

Accounting and Tax Concerns at Chicago Youth Shakespeare

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ABSTRACT

This instructional case focuses on Chicago Youth Shakespeare (CYS), a not-for-profit entity devoted to teaching high school students how to perform the classic works of the Bard. The case touches at least three areas of accounting education: accounting information systems, not-for-profit accounting and taxation. With respect to accounting information systems, the case asks students to design a chart of accounts and an internal control plan. The not-for-profit segment of the case focuses on journal entries and the preparation of not-for-profit financial statements. From the tax perspective, the case asks students to determine whether guest instructors and guest directors should be classified as employees of CYS or independent contractors. Students are asked to assume the role of pro bono consultant to give CYS advice; case questions are appropriate for either individual or group assignments.

Keywords: accounting information systems, not-for-profit entities, employee and independent contractor classification, internal control, journal entries and financial statements, taxation

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INTRODUCTION

Manon Spadaro, founding artistic director of Chicago Youth Shakespeare (CYS), knew that the non-profit's recent growth would require a better accounting information system. In addition, she was fed up and frustrated with the software CYC was currently using to manage its accounting tasks. And, an increase in revenues would likely require more extensive tax reporting to the IRS in fairly short order.

But, with a background in the arts and very little expertise in accounting, Manon knew she didn't have the skill set required for any of those tasks. She contacted Taproot Foundation to see if they could help her find a pro bono consultant to address CYC's need for accounting expertise.

DESCRIPTION OF CYC

According to its web site¹, the non-profit is:

dedicated to fostering a community of inspired learners, innovative artists, and compassionate global citizens through the timeless lens of Shakespeare's works. [CYS serves its] commitment to diversity and community engagement by increasing the accessibility of Shakespeare performance, education, and outreach programs to students across the Chicagoland region.

CYC collaborates on programming and events with a variety public, private, charter, and parochial schools throughout the Chicago region. Since its start in March 2013, CYC had achieved some impressive results²:

CYC programs have reached over 4000 students from more than 60 public, private, and parochial schools in the Chicago area. CYC has granted over \$50,000 in need-based program scholarships, helped students raise over \$5,000 to support arts programming in public schools, and continues to bring free Shakespeare performances to hundreds of new students each year.

CYC serves its mission through three central programs: Chicago Youth Shakespeare Ensemble (CYSE), Battle of the Bard and CYC in Schools.

- The Chicago Youth Shakespeare Ensemble (CYSE) is a need-blind program open to high school students across the Chicagoland area. Representing a variety of communities, ethnicities, cultures, and life experiences, CYSE students come together to create a unique artistic

¹ Chicago Youth Shakespeare - Chicago Youth Shakespeare. (n.d.). Retrieved April 04, 2017, from <http://www.chicagoyouthshakespeare.org/>

² Chicago Youth Shakespeare - Chicago Youth Shakespeare. (n.d.). Retrieved April 04, 2017, from <http://www.chicagoyouthshakespeare.org/>

ensemble, fueled by collaboration, innovation, and a diversity of approaches and ideas.

- Battle of the Bard (BOTB) is a region-wide series of Shakespeare slam events open to high school teams throughout the Chicago area, designed to build community across geographic, demographic, and cultural boundaries through performance, team spirit, and friendly competition. BOTB is a collaborative program between Chicago Youth Shakespeare (CYS) and Chicago Shakespeare Theater (CST), organizations that are committed to teaching and learning Shakespeare through active engagement and performance.
- In its CYS in Schools program, Chicago Youth Shakespeare offers a variety of workshops and residency programs for middle and high school students and their teachers during the school day. Designed specifically for each school's curriculum and student learning goals, projects can range from a single workshop, to a full week of immersion classes or longer-term residency program. CYS teaching artists work collaboratively with classroom teachers to make Shakespeare come alive in their classrooms, giving them the tools to get students up on their feet and participating actively in the learning process.

CYS arranges all of its programs, to include CYSE productions, the annual BOTB event, and the CYS in Schools workshops and residency programs.

CYS' board of directors comprised ten people, all of whom volunteered their time to the organization. CYS has four full-time employees, including Manon; CYS regularly utilized guest directors and guest instructors to work on specific programs. Once a program has been scheduled by CYS, CYS will contract with a guest director (sample contract attached) or a guest instructor (sample contract attached). CYS typically maintains ongoing relationships with a small cadre of guest directors and guest instructors.

CYS employees receive paychecks issued at the beginning of the month provided CYS had sufficient cash on hand. Guest directors and guest instructors were paid on a "project basis" at the end of each project (i.e., a "project" might include directing a specific Shakespearean production, coaching for BOTB event, or teaching workshops and/or residency programs to a CYS participant school). CYS also faced a tax issue regarding guest directors and guest instructors: should they be treated as employees or as independent contractors?

ACCOUNTING CONSIDERATIONS

Accounting for not-for-profit (NFP) entities varies considerably from business accounting. Some of those differences include:

- The absence of "equity" accounts in the NFP general ledger. Since NFP organizations don't have owners, they don't have accounts like capital stock and retained earnings representing ownership interests. Rather, NFPs refer to the difference between assets and liabilities as "net assets." And, those net assets must be further subdivided into unrestricted, temporarily restricted and permanently restricted.

