining when an exception is appropriate, consider including language in the policy itself that addresses exceptions and the process to be followed when one is deemed necessary.

CONTINUING 2017 TAX CUTS AND JOBS ACT PROVISIONS AFFECTING NFP ORGANIZATIONS

NFP organizations will continue to feel the impact of the 2017 tax law for some time. We believe two areas will be especially sensitive: charitable contributions and unrelated business income tax.

Charitable Contributions

One potential area indirectly impacting NFP organizations surrounds the changes to the itemized deductions for individuals. The final bill nearly doubled the standard deduction, increasing it to $24,000 for married couples and $12,000 for individuals. This was predicted to adversely affect charitable giving for those who previously itemized their deductions, but who may now find the total of those deductions to be below the standard deduction amounts.

There has been considerable effort by NFP organizations nationwide to get Congress to extend the charitable deduction to all taxpayers, regardless of whether individuals itemize or not. New legislation was recently introduced to attempt to achieve this, but a final decision has not been made.

While many organizations think they may have weathered the storm on changes in giving patterns, experts predict more change may come in 2019 as donors file their individual returns for 2018 and realize their contribution was not deductible. One way to encourage donors to continue to give when they may be on the cusp of itemizing is to "bunch" their contributions. Rather than giving small amounts each year, combine two years of giving into one year. If donors are not inclined to give a large some to their favorite charity, a donor advised fund may be an attractive option.

A donor advised fund allows an individual to contribute an amount to the fund and take the charitable contribution when gifted. The donor can then direct the fund to disperse funds to their charities of choice at a later date.

Unrelated Business Income Tax

The tax on unrelated business income (UBI) changed to a flat rate of 21% with the new law. Some organizations with UBI income could see a decrease in tax, as the prior graduated system had rates as high as 35%. Other organizations with a minimal amount of UBI may have been surprised to find their tax increased as their income had previously been taxes at the lowest 15% bracket.

In addition to the change in rates, the tax on qualified transportation benefits took many in the NFP world completely by surprise. Many organizations never imagined the tax would apply to them; however, a new Internal Revenue Code Section 512(a)(7) states that a tax exempt organization must treat qualified transportation benefits as unrelated business income.

The qualified transportation benefits issue is a wide reaching concept. This does not just include items like transit passes seen in large metropolitan areas, but can include something as simple as providing parking to your employees - even if your organization is located in an area where no one pays for parking. Despite the Internal Revenue Service not issuing guidance on implementation until December 2018, the law was effective for benefits provided after December 31, 2017.

BE PREPARED - CYBER SECURITY TRENDS IN THE NFP INDUSTRY

In our 2018 current events update letter, we provided five cost effective measures NFP organizations could take to significantly improve their cyber security position and posture. These include keeping your software updated (do not run old versions of unsupported software) and patched; providing periodic training for your employees about good security practices; implementing strong password requirements; and finally periodically assessing your process and technical controls via formal assessments.

These control suggestions have not changed. While these measures improve your overall cyber position, the list is by no means exhaustive. Additionally, studies have shown that many of these controls, and others, are being ignored by the NFP world.

In a recent joint Non-Profit Technology Enterprise Network/Microsoft survey of 250 NFPs, the survey revealed some bright spots such as 70% of respondents reporting they have backup policies, and over half have policies for risk, usage, and privacy. However, one of the most cost effective and important controls that we pointed out last year, training, is being addressed by less than 40% of respondents.

Some of the other findings from the study showed some additional gaps in organizations' cyber security maturity including:

- Almost 80% of respondents do not have plans to react to a breach of data or a ransomware attack.
- 55% of respondents do not have plans as to how they will share their data with outside agencies.
- More than 50% do not have policies regarding what they consider confidential data (e.g., Personally Identifiable Information, HIPAA, credit card numbers, etc.).

- More than 70% allow employees to use unsecured mobile devices to access organizational emails and files.
- Finally, less than 25% have undergone any type of formal assessment of their security risks and practices/technology to manage those risks down to an acceptable level.

As you are considering new board members for your organizations, it is advisable to consider individuals from local businesses who have extensive IT and cyber security experience. Their ability to help develop (or simply provide) policies such as incident response, or perform an independent assessment of your network and processes, could help advance your cyber security posture dramatically. This will help prevent your organization from recreating the wheel in some of these important cyber security key activities.

