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GAAP versus Form 990 Reporting

Form 990 preparers and users must understand the differences in GAAP and tax reporting requirements. Since the implementation of FASB ASU 2016-14 guidance, effective for organizations with calendar year 2018 and fiscal year 2019 year ends, it's important to consider some of these differences.

General Considerations

Some basic considerations to keep in mind when approaching Form 990 preparation with GAAP based financial statements follow—

1. What entities are included in the financials? GAAP consolidated financial statements may be required when controlling and economic interests exist, while a Form 990 consolidated filing is only allowed in the case of a disregarded entity or when subordinate organizations file a group return if a group exemption is in place.
2. Is it material? Materiality, which is judgment based, is not a tax consideration but is allowed for GAAP. Form 990 has specific reporting thresholds; consequently items that were not considered in the preparation of the financial statements may require additional work for tax reporting. Consulting audit workpapers, general ledgers, and auditors or accounting staff may be necessary to obtain the additional information