Report to the Board of Directors and Management

Audit Planning:
Year Ended December 31, 2021

Contents

The following communication was prepared as part of our audit, has consequential limitations, and is intended solely for the information and use of those charged with governance (e.g., Board of Directors and Audit Committee) and, if appropriate, management of the Foundation and is not intended and should not be used by anyone other than these specified parties.

Welcome

May 16, 2022

To the Board of Directors and Management
The Pentagon Federal Credit Union Foundation

Professional standards require us to communicate with you regarding matters related to the financial statement audit that are, in our professional judgment, significant and relevant to your responsibilities in overseeing the financial reporting process. This document provides an overview of our plan for the audit of the financial statements of The Pentagon Federal Credit Union Foundation (the Foundation) as of and for the year ended December 31, 2021, including a summary of the nature, scope, and timing of the planned audit work.

We are pleased to be of service to the Foundation and look forward to discussing our audit plan, as well as other matters that may be of interest to you.

Respectfully,

BDO USA, LLP

Executive Summary

Responsibilities

BDO USA, LLP, as your auditor, is responsible for forming and expressing an opinion about whether the financial statements that have been prepared by management, with your oversight, are prepared, in all material respects, in conformity with accounting principles generally accepted in the United States of America. The audit of the financial statements does not relieve you of your responsibilities and does not relieve management of their responsibilities. The engagement letter, a copy of which has been provided to you, includes specific details regarding the auditor's and management's responsibilities.

Audit Strategy

Overall, our audit strategy is to assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design further audit procedures responsive to assessed risks. 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. In connection with our audit, we will obtain a sufficient understanding of the Foundation's internal control to plan the audit of the financial statements. However, such understanding is required for the purposes of determining our audit procedures and not to provide any assurance concerning such internal control.

We focus on areas with higher risk of material misstatement (whether due to error or fraud). Our audit strategy includes consideration of:

- prior year audit results together with current year preliminary analytical review, including discussions with management and those charged with governance regarding the Foundation's operations,
- inherent risk within the Foundation,
- recent developments within the industry, regulatory environment and general economic conditions,
- recently issued and effective accounting and financial reporting guidance,
- the Foundation's significant accounting policies and procedures, including those requiring significant management judgments and estimates and those related to significant unusual transactions,
- the control environment and the possibility that the control system and procedures may fail to prevent or detect a material error or fraud,
- Information about systems and the computer environment in which the related systems operate, and
- a continual assessment of materiality thresholds based upon qualitative and quantitative factors affecting the Foundation.

Planned Scope

Based upon our initial assessment, our planned scope for the audit is described below:

- The areas indicated below relate to significant risks identified during our risk assessment procedures and include a brief description of how we propose to address them:
  - Fraud Risk
  - Contributions and Donated Services
  - Investments in Limited Liability Company and Related Disclosures
  - Net Assets With or Without Donor Restrictions
  - Evaluation of Related Party Relationships and Transactions
  - Evaluation of Going Concern
  - Continuing Evaluation of the Impact of the COVID-19 to the Foundation

Primary Areas of Focus and Audit Strategy

FRAUD RISK

Consideration

- Fraud risk may be impacted by the following characteristics:
  - Incentive or pressure
  - Opportunity
  - Rationalization or attitude
- Presence of fraud risk factors and how management's controls and programs to detect and prevent fraud may mitigate these risks.
- Risk of management override of controls.

Approach

- Review management's controls and programs relating to fraud and assess operating effectiveness of such programs.
- Inquire of management and the Foundation's personnel to their knowledge of any potential fraudulent or alleged fraudulent activities.
- Inquire of those charged with governance about its views about risks of material misstatements, including fraud risk, and whether they are aware of:
  - tips or complaints regarding the Foundation's and
  - matters relevant to the audits including, but not limited to, violations or possible violation of laws or regulations.
- Consider additional procedures to address any fraud risks identified, including improper revenue recognition and management override of controls.
- Introduce an element of unpredictability into our procedures by altering the nature, timing, or extent of the procedures when compared to procedures performed in the prior year.
- Perform focused procedures on any significant unusual transactions, including gaining an understanding of the business purpose for the Foundation entering into the transaction.
- Obtain an understanding of the Foundation's financial relationships and transactions with its executive officers and the those charged with governance for risk assessment purposes.
- Exercise professional skepticism.
- Communicate with management, those charged with governance, as necessary.