- Exemption (in most cases) from Federal income tax. NFPs don't file income tax returns as businesses do. They must, however, report certain information to the Internal Revenue Service on Form 990³. Formally titled "Return of Organization Exempt from Income Tax," Form 990 provides summary information about activities & governance, revenue, expenses and net assets. It also provides more detailed information in many of those areas. NFPs with gross receipts of \$50,000 or less can file a simplified version of Form 990, often referred to as the "postcard" version. Form 990-EZ may be an alternative depending on the NFP's gross receipts and end-of-year assets.
- Expense reporting. Most businesses divide expenses into operating and non-operating; they further classify operating expenses as general & administrative or selling expenses. On the other hand, NFPs report expenses in three broad groups: program expenses, management & general expenses, and fundraising expenses.
- Financial statements. Businesses summarize their financial position and results of operations via four general purpose financial statements: income statement, statement of changes in shareholders' equity, balance sheet and statement of cash flows. NFPs also require four financial statements, but their names are slightly different: statement of financial position, statement of functional expenses, statement of activities and statement of cash flows. For both types of organizations, notes to the financial statements are an integral part of financial reporting.

Like business organizations, NFPs use a chart of accounts as the basis for recording transactions in a journal. Many NFPs base their chart of accounts on the Unified Chart of Accounts⁴ (UCOA) developed by the National Center for Charitable Statistics (NCCS). Selected items from the UCOA are presented in Table 1 (Appendix).

Finally, NFPs need strong internal controls. Some common internal controls that cut across specific NFP entities include⁵: separation of duties, procedures manuals, adequate documentation of transactions, daily deposit of cash receipts, operating budget development and various information technology controls.

Balance sheets as of 31 December 2014 and 2015 appear in Figure 1 (Appendix). In January 2016, CYS completed the following general operations transactions:

1. CYS makes the grant payment to students who were previously awarded in the amount of \$8,500.
2. CYS collects pledges receivable in the amount of 6,332 on Jan. 13, 2016.
3. CYS purchases office supplies in the amount of \$902. It expends it right away.

³ Form 990, Return of Organization Exempt From Income Tax. (2016, August 2). Retrieved April 04, 2017, from <https://www.irs.gov/uac/about-form-990>

⁴ Unified Chart of Accounts (UCOA). (n.d.). Retrieved April 04, 2017, from <https://4good.org/bill-levis/unified-chart-of-accounts-ucoa>

⁵ Hurt, R. L. (2016). *Accounting information systems: basic concepts and current issues*. New York, NY: McGraw-Hill Education.

4. CYS has just learned the news that it was granted a State of Illinois grant for students' theatrical education in the amount of \$25,000 which will be paid in the form of reimbursement equally for the next two years only after it incurs the expenses.
5. CYS makes a rent payment for the month of January for one of its studios in the amount of \$2,500.
6. CYS received a utilities bill for January in the amount of \$125. It accrues the expense until it pays in the following month.
7. One of CYS' long term donor donated \$10,000 requiring that only earnings can be used to support art education for high school students. All \$10,000 was received in cash.
8. CYS records depreciation expense in the amount of \$125.
9. \$4,200 of the prepaid expenses are for marketing costs that will cover the year 2016. One month of these marketing costs has been adjusted at the end of January.
10. Salaries in the amount of \$4,169 for employees for January has been accrued at the end of January. CYS pays its employees monthly every first Thursday of a month.

CYS expects its transactions for the remainder of 2016 to parallel those shown above for the month of January.

ASSIGNMENT QUESTIONS

You are a pro bono consultant to CYS. In a format specified by your instructor, address the following questions:

- a) Construct a chart of accounts for CYS. The chart of accounts may be based on the UCOA; it must differentiate general operations and CYS' three distinct programs.
- b) Use COSO's Internal Control—Integrated Framework⁶ to prepare an internal control plan for CYS.
- c) Journalize the ten transactions for January 2016. Then, prepare a statement of activities for the month of January 2016 and a statement of financial position as of 31 January 2016.
- d) Using the sample contracts provided and other relevant information sources (such as IRS publications), recommend how guest directors and guest instructors should be treated for tax purposes: independent contractors or employees. (Note that the guest directors and guest instructors may or may not have the same classification.) You may make any reasonable assumptions in your analysis, so long as they are explicitly stated in your

⁶ *COSO Internal Control Integrated Framework Executive Summary*. (2013). Durham, NC: AICPA.

recommendation. As part of your analysis, explain why properly categorizing the guest directors and guest instructors is important.



CYS EMPLOYMENT AGREEMENT GUEST DIRECTOR

The Agreement for employment made between [NAME] (“Guest Director”) and Chicago Youth Shakespeare (“CYS”) shall be for presenting the production stated below in accordance with the conditions outlined in this Agreement.

Production

NAME OF PRODUCTION
OF PERFORMANCES
RUNNING DATES

Scope of Services

Guest Director shall perform the normal and typical duties of a Director consistent with the standards established in the theatrical profession. The Guest Director shall, with the advice and final consent of the Artistic Director, be responsible for all decisions related to the full production package, including the casting of individual roles or any effects deemed necessary to better enhance the vision of the final product. It is understood that at any time during the rehearsal process the Artistic Director may attend rehearsal(s) and reserves the right to make changes as needed.

The Guest Director will be provided with a Production Budget by CYS. It is the Guest Director’s responsibility to adhere to the budget provided. Any decision that might result in cost overruns must be approved by the Artistic Director.

The Guest Director will hold, and be present for, regularly scheduled production meetings with the product on staff and any others involved with the creation of the production. Only the Guest Director and Artistic Director will make final decisions concerning a production. The Guest Director may not bring in co-directors or others without the permission of the Artistic Director.

Production deadlines will be determined by the Guest Director and the Artistic Director. It is the responsibility of the Guest Director to ensure all deadlines are met. Failure to comply may result in termination of this Agreement.

The Guest Director shall be responsible for any scripts and other materials provided by CYS for work under this Agreement. All scripts and other materials shall be maintained in a safe manner and shall be promptly returned to CYS at the conclusion of this Agreement. The Guest Director shall be responsible for reimbursing CYS for any lost, defaced or otherwise non-returnable materials.

Any additional responsibilities, duties and remuneration that are mutually agreed upon by the Guest Director and CYS may be added to this Agreement as an addendum.