FINANCIAL ACCOUNTING STANDARDS BOARD (FASB) ACCOUNTING STANDARDS UPDATE (ASU) NO. 2014-09 - UPDATE ON THE IMPACT OF THE NEW REVENUE RECOGNITION STANDARD ON NFP ORGANIZATIONS

Overview

During 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers*. This standard, as edited by subsequent amendments, is effective for public entities, including NFPs whose bonds are publicly traded, for reporting periods beginning after December 15, 2017. For all other entities, including all other NFPs, the standard is effective for reporting periods beginning after December 15, 2018, which means calendar year 2019 and after. If you have a fiscal year end, this would mean that the standard is first effective for your fiscal year ending in 2020. Early application of the amendments in this standard is permitted.

The standard does not apply to contributions received by NFPs, but it does apply to exchange transactions, which are relevant to most NFPs to some extent. Some transactions contain elements of both contributions and exchange transactions, and will require special consideration to determine the proper accounting treatment. Examples of transactions that may contain at least some exchange element include tuition and housing revenue, government grants, membership dues, advertising, subscriptions, sponsorships, special events, royalties and licensing revenues.

The core principle of this new guidance is that "an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services."

The standard prescribes a five-step process to achieve this principle:

- Step 1: Identify the contract with a customer
- Step 2: Identify the performance obligations in the contract
- Step 3: Determine the transaction price
- Step 4: Allocate the transaction price to the performance obligations in the contract
- Step 5: Recognize revenue when or as the entity satisfies each performance obligation

Membership Dues Implementation Issues

When membership dues carry traits of both contributions and exchange components, they should be analyzed separately. Usually, the determination of whether membership dues are contributions rests on whether the value received by the member is commensurate with the dues paid. For example, if an NFP has annual dues of $100 and the only benefit members receive is a monthly newsletter with a fair value of $25, that means that $25 of the dues are received in an exchange transaction and $75 of the dues are a contribution.

To overview a specific example of the five step revenue recognition process, an NFP trade association produces a quarterly journal that discusses and highlights research, issues, and trends of interest to its members and others in the respective discipline related to the NFP's mission. Members receive the NFP's quarterly journal as part of their annual membership dues, which are $300 per year. In addition to the quarterly journal, members receive other membership benefits, such as access to the members-only section of the association's website and legislative advocacy services. The NFP sells individual journals to others who are not members of the NFP for $25 per journal. The NFP has determined there is no contribution included in the payment from the customer.

Step 1 — Identify the Contract. There is a contract between the NFP and the member related to both membership and the journal subscription.

Step 2 — Identify Performance Obligations. There are six promised goods or services that are to be evaluated as to whether they are performance obligations that meet the criteria, as follows:

- The promise to the member to provide access to the website during the one-year term.
- The promise to the member to provide legislative advocacy services during the one-year term.
- The promise to the member of a subscription to provide four quarterly journals (four distinct performance obligations).

For the purposes of this example, the promises to deliver all of these goods and services are distinct. However, the promise to deliver access to the website and the promise to provide advocacy services are delivered concurrently and have the same measure of progress; therefore, they may be accounted for as if they were a single performance obligation (referred to as "membership benefits") .

Step 3 — Determine the Transaction Price. The transaction price is the contract price of $300 for a one-year membership, which includes the subscription.

Step 4 — Allocate the Transaction Price to Performance Obligations. The transaction price should be allocated between the six performance obligations based on the relative standalone selling prices of each performance obligation.

- The standalone selling price for each journal would be the observable price of $25, because that is the price at which the NFP separately sells the journals to customers.
- The NFP does not sell membership separately without including the quarterly journals. Because there is no directly observable selling price, the NFP should estimate the standalone selling price. The NFP determines that the adjusted market assessment approach is a suitable method

to use to estimate the standalone selling price for the membership, as the estimate will refer to prices charged by other NFPs for similar services. In this case, the standalone selling price was determined to be $250.

Therefore, on a relative basis, each quarterly journal would be allocated a transaction price of $21 ($25 per journal is 7% of the total stand-alone prices aggregating $350) and the membership benefits would be allocated $216.

Step 5 — Recognize Revenue When Each Performance Obligation is Satisfied. The NFP concludes the following:

- The member simultaneously receives and consumes the benefits of membership, and the membership performance obligation is satisfied over time. The NFP also concludes that the best measure of progress toward complete satisfaction of the membership performance obligation over time is a time-based measure. Thus, $216 is recognized ratably over the one-year membership period.
- The performance obligation for each quarterly journal is satisfied at a point in time, and revenue should be recognized when control of the journal has been transferred to the customer. Assuming the NFP concludes that control of the journal transfers to the customer upon shipment, $21 is recognized when each quarterly journal is shipped.