Primary Areas of Focus and Audit Strategy (continued)

CONTRIBUTIONS AND DONATED SERVICES

Consideration

- High inherent risk due to the following factors:
  - Economic pressures associated with industry conditions and increased competition
  - Significant estimates and judgments used in assessing need for establishing allowances

Approach

- Perform testing of aging of receivables to assess adequacy of reserves.
- Review nature of balances of any significant changes in type, nature or amounts of contributions received and other factors that could impact ultimate valuation of collectability.
- Review the management's methodology in estimating the fair value of donated services.
- Review donor letter and cash receipts to determine if the control was properly recorded and classified (with or without donor restrictions).

Primary Areas of Focus and Audit Strategy (continued)

INVESTMENTS AND RELATED DISCLOSURES

Consideration	Approach
▶ Existence and accuracy of investment balances. ▶ Valuation of certain investments requires specialized skill and knowledge. ▶ Whether investment transactions are recorded in conformity with U.S. GAAP.	▶ Consider management's policies, procedures and controls surrounding the recorded valuation of investments, transactions and performance analyses and disclosures. ▶ Confirm investment balances, transactions and terms with third-party managers and custodians. ▶ Due to the specialized skill and knowledge required, utilize BDO Consulting Valuation and Business Advisors or other third party to assist in assessing reasonableness of valuation methodologies used for a selection of funds. ▶ Review investments for other than temporary impairment or other performance issues that may require disclosure in the financial statements. ▶ Review changes including redemptions, subscriptions, transfers, etc. ▶ Review the minutes of those charged with governance meetings to ensure that those charged with governance is aware of activity. ▶ Review the related disclosures on the financial statement.

Primary Areas of Focus and Audit Strategy (continued)

NET ASSETS WITH AND WITHOUT DONOR RESTRICTIONS

Consideration	Approach
▶ Books and records are properly closed out at year-end. ▶ Restricted amounts are properly recorded and classified.	▶ Agree the net asset balances per the general ledger to the prior year audited financial statements. ▶ Review award letters for restricted contributions to ensure proper classification. In addition, review the subsequent release of those prior year net assets to ensure that the entity has expended the funds based on their intended purpose. ▶ Review the net asset classification and related disclosures.

Primary Areas of Focus and Audit Strategy (continued)

EVALUATION OF RELATED PARTY RELATIONSHIPS AND TRANSACTIONS

Consideration

- Consider whether we have an adequate understanding of the Foundation's relationships and transactions with its related parties, including the nature of, terms of, and business purposes (or the lack thereof).
- Consider whether the Foundation's management has properly identified, authorized and approved, accounted for, and disclosed its related parties and relationships and transactions with those parties.
- Ensure that related parties are properly disclosed in the financial statements.

Approach

- Perform specific procedures to obtain an understanding of the Foundation's relationships and transactions with related parties and its process for identifying, authorizing and approving, and accounting for and disclosing such transactions.
- Evaluate whether the Foundation's management has properly identified related parties and relationships and transactions with those parties.
- Inquire of those charged with governance regarding their understanding of the Foundation's 's relationships and transactions with related parties that are significant to the Foundation and whether there are any concerns and the substance of such concerns regarding relationships or transactions with related parties.
- Perform specific procedures if we determine that a related party or relationship or transaction with a related party previously undisclosed to us exists.
- For each transaction that is required to either be accounted for and disclosed in the Foundation's financial statements or determined to be a significant risk, perform specific procedures as applicable.
- Communicate to those charged with governance our evaluation of the Foundation management's (a) identification of, (b) accounting for, and (c) disclosure of the Foundation's relationships and transactions with related parties, and other related significant matters arising from our audit.