Rehearsal and Performance Schedules

The Guest Director shall prepare a complete rehearsal schedule in consultation with CYS. Any changes in the schedule, including the addition of pick-up rehearsals, must be approved by CYS. The rehearsal schedule must be approved before dispensing to the cast to verify theater availability.

It is anticipated the services to be performed under this Agreement shall begin at least XX weeks before the opening date and be completed by closing date of the production.

Payment Schedule

CYS shall pay the Guest Director \$XXXX as follows or otherwise as mutually agreed upon:

- The first payment shall be made upon signing this Agreement in the amount of \$XXXX.
- The second payment shall be made on [DATE] in the amount of \$XXXX.
- The final payment shall be made on [DATE] in the amount of \$XXXX.

The professional fee shall be pro-rated should there be an early termination of this Agreement.

Independent Contractor

The Guest Director shall be categorized as an independent contractor for the services included in this Agreement and not as an employee of CYS. As such, CYS will not be withholding any federal, state or social security taxes. The Guest Director shall be responsible for all applicable taxes pertaining to the Payment Schedule.

CYS shall have no responsibility for health care, accident insurance, unemployment insurance or workers' compensation insurance for the Guest Director and shall bear no responsibility for any medical or other expenses incurred by the Guest Director.

Policies Governing Professionals

As a professional connected with the work of CYS, the Guest Director is expected to conduct him/herself in a professional manner at all times when representing CYS as is stated in the Policies and Procedures attached to this Agreement. Punctuality for rehearsals is the norm unless specific arrangements have been made with CYS. Once the rehearsal schedule is set, it shall be rigidly followed to allow maximum preparation time for the planned production

All media contacts will be arranged by CYS. If the Guest Director has personal connections with any media representatives, contact information should be given to the CYS. No contact will be made directly to the media without the permission of CYS.

As Guest Director will be working with minors, alcohol in any form will not be tolerated before or during rehearsals, or before, during or after performances. Under no circumstances shall any abuse of non-prescription, prescription or use of illegal drugs be tolerated while representing CYS. Smoking shall not be permitted during rehearsals or performances.

Any use of theater equipment shall be subject to the approval of CYS. Equipment may not be borrowed or taken from the theater. Any equipment or instruments used by the Guest Director shall be preserved, kept free of dust, and, where applicable, covered, protected and turned off at the end of each use.

The Artistic Director shall have primary authority and reserve the right to make final decisions on all matters related to the production.

Failure to comply with the rules and policies outlined herein may result in termination of the Agreement.

Governing Law

The parties agree this Agreement shall be construed in accordance with the laws of the State of Illinois.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement on the day and year written below.

GUEST DIRECTOR: [NAME]

CHICAGO YOUTH SHAKESPEARE

Signature: _____
[NAME]

By: _____
Manon Spadaro, Artistic Director

Date: _____

Date: _____

PRODUCTION SCHEDULE

DATE

Rehearsal Schedule

Sound

Set design and drawings

Lighting design

Lighting materials

Scenic Materials

Costume

Set completed

Show ready

Properties-set dressing



CYS POLICIES AND PROCEDURES⁷

Responsible Behavior

1. Directors should strive to create a good, harmonious, supportive working environment—creativity does not blossom on negative energy.
2. The rehearsal room should not be seen as a battlefield—the vast majority of actors actively want constructive direction.
3. Aim to be open to constructive suggestions where practicable within the time-scale.
4. Aim to draw out (extend) rather than impose—positive rather than negative reinforcement is more likely to enhance the actor's processes.
5. Be flexible; recognize all actors have different ways (and speeds) of working. Allow for all different approaches within the time constraints of the production.
6. Don't be afraid to admit you could be wrong or simply don't immediately know the answer to a problem—tolerance does not equate with weakness.
7. Be aware of the power you have (i.e., as a referee, mentor, etc.). Don't abuse it by putting actors in the position of potential sycophancy—this will invariably be counter-productive to their creativity.
8. Be aware an actor who appears “difficult” could simply be anxious or insecure. Develop strategies for recognizing, understanding and dealing with people's behavior in the creative context. Remember, everyone (including the director) is insecure—no matter how tough they may appear to be on the surface.
9. CYS is a “no harm” theater. If for some reason a situation seems to get out of hand or a conflict arises between a director, a member of the cast and/or production team, the Artistic Director must be immediately informed of the situation. The Artistic Director's decision in the matter is final.

Ethics

1. The director has similar moral responsibilities to those of a parent, doctor, teacher, etc. (i.e., all the professions that might be called ‘caring’).
2. Remember how vulnerable the actor makes her/himself during the rehearsal process—take care with other people's psyches.
3. The director should hold the intimacies of the rehearsal room as confidential, and they should make this position clear from the outset to the company.
4. Remember the professional working relationship is not limited to the rehearsal room.
5. The casting process should remain as confidential as feasible.
6. Respect an actor's privacy in wardrobe calls and dressing rooms.
7. Don't bring your personal problems to the rehearsal or audition room.

Giving Notes

1. Notes should be constructive rather than destructive.

⁷ Based on *Recommended Guidelines for Ethical and Responsible Behaviour by Theatre Directors*, Retrieved November 27, 2016, from <http://www.michaelpope.co.uk/ethics.pdf>.

2. Be sensitive as to when you give notes—timing is as important as the content.
3. Remember actors need the half (30 min. before the show) not just to make practical preparations but also mental ones.
4. It is usually divisive and destructive to single out one person for public criticism.
5. Remember some notes are better given in private. Also, remember most notes affect not just the immediate recipient but often other actors in the production.
6. Invidious comparisons with other actors/performances are unhelpful.

Organization

1. Disorganization does not enhance creativity.
2. The director is at the head of the chain of command of a production—be organized.
3. Treat actors free time with respect; calls should be carefully thought out and made to work.
4. Be aware of the time constraints of the students and others working on the production.