FASB ASU NO. 2018-08 – CLARIFYING THE SCOPE AND THE ACCOUNTING GUIDANCE FOR CONTRIBUTIONS RECEIVED AND CONTRIBUTIONS MADE

During 2018, the FASB issued ASU No. 2018-08, *Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made,* to clarify and improve the scope and accounting guidance for contributions received and contributions made.

Contribution or Exchange Transaction?

These amendments provide a more robust framework for determining whether a transaction should be accounted for as a contribution or as an exchange transaction. Specifically, the amendments clarify how an entity determines if the resource provider is participating in an exchange transaction by evaluating whether the resource provider has received commensurate value in return for the resources transferred to the recipient organization. The presence of commensurate value suggests exchange transaction. The amendments specifically indicate that a resource provider (including a foundation or a government agency) is not synonymous with the general public. A benefit received by the public as a result of the assets transferred is not equivalent to commensurate value received by the resource provider.

If a Contribution, is it Conditional or Unconditional?

In addition, ASU 2018-08 requires that an NFP entity determine whether a contribution is conditional on the basis of whether an agreement includes barriers that must be overcome and either right of return of assets or a right of release of a promisor's obligation to transfer the assets. Indicators are used to guide the assessment of whether an agreement contains a barrier. The presence of both a

barrier and right to return or right to release indicates a recipient is not entitled to the transferred assets until it has overcome the barrier listed in the agreement. After the contribution has been deemed unconditional, the NFP entity would consider whether the contribution includes donor-imposed restrictions.

The amendments in ASU 2018-08 will likely result in more grants and contracts being accounted for as either contributions or conditional contributions than observed in current practice.

Effective Dates and Implementation

ASU 2018-08 should be applied on a modified prospective basis in the period in which the amendments are applied to agreements that are not completed as of the effective date or entered into after the effective date. ASU 2018-08 applies to both resources received by a recipient and resources given by resource provider. However, the effective date differs depending on whether the role is resource recipient or resource provider.

Resource Recipients - For transactions in which an NFP entity has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market and serves as a resource recipient, the NFP entity should apply the amendments on contributions received to annual periods beginning after June 15, 2018, including interim periods within those annual periods. All other entities should apply the amendments for transactions in which the entity serves as the resource recipient to annual periods beginning after December 15, 2018, which means calendar year 2019 and after. If you have a fiscal year end, this would mean the standard is first effective for your fiscal year ending in 2020. Early application of the amendments in this standard is permitted.

Resource Providers - For transactions in which an entity is an NFP entity that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market and serves as a resource provider, the entity should apply the amendments on contributions made to annual periods beginning after December 15, 2018. All other entities should apply the amendments for transactions in which the entity serves as the resource provider to annual periods beginning after December 15, 2019, which means calendar year 2020 and after. If you have a fiscal year end, this would mean the standard is first effective for your fiscal year ending in 2021. Early application of the amendments in this standard is permitted.

In the meantime, we encourage organizations to begin working on implementation issues related to revenue recognition by:

1. Assigning individuals to be responsible for understanding and implementing the standards.
2. Compiling a detailed list of all organizational revenues.
3. Beginning to apply the five-step process to each revenue stream involving exchange transactions.
4. Analyze agreements to determine if resource providers or other third parties have received commensurate value that support exchange transaction treatment and whether barriers exist that would suggest that contributions are conditional.

5. Determine the potential effects on the contract language and accounting systems and processes, as applicable.

FASB ASU NO. 2016-02 – LEASES

Overview

During 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. This standard intends to improve financial reporting about leasing transactions by requiring entities that lease assets to recognize on their statement of financial position the assets and liabilities for the rights and obligations created by those leases, and to provide additional disclosures regarding the leases. The overarching goal is to regulate reporting practices so that financial statement users can more easily compare reports from different organizations.

Because of the significance of the changes required, the effective date of this standard was set several years in advance to give organizations proper time to consider the impacts and prepare for implementation. This standard is effective for public entities, including NFPs whose bonds are publicly traded for fiscal years beginning after December 15, 2018, which means calendar year 2019 and after. For all other entities, including all other NFPs, this standard is effective for annual financial statements issued for fiscal years beginning after December 15, 2019, which means calendar year 2020 and after. If you have a fiscal year end, this would mean that the standard is first effective for your fiscal year ending in 2021. Early application of the standard is permitted.

Lessees (the party obtaining the right to use an asset) will likely see the most significant changes, although there are elements of the new standard that could impact almost all entities to some extent. The main difference from the previous guidance is that operating leases with contract periods greater than 12 months will now be recorded on the statement of financial position as *right-of-use assets* with offsetting *lease liabilities* based on the present value of future lease payments. Previously, only finance (formerly known as capital) leases were recognized on the statement of financial position.