Primary Areas of Focus and Audit Strategy (continued)

EVALUATION OF GOING CONCERN

Consideration	Approach
▶ Competitiveness of industry – wide variety of organizations vying for donor dollars – and a constantly changing regulatory landscape. ▶ The Foundation has continued to experience a decrease in net assets. ▶ The Foundation is not in compliance with debt covenants.	▶ Perform additional auditing procedures to assess recoverability and classification of assets and liabilities. ▶ Evaluate waivers of debt covenant violations or the impact if no waiver is obtained. ▶ Discuss with management and analyze mitigating factors such as: • Review management forecasts • Consider management's plans to generate alternative cash flows to support continued operations for a reasonable period (e.g., generally 12 months from the date of the financial statements).

Overall Audit Timeline

The following represents our anticipated schedule with regard to our audit of the annual financial statements of the Foundation:

	Apr	May	Jun	July
Periodic Meetings and Discussions with Management	✓	✓	✓	
Develop Audit Strategy, and Determine Nature and Scope of Testing – Financial Statement		✓		
Internal Control Assessment and Testing		✓		
Substantive Testing (confirmation procedures, etc.)		✓	✓	
Review Draft Financial Statements		✓	✓	
Meetings with Those Charged with Governance		✓		✓
Release Opinion on Financial Statements				✓

Independence

Our engagement letter to you dated May 4, 2022, describes our responsibilities in accordance with professional standards and certain regulatory authorities with regard to independence and the performance of our services. This letter also stipulates the responsibilities of the Foundation with respect to independence as agreed to by the Foundation. Please refer to that letter for further information.

Client Service Team

As a matter of policy, we attempt to provide continuity of service to our clients to the greatest extent possible. Where engagement team rotation is necessary, we will discuss this matter with you and determine the appropriate individual to be assigned to the engagement based on particular experience, expertise, and engagement needs.

We are pleased to be of service to the Foundation and look forward to answering questions you may have regarding our audit plan as well as other matters that may be of interest to you.

Andy Afuang

Audit Director
aafuang@bdo.com / 1 (301) 354-2504

Marc Berger

National Director, Nonprofit Tax Services
mberger@bdo.com / 1 (301) 385-2516

Carol Shi

Audit Manager
zshi@bdo.com / 1 (301) 354-0710

Appendix

Implementation of New Accounting Standards

Leasing Standards Implementation Timelines

PRIVATE COMPANY AND PRIVATE NONPROFIT LEASE IMPLEMENTATION TIMELINE

2021 — **2022**

Q1 ‘21	Q2 ‘21	Q3 ‘21	Q4 ‘21	Q1 ‘22	
Technical Analysis and Assessment	Testing &	Implementation		Financial Reporting and Disclosure	Post Adoption

PUBLIC NONPROFIT LEASE IMPLEMENTATION TIMELINE

2019 — **2020**

Q1 ‘19	Q2 ‘19	Q3 ‘19	Q4 ‘19	Q1 ‘20	
Technical Analysis and Assessment	Testing &	Implementation		Financial Reporting and Disclosure	Post Adoption

Implementation of New Accounting Guidance: Leases

OVERVIEW

Summary: In 2016, the FASB issued the leasing standard ASU 2016-02, Leases (ASC Topic 842) for both leases and lessors. Under its core principle, a leases will recognize right-of-use (ROU) assets and related lease liabilities on the statement of financial position for all arrangements with terms longer than 12 months. The pattern of expense recognition in the statement of activities will depend on a lease's classification.

Lessor accounting remains largely consistent with U.S. GAAP but has been updated for consistency with the new lessee accounting model and with the new revenue recognition standard, FASB ASC 606.