Interviews & Auditions

1. Always treat an actor with consideration and respect at interviews and auditions. Also, aim to put the actor at ease so that she/he has the chance to give her/his best, e.g. by providing information about the production beforehand and minimizing waiting times.
2. Always point out to the actor any ‘extreme’ that might be required in a production before or while offering a part (e.g. revealing costumes, potentially embarrassing character, ‘different’ ways of working, etc.)
3. Exchange of ideas before rehearsals can be very important.
4. Never make (or even imply) any promise to an actor regarding casting.

Health & Safety

1. Don’t ask actors to do stunts.
2. Don’t try to direct fight scenes yourself; use a qualified fight director.
3. Listen to stage management and technicians in all matters of safety.
4. Don’t run a technical rehearsal without taking reasonable steps to ensure all areas and equipment to be used are safe.
5. Familiarize yourself with the safety procedures at the theater and local emergency contact information.

CYS AGREEMENT FOR PROFESSIONAL SERVICES

Guest Instructor

THIS AGREEMENT (“Agreement”) made and entered into this ____ day of _____, 20____, by and between __ [GUEST INSTRUCTOR NAME] _____ (“Guest Instructor”), and Chicago Youth Shakespeare (“CYS”).

1) **Scope of Services.** Guest Instructor agrees to supply CYS with the following professional services (the “Services”):

2) **Term.** Guest Instructor shall commence providing the Services on _____, 20____, and shall terminate on _____, 20____ (the “Term”).

3) **Payment.** In consideration of the Services provided pursuant to this Agreement, CYS shall pay Guest Instructor a fee of _____ Dollars per hour (\$_____). For projects lasting 30 days or less, payment shall be made to Guest Lecturer upon completion of the project. For projects lasting more than 30 days, payment shall be made to Guest Lecturer monthly at the beginning of the month.

4) **Guest Instructor’s Obligations.**

a) **Means, Manner and Method.** Guest Instructor has the right to control and direct the means, manner and method by which the Services are performed and shall furnish all materials to perform the Services.

b) **Care of Property.** Guest Instructor shall be responsible for the proper custody and care of any property furnished by CYS to Guest Instructor for use in connection with the provision of Services, and Guest Instructor shall reimburse CYS for loss or damage to any such property.

c) **Advertising.** Guest Instructor will be provided to CYS photos and verbiage for promotional flyers and post cards. However, CYS has sole authority to promote and advertise CYS programs.

d) **Subcontracting, Assignment, and Transfer Prohibited.** Due to Guest Instructor’s unique abilities, this Agreement is for personal services and Guest Instructor shall not subcontract, assign, or transfer any interest in this Agreement without prior written approval of CYS.

e) **Other Employment.** Guest Instructor may work for other entities. However, it is expected that Guest Lecturer’s other employment will not infringe upon Guest Lecturer’s duties to CYS under this Agreement. To this purpose, Guest Instructor should inform CYS when Guest Instructor is working for other entities.

f) **Compliance with Applicable Law.** Guest Instructor shall comply with all federal, state, and local laws, ordinances, codes, rules, regulations, and licensing requirements applicable to the conduct of its business and the provision of the Services.

5) **Termination.**

a) CYS shall have the right to terminate this Agreement for good cause. It is specifically understood that good cause for termination shall include but not limited to: inadequacy of teaching, misconduct, neglect of duty, physical or mental incapacity, violation of the terms

- of this Agreement, or any conduct not in keeping with CYS' vision, or conduct tending to reflect discredit upon CYS or the participating school or tending to impair Guest Instructor's usefulness in his/her capacity as a teacher.
- b) Termination shall be effective upon receipt of written notice by CYS and Guest Instructor shall cease work immediately upon receipt of such notice.
 - c) In the event of early termination, Guest Instructor shall be entitled to receive just and equitable compensation only for costs incurred before receipt of notice of termination and for the satisfactory Services provided as of the date of termination and delivered to CYS.
- 6) **Indemnification.** Guest Instructor shall indemnify, defend, and hold harmless CYS, its Board of Directors, officers, agents, and employees, from liability of any kind, including all claims and losses for injuries to persons or damage to property accruing or resulting to any other person, firm, or corporation furnishing or supplying work, services, materials, or supplies in connection with the performance of this Agreement, and from any and all claims and losses accruing or resulting to any person, firm, or corporation that may be injured or damaged by Guest Instructor in the performance of this Agreement. This representation and warranty shall survive the termination or expiration of this Agreement.
- 7) **Intellectual Property and Copyright.** All intellectual property, including but not limited to, patentable inventions, copyrightable works, mask works, trademarks, service marks and trade secrets invented, developed, created or discovered by Guest Instructor in the performance of this Agreement shall be the property of CYS. Copyright in and to any copyrightable work, including, but not limited to, copy, art, negatives, photographs, designs, text, software, or documentation created as part of Guest Instructor's provision of Services shall vest in CYS.
- 8) **Advertising.** Guest Instructor agrees, beginning as of the date of execution of this Agreement, that photographs, whether still or action, videos, film and/or motion pictures (hereinafter "Pictures") and/or audio recordings ("Recordings") may be taken of Guest Instructor, individually or with others, by or on behalf of CYS in connection with the services to be provided indicated above and agrees that all rights therein shall irrevocably, exclusively, unconditionally, and perpetually belong to CYS and such rights are freely assignable by CYS. Guest Instructor agrees that, without any compensation or notification to or approval by Guest Instructor, the Pictures or Recordings may be used, reproduced or otherwise disseminated or published by or on behalf of CYS directly or indirectly for any purpose, including but not limited to advertising and/or promotional purposes, in any manner, and at any time CYS desires.
- 9) **Independent Contractor.** Guest Instructor acknowledges and represents the relationship of Guest Instructor to CYS is that of an independent contractor, and nothing in this Agreement shall be construed as making Guest Instructor an employee of CYS or to empower Guest Instructor to bind or obligate CYS in any way or as creating any other relationship.
- 10) **Entire Agreement.** This Agreement contains the entire agreement between the parties, and there are no representations, inducements or other provisions other than those expressed herein. All changes, additions or deletions to this Agreement shall be in writing and executed by the authorized representatives of both parties.
- 11) **Governing Law.** This Agreement and the rights and obligations of the parties hereto shall be interpreted, construed and enforced in accordance with the laws of the State of Illinois.