Similar to previous guidance, the lessee will need to classify leases as either finance or operating to determine the proper accounting treatment. However, the explicit thresholds in the criteria under previous guidance have been removed. When a lease meets **any** of the following specified criteria at commencement, the lease should be classified by the lessee and lessor as a finance lease and a sales-type lease, respectively. Those criteria are below:

1. Transfers of ownership to lessee
2. Purchase option reasonably certain to be exercised
3. Lease term for major portion of asset's remaining economic life
4. Present value of lease payments and residual value exceeds substantially all of the fair value of the underlying asset
5. Specialized nature of underlying asset results in no expectation of alternative use after the lease term

If none of the above criteria are met, the lease should be classified as an operating lease for the lessee. The lease should also be classified as operating for the lessor, unless the lease meets both of the following criteria (in which case, the lessor would classify the lease as a direct financing lease):

1. The present value of the lease payments and any residual value guarantee that equals or exceeds substantially all of the fair value of the underlying asset, and
2. It is probable that the lessor will collect the lease payments plus any residual value guarantee

The expense recognition will not significantly change from the previous guidance. Operating leases will result in straight-line expense over the lease term, while finance leases will result in a front-loaded expense pattern (similar to interest expense on long-term debt).

For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election **not** to recognize lease assets and lease liabilities. In addition, there is a practical expedient that allows lessees to account for non-lease components (common area maintenance charges) with lease components.

While the recording of the assets and the liabilities for operating leases under the new guidance will primarily impact the statement of financial position, it will be important to consider whether these changes will impact contractual agreements and loan covenants, particularly those linked to specified debt to equity and debt service coverage ratios. Typically, these agreements are based upon the accounting rules in effect when the agreement was signed and may need to be adjusted to remain in compliance when the new guidance takes effect.

Other key differences in the new guidance center around the basic definition of a lease, the inclusion of *reasonably certain* to be exercised renewal options when measuring lease assets and lease liabilities, segregating lease and non-lease components, sale and leaseback transactions, and leases of specialized assets that will have no alternative use to the lessor (the party providing the right to use the asset) at lease conclusion.

Lessor accounting is largely unchanged from previous guidance and lessors will continue to classify leases as operating, direct financing, or sales-type. The vast majority of operating leases should remain classified as operating leases and permit lessors to generally recognize lease income on a straight-line basis over the lease term. Some changes have been made to lessor accounting to conform and align that guidance with the lessee guidance and with the new revenue recognition guidance issued in 2014.

NFPs that receive donated rent or have commitments for below-market leases should also consider the impacts of this new standard. Donated rent often means an NFP receives an unconditional promise to give the use of long-lived assets (such as a building or other facilities) for a specified number of periods in which the donor retains legal title; in this case the lease would have no lease payments. Since this standard defines leases as contracts that convey the right to control the use of identified property for a period of time in exchange for consideration, and there is no consideration exchanged, donated rent falls outside the scope of this standard.

NFPs that receive below-market leases (where lease agreements call for lease payments below the fair rental value of the property) also need to consider the impacts of the new lease standard. When calculating the right to use assets and lease liabilities, organizations should only include the actual lease payments made (and not the excess value of the fair rental value of the property). Any additional value (essentially, donated rent) would be recorded as a contribution. That contribution should be recorded at the fair value of the use (less any actual lease payments made) in the period in which the contribution is received and expense in the period the property or facilities are used.

Implementation Considerations

While ASU 2016-02 will likely have the greatest effect on organizations with large amounts of leased real estate or equipment, virtually all NFPs will also have to consider the impact of this standard on their leases of office space, equipment, and other items. Organizations should begin now with implementation considerations, including the following:

1. Analyze existing lease agreements individually for proper treatment under new guidance.
2. Evaluate the overall impact on your organization's financial statements as it relates to those existing leases.
3. Communicate with lenders and other parties with which the organization has contractual commitments to determine impact on existing or future covenants.
4. Educate management and board members on the impacts of this standard change.
5. Consider any future leasing commitments and the impact of the new standard on financial reporting for the organization.

This communication is intended solely for the information and use of management, the Board of Directors, and others within the Organization, and is not intended to be and should not be used by anyone other than those specified parties.

We appreciate this opportunity to be of service and extend our thanks to everyone at the Organization for their cooperation and assistance. We would be pleased to discuss any of the above matters with you at your convenience.

Very truly yours,

Blue & Co., LLC