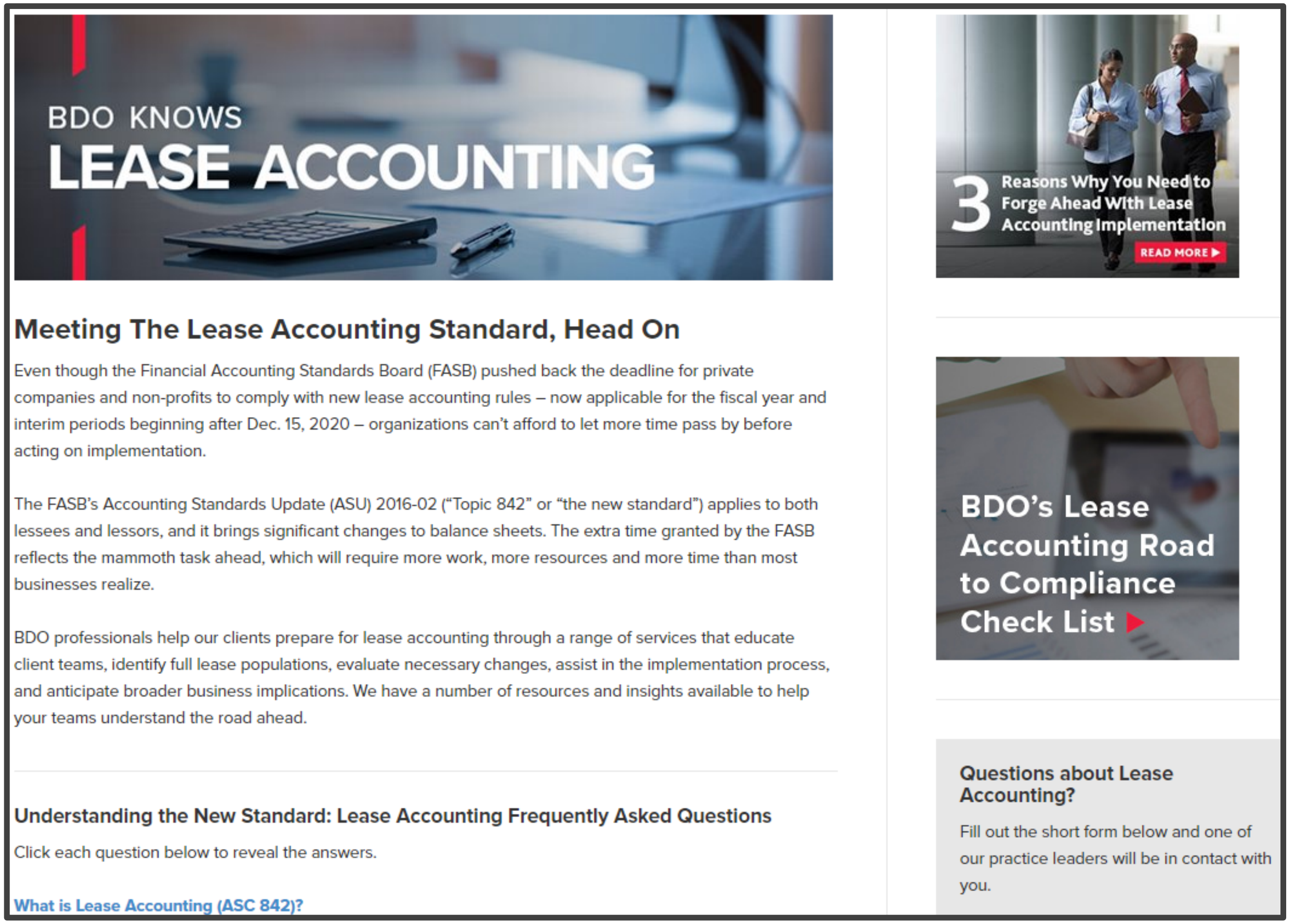
ASU 2016-02 was subsequently updated by ASUs 2018-01, 2018-10, 2018-11, 2018-20, 2019-01 and 2020-05.