IN WITNESS THEREOF, the parties have executed this Agreement in duplicate originals, one of which is retained by each of the parties, effective the day and year first written above.

Guest Instructor: _____

Print Name: _____ **Date:** _____

CYS: _____ **Date:** _____

Manon Spadaro, Artistic Director



Table 1
Excerpt from Uniform Chart of Accounts

Account title	Element of financial statements	UCOA account number
Cash in bank—operating	Assets	1010
Pledges receivable	Assets	1210
Accounts payable	Liabilities	2010
Accrued payroll taxes	Liabilities	2130
Unrestricted net assets	Net assets	3010
Endowment net assets	Net assets	3210
Individual / small business contributions	Contributions & support	4010
Program service fees	Earned revenues	5180
Fundraising fees	Expenses—personnel related	7510



Figure 1
Balance Sheets

Chicago Youth Shakespeare		
Balance Sheet		
	At Dec. 31, 2015	At Dec. 31, 2014
Assets		
Cash	6,818	9,612
Savings and Investments	13,189	12,298
Pledges & Grants Receivable	63,550	49,651
Prepaid Expenses	4,491	3,822
Land and Buildings, net	3,988	2,312
Investments, Long-Term	5,517	5,170
Other Assets	1,368	1,823
	98,921	84,688
Total Assets		
Liabilities and Net Assets		
Accounts Payable	740	694
Grants Payable	17,503	15,323
Deferred Revenues	7,214	5,800
Loans and Notes Payable	522	480
Net Assets		
Unrestricted	7,846	8,253
Temporarily Restricted	62,043	51,085
Permanently Restricted	3,053	3,053
	72,942	62,391
Total Net Assets	72,942	62,391
Total Liabilities and Net Assets	98,921	84,688

TEACHING NOTE FOR ACCOUNTING AND TAX CONCERNS AT CHICAGO YOUTH SHAKESPEARE

This case, based on an actual not-for-profit organization, touches at least three courses in the undergraduate accounting program: accounting information systems, government and not-for-profit accounting and taxation. While the case may be usefully assigned to students in any of the three, its best use is as a coordinated assignment across them. Such coordination would require some extra effort on the part of instructors; however, students would benefit significantly from such an approach, as it demonstrates how a single organization confronts issues from multiple areas of accounting. The case could also be used in an accounting capstone course.

Following are some specific ideas for using the case with students:

- Routine homework assignment. Both Question A (chart of accounts design) and Question C (journal entries and financial statements) are brief and focused enough to assign as routine homework. The concepts are straightforward; students could submit their work as part of the course grade and / or present it to the class.
- Group project. Question B (internal control plan) lends itself well to a group project setting. In most organizations, internal controls are developed and vetted by a team rather than an individual; assigning this question to groups of three to five students would stimulate critical thinking and align with professional practice. Once again, students could present the results of their work to the class and / or submit it as a component of the grade.
- Individual research assignment. Question D (employee vs. independent contractor) is ideal for an individual research assignment. As noted later in this teaching note, the question does not have a deterministic answer; rather, a student's response would depend on his / her interpretation of the relevant factors and cases.

Instructors using the case are invited to contact the authors to discuss additional options.

Here are sample responses to the case questions:

- a) The simplest, most straightforward system for the CYS chart of accounts is hierarchical coding, a specialized form of block coding. In block coding, the first digit of the account number indicates the element of financial statements. For example, all current assets begin with the number "1." The UCOA illustrated in the case is block coded.

In hierarchical coding, an additional digit is added, typically with a decimal place, as an additional subdivision. Since CYS has its basic operations plus three specialized programs, it will need four additional subdivisions. If "0" designates its basic operations, "1" could indicate the ensemble group. "2" could be used for Battle of the Bard accounts and "3" for CYS in Schools. Combining those codes with account numbers from the UCOA would produce the following partial chart of accounts:

1010.0	Cash in Bank, General Operations
1010.1	Cash in Bank, CYS ensemble
1010.2	Cash in Bank, Battle of the Bard
1010.3	Cash in Bank, CYS in Schools
2010.0	Accounts Payable, General Operations
2010.1	Accounts Payable, CYS ensemble
2010.2	Accounts Payable, Battle of the Bard
2010.3	Accounts Payable, CYS in Schools

The same pattern would continue for all other accounts. While other coding systems (e.g. block coding or mnemonic coding) could also be adapted, hierarchical coding would be easily interpreted by most general ledger software. Additionally, hierarchical coding would allow CYS to quickly and easily generate its overall financial statements and / or financial statements focused exclusively on a single program.

- b) A sample internal control plan based on the COSO framework⁸ might look like this:

Control environment. Establishing a strong control environment is a critical prerequisite for developing and implementing strong, effective internal controls. This element of the COSO framework identifies actions top management can take to demonstrate their commitment to both the process and its outcomes. For CYS, actions to establish a strong control environment could include discussing internal controls at board meetings, providing training and discussion opportunities and / or engaging auditors to review the plan periodically.

Risk assessment. In this section of the COSO framework, CYS identifies its major risk exposures as a precursor for developing specific controls to address them. Some of CYS' risk exposures include: insufficient operating cash, injury to program participants and errors in accounting and tax reporting.

Control activities. Each identified risk should have at least one associated control activity; controls may be preventive, detective, corrective or some combination of the three. To address the risk of insufficient operating cash, CYS should develop and maintain a detailed cash budget; they should also subscribe to grant databases and submit grant proposals regularly. Insurance and proper supervision will mitigate the risk of injury to program participants. And, ensuring that their board includes at least one 'financial professional' will address the risk of financial reporting errors.

Information and communication. An organization can have an excellent internal control plan. But, if it's not communicated to relevant stakeholders, it's virtually useless. To ensure their internal control plan is adequately communicated, CYS could do one or more of the following: Post the plan on their Web site. Present it to the Board at least annually. Mention its development in grant materials, donor solicitations and other appropriate communications.

⁸ *COSO Internal Control Integrated Framework Executive Summary.* (2013). Durham, NC: AICPA.

Monitoring. As an organization's risk exposures change over time, the controls it needs must also change to remain relevant. The monitoring function ensures that the entire plan is reviewed regularly for ongoing effectiveness. CYS should assign specific stakeholders to review the plan regularly; those stakeholders might include board members, CYS management and / or external consultants. Monitoring tools could include simple observations of the controls, surveys, interviews and focus groups.

c) The relevant journal entries and other information follow:

1	Grants Payable		8,500	
	Cash			8,500
2	Cash		6,332	
	Pledges & Grants Receivable			6,332
3	Supplies Expense		902	
	Cash			902
4	Pledges & Grants Receivable		25,000	
	Grants Revenue			25,000
5	Rent Expense		2,500	
	Cash			2,500
6	Utilities Expense		125	
	Accounts Payable			125
7	Cash		10,000	
	Revenues - Endowed Fund			10,000
8	Depreciation Expense		125	
	Accumulated Depreciation - Buildings			125
9	Marketing Expense		350	
	Prepaid Expenses			350
10	Salaries Expense		4,169	
	Salaries Payable			4,169

Chicago Youth Shakespeare				
Statement of Activities				
For the month ending January 31, 2016				
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenues and Support				
Grant Revenues		\$ 25,000		\$ 25,000
Revenues--Endowed Fund			\$ 10,000	10,000
Total Revenues				\$ 35,000
Expenses				
Supplies Expense	\$ 902			\$ 902
Rent Expense	2,500			2,500
Utilities Expense	125			125
Depreciation Expense	125			125
Marketing Expense	350			350
Salaries Expense	4,169			4,169
Total Expenses	\$ 8,171			\$ 8,171
Change in Net Assets	\$ (8,171)	25,000	10,000	\$ 26,829
Net Assets, Beginning of Month	7,846	62,043	3,053	72,942
Net Assets, End of Month	\$ (325)	\$ 87,043	\$ 13,053	\$ 99,771

Chicago Youth Shakespeare		
Balance Sheet		
	At Jan. 31, 2016	At Jan. 1, 2016
Assets		
Cash	\$ 11,248	\$ 6,818
Savings and Investments	13,189	13,189
Pledges & Grants Receivable	82,218	63,550
Prepaid Expenses	4,141	4,491
Land and Buildings, net	3,863	3,988
Investments, Long-Term	5517	5,517
Other Assets	<u>1368</u>	<u>1,368</u>
	\$ 121,544	\$ 98,921
Total Assets		
Liabilities and Net Assets		
Accounts Payable	\$ 865	\$ 740
Grants Payable	9,003	17,503
Salaries Payable	4,169	-
Deferred Revenues	7,214	7,214
Loans and Notes Payable	522	522
Net Assets		
Unrestricted	(325)	7,846
Temporarily Restricted	87,043	62,043
Permanently Restricted	<u>13,053</u>	<u>3,053</u>
	99,771	72,942
Total Net Assets	99,771	72,942
Total Liabilities and Net Assets	\$ 121,544	\$ 98,921

Extra Transactions (The following transactions are provided for instructors who would want to give more exercise problems to students. If these transactions are added to January, statements need to be revised.)

- CYS purchased a used van by making \$3,000 down payment from a local dealership. From the next month, CYS has to pay \$559 on the 15th for 60 months.
- On January 15, CYS borrowed \$12,000 from a local bank to expand the program to a wider geographic region by signing a 6.75% note which is due in 6 months.

- CYS has made a reimbursement payment for \$3,256 to an instructor who traveled to New York last month to accompany students who competed at a national teenagers' theatrical show.
 - CYS made a short term investment in S&P 500 stocks in the amount of \$5,000.
 - On Jan. 29, CYS had a successful fundraising event called Teens Act where it raised \$8,692 in cash. 25% of this amount was paid to the third party fundraising company.
- d) For federal tax purposes, the Internal Revenue Service (“IRS”) has developed a 20-factor test based on common law principles to assist in determining whether a worker is an employee or an independent contractor⁹. The 20 factors are:
- Instructions: A worker who is required to comply with the entity’s instructions about the time, place, and manner of work is usually considered an employee.
 - Training: If the entity trains the worker, an employment relationship will usually be found to exist. Independent contractors ordinarily use their own methods and do not receive training from the purchaser of services. In fact, it is usually independent contractor's methods that bring him/her to the attention of the purchaser.
 - Integration: Whether the worker’s services are integrated into the entity’s business operations. Integration suggests the worker is subject to the entity’s direction and control.
 - Services Rendered Personally: Whether the services are required to be performed personally. If they are, it suggests the entity is interested in the methods used by the worker in addition to the results, suggesting an employer-employee relationship.
 - Hiring, Supervising and Paying Assistants: Whether the entity hires and pays for the worker’s assistants. If the worker hires its own assistants, it indicates the worker is an independent contractor.
 - Continuing Relationship: A continuing relationship between the worker and the entity supports a finding that an employer-employee relationship exists.
 - Set Hours of Work: If the entity sets the worker’s hours, it indicates an employer-employee relationship.
 - Full Time Required: If the worker is required to work full time for the entity, the entity has control over the amount of time worker spends working, or the entity impliedly restricts the worker from doing other gainful work for third persons in the normal course of business all indicate control. Independent contractors are free to work whenever and for whomever they wish.