Some of the impacts of the leasing standard:

- Lease arrangements have to be classified as either finance leases or operating leases.
- Establishes the right-of-use asset model, which shifts from the risk-and-reward approach to a control-based approach.
- Lessees will recognize an asset on the statement of financial position, representing their right to use the leased asset over the lease term and recognize a corresponding lease liability to make the lease payments.
- The lease lability is based on the present value of future lease payments using a discount rate to determine the present value based on the rate implicit in the lease, if readily determinable, or the lessee's incremental borrowing rate.
- As a result, a lessee's operating lease accounting model will change significantly.

Ways to Prepare for and Implement the New Standard:
• Become familiar with the new standard, discuss the new standard with your accounting advisors and evaluate the impact the standard will have on all facets of your organization's leasing activities.
• Identify and classify all leases based on the criteria in the ASU.
• Prepare draft financial statements based on the guidance in the ASU and determine if your organization has any potential issues with meeting current debt covenants as a result of recording these leases on the statement of financial position.
• Review current lease disclosures and update to meet the criteria of the ASU.

FASB: Lease Accounting



BDO KNOWS
LEASE ACCOUNTING

Meeting The Lease Accounting Standard, Head On

Even though the Financial Accounting Standards Board (FASB) pushed back the deadline for private companies and non-profits to comply with new lease accounting rules – now applicable for the fiscal year and interim periods beginning after Dec. 15, 2020 – organizations can't afford to let more time pass by before acting on implementation.

The FASB's Accounting Standards Update (ASU) 2016-02 ("Topic 842" or "the new standard") applies to both lessees and lessors, and it brings significant changes to balance sheets. The extra time granted by the FASB reflects the mammoth task ahead, which will require more work, more resources and more time than most businesses realize.

BDO professionals help our clients prepare for lease accounting through a range of services that educate client teams, identify full lease populations, evaluate necessary changes, assist in the implementation process, and anticipate broader business implications. We have a number of resources and insights available to help your teams understand the road ahead.

Understanding the New Standard: Lease Accounting Frequently Asked Questions

Click each question below to reveal the answers.

What is Lease Accounting (ASC 842)?

3 Reasons Why You Need to Forge Ahead With Lease Accounting Implementation
READ MORE

BDO's Lease Accounting Road to Compliance Check List

Questions about Lease Accounting?

Fill out the short form below and one of our practice leaders will be in contact with you.

Visit BDO's Lease Accounting Resource Center:

https://www.bdo.com/email-landing-pages/lease-accounting

Additional New Accounting Standards

ASU 2016-13, FINANCIAL INSTRUMENTS – CREDIT LOSSES

Summary: This ASU was issued to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by an entity. The ASU changes the impairment model for most financial assets that are measured at amortized cost and certain other instruments from an incurred loss model to an expected loss model. Entities will be required to estimate credit losses over the entire contractual term of an instrument. The ASU includes financial assets recorded at amortized cost basis such as loan receivables, trade and certain other receivables as well as certain off-balance sheet credit exposures such as loan commitments and financial guarantees. The ASU does not apply to financial assets measured at fair value, promises to give (pledges receivable) and loans and receivables between entities under common control.

Subsequently, the FASB issued ASU 2018-19, ASU 2019-04, ASU 2019-05 and 2019-10 and 2019-11 to clarify and improve ASU 2016-13.

Effective date: The ASU is effective for fiscal years beginning after December 15, 2022 for all nonprofit entities. Early adoption may be selected for fiscal years beginning after December 15, 2018. An entity must apply the amendments in the ASU through a cumulative-effect adjustment to net assets as of the beginning of the first reporting period in which the guidance is effective except for certain exclusions.

ASU 2020-07, PRESENTATION AND DISCLOSURES BY NOT-FOR-PROFIT ENTITIES FOR CONTRIBUTED NONFINANCIAL ASSETS

Summary: This ASU was issued to increase transparency on how contributed nonfinancial assets (also referred to as gifts-in-kind) received by nonprofits are to be used and how they are valued. The ASU states that contributed nonfinancial assets be presented on a separate item in the statement of activities apart from contributions of cash and other financial assets. The ASU also outlines specific disclosures that must be made regarding the contributed nonfinancial assets.

Effective date: The effective date is for fiscal years beginning after June 15, 2021.

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