⁹ Small Business/Self-Employed Topics. (2017, March 23). Retrieved April 04, 2017, from <https://www.irs.gov/businesses/small-businesses-self-employed/independent-contractor-self-employed-or-employee>

- Doing Work on Employer's Premises: Whether the worker's services are performed on the entity's premises. Control over the worker's place of work indicates an employer-employee relationship.
- Order or Sequence Set: Whether the worker is free to follow his own pattern of work or is instead required to follow the entity's established routines and schedules.
- Oral or Written Reports: Whether the worker is required to submit regular reports to the entity, which indicates a degree of control over the worker.
- Payment by Hour, Week, or Month: Payment by the hour, week, or month suggests an employer-employee relationship unless it is simply a convenient way of paying a lump sum agreed upon for the cost of a job. A lump sum payment per job or payment by commission supports the worker is an independent contractor.
- Payment of Expenses: If the entity pays for the worker's expenses, the worker is generally an employee.
- Furnishing of Tools and Materials: If the entity supplies the worker with significant tools, materials, and other equipment, it suggests an employer-employee relationship exists.
- Significant Investment: If the worker invests in facilities used by the worker in performing services (e.g., an office), it supports a finding of independent contractor status.
- Realization of Profit or Loss: If the worker can realize a profit or suffer a loss as a result of the worker's services, the worker is generally an independent contractor.
- Working for More than One Firm: Working for multiple companies at the same time suggests the worker is an independent contractor.
- Making Services Available to the Public: If the worker makes his services available to the general public on a regular and consistent basis, it suggests the worker is an independent contractor.
- Right to Discharge: If the entity has the right to fire the worker, it suggests an employer-employee relationship. In comparison, independent contractors generally cannot be fired as long as they meet the contract specifications.
- Right to Terminate: If the worker has the right to terminate the relationship without incurring a liability, it suggests an employer-employee relationship. Independent contractors usually work under a written contract and do not have right to terminate at will.

A student's analysis of the relevant authorities (e.g., Internal Revenue Code, Regulations, cases, and IRS publications) as applied to the facts set forth in the prompt and sample contracts for Guest Directors might be summarized like this:

Factor	Guest Directors	Applicable Authorities
Instructions	IC	<u>Quintanilla v. Comm'r</u> , TC Memo 2016-5 <u>Images in Motion of El Paso, Inc. v. Comm'r</u> , T.C. Memo. 2006-19
Training	IC	Rev. Rul. 87-41, 1987-1 C.B. 296
Integration	EE	<u>Potter v. Comm'r</u> , TC Memo 1994-356 <u>Mladimich v. United States</u> , 379 F.Supp. 117 (S.D. MI 1974) <u>Walz v. Comm'r</u> , TC Summ. 2005-1 Rev. Rul. 70-338, 1970-1 CB 200 (1970)
Services Rendered Personally	Either IC or EE	Rev. Rul. 87-41, 1987-1 C.B. 296
Continuing Relationship	EE	<u>Quintanilla v. Comm'r</u> , TC Memo 2016-5 <u>Potter v. Comm'r</u> , TC Memo 1994-356 <u>Reece v. Comm'r</u> , T.C. Memo. 1992-335 Rev. Rul. 87-41, 1987-1 C.B. 296
Set Hours of Work	IC	Rev. Rul. 87-41, 1987-1 C.B. 296
Doing Work on Employer's Premises	EE	Treas. Reg. §31.3121(d)-1(c)(2) Rev. Rul. 87-41, 1987-1 C.B. 296 PLR 9126006 (3/27/91)
Order or Sequence Set	IC	Rev. Rul. 87-41, 1987-1 C.B. 296
Oral or Written Reports	IC	<u>Potter v. Comm'r</u> , TC Memo 1994-356 Rev. Rul. 87-41, 1987-1 C.B. 296
Payment by Hour, Week or Month	IC	Rev. Rul. 87-41, 1987-1 C.B. 296 <u>Weber v. Comm'r</u> , 103 T.C. 378, 386 (1994), aff'd 60 F.3d 1104 (4th Cir. 1995)
Furnishing of Tools & Materials	Either IC or EE	Treas. Reg. §31.3121(d)-1(c)(2) <u>Radio City Music Hall Corp. v U.S.</u> , 135 F.2d 715, (2 nd Cir. 1943)
Realization of Profit or Loss	IC	<u>Quintanilla v. Comm'r</u> , TC Memo 2016-5 Rev. Rul. 87-41, 1987-1 C.B. 296
Right to Discharge	IC	<u>Quintanilla v. Comm'r</u> , TC Memo 2016-5 Rev. Rul. 87-41, 1987-1 C.B. 296
Right to Terminate	IC	Rev. Rul. 87-41, 1987-1 C.B. 296

(In the table, “IC” signifies that the factor weighs in favor of independent contractor status; “EE” signifies that the factor weighs in favor of an employer/ employee relationship. Neutral factors are omitted.) Thus, Guest Directors are likely (but not definitively) to be considered independent contractors.

An analysis of the 20 factors for Guest Instructors might look like this:

Factor	Guest	Applicable Authorities
Instructions	EE	Potter v. Comm'r, TC Memo 1994-356 PLR 9126006 (3/27/91)
Training	IC	Rev. Rul. 87-41, 1987-1 C.B. 296
Integration	EE	Potter v. Comm'r, TC Memo 1994-356 Mladinich v. United States, 379 F.Supp. 117 (S.D. MI 1974) Walz v. Comm'r, TC Summ. 2005-1 Rev. Rul. 70-338, 1970-1 CB 200 (1970)
Services Rendered Personally	EE	Rev. Rul. 87-41, 1987-1 C.B. 296
Continuing Relationship	EE	Quintanilla v. Comm'r, TC Memo 2016-5 Potter v. Comm'r, TC Memo 1994-356 Reece v. Comm'r, T.C. Memo. 1992-335 Rev. Rul. 87-41, 1987-1 C.B. 296
Set Hours of Work	EE	Potter v. Comm'r, TC Memo 1994-356
Doing Work on Employer's Premises	EE	Treas. Reg. §31.3121(d)-1(c)(2) Rev. Rul. 87-41, 1987-1 C.B. 296 PLR 9126006 (3/27/91)
Order or Sequence Set	EE	Beitel v. Comm'r, TC Summ. 2001-101 Potter v. Comm'r, TC Memo 1994-356 Bilenas v. Comm'r, TC Memo. 1983-661 Rev. Rul. 70-308, 1970-1 CB 199 (1970) Rev. Rul. 70-363, 1970-2 CB 207 (1970) PLR 9132032 (5/9/91) PLR 9612016 (3/22/96)
Oral or Written Reports	EE	Rev. Rul. 87-41, 1987-1 C.B. 296
Payment by Hour, Week or Month	EE	Rev. Rul. 87-41, 1987-1 C.B. 296
Realization of Profit or Loss	EE	Laraway v. Comm'r, T.C. Memo. 1992-705 Rev. Rul. 87-41, 1987-1 C.B. 296
Working for More than One Firm	EE	Rev. Rul. 57-155, 1957-1 CB 333 (1957)
Making Services Available to the Public	EE	Mladinich v. United States, 379 F.Supp. 117 (S.D. MI 1974) Rev. Rul. 65-262, 1965-2 CB 391 (1965)
Right to Discharge	EE	Treas. Reg. §31.3121(d)-1(c)(2) Potter v. Comm'r, TC Memo 1994-356 Rev. Rul. 87-41, 1987-1 C.B. 296
Right to Terminate	EE	Mladinich v. United States, 379 F.Supp. 117 (S.D. MI 1974) Potter v. Comm'r, TC Memo 1994-356 Rev. Rul. 87-41, 1987-1 C.B. 296

(As above, “IC” signifies that the factor weighs in favor of independent contractor status; “EE” signifies that the factor weighs in favor of an employer/ employee relationship. Neutral factors are omitted.) Thus, Guest Instructors are likely (but not definitively) to be considered employees.

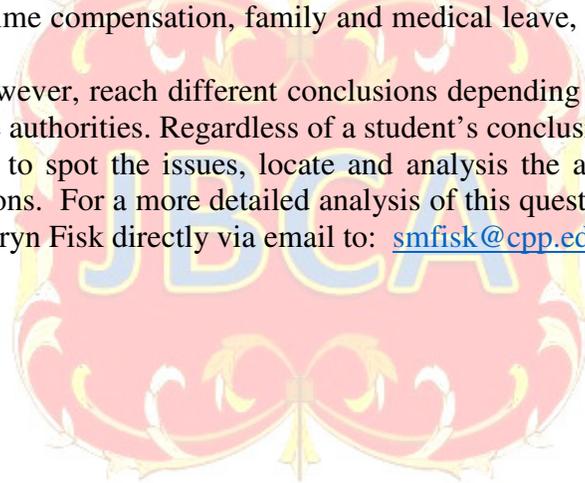
The failure to properly categorize a worker as an employee or independent contractor can have serious tax ramifications. Employee misclassification generates substantial losses to the federal government and state governments in the form of lower tax revenues, as well as to state unemployment insurance and workers’ compensation funds.

An entity may prefer to categorize a worker as an independent contractor to avoid employment taxes and benefit costs. Employers must withhold income taxes, withhold and pay Social Security and Medicare taxes, and pay unemployment tax on wages paid to an employee. Entities do not have to withhold or pay any taxes on payments to independent contractors. Treating workers as independent contractors rather than employees also reduces the costs of employee

fringe benefits (e.g., healthcare, retirement plans, sick leave, holiday pay, overtime, etc.). Many of these benefits must be provided on a nondiscriminatory basis; thus, they can be quite costly. Lastly, independent contractors are not entitled to same legal rights and protections as employees.

A worker may prefer to be treated as an independent contractor. A major tax advantage to independent contractors is they can write off all reasonable and necessary business expenses, which could include office expenses and staffing costs. These business expenses are classified as above-the-line deductions rather than below-the-line deductions subject to limitations. An employee does not have the same tax advantages. An employee may not have many costs beyond commuting, business clothes and other costs of the profession. These unreimbursed employee business expenses are limited in deductibility. While an independent contractor must absorb the cost of fringe benefit equivalents, the independent contractor can pick and choose what fringe benefits to purchase or forego. A worker may, on the other hand, prefer to be treated as an employee. An employee only must pay the employee part of payroll taxes (FICA, FUTA) while an independent contractor must pay the higher self-employment tax. An employee may be able to obtain better benefits than an independent contractor. Employer subsidized health, life, disability and retirement benefits represent part of the “hidden paycheck” for employees not available to independent contractors. By law, employees are entitled to critical benefits and protections such as minimum wage, overtime compensation, family and medical leave, unemployment insurance, and safe workplaces.

Students may, however, reach different conclusions depending on how they interpret the facts under the applicable authorities. Regardless of a student’s conclusion, the object of this case study is for the students to spot the issues, locate and analysis the applicable authorities, and support their determinations. For a more detailed analysis of this question, case users are invited to contact Asst. Prof. Sharyn Fisk directly via email to: smfisk@cpp.edu.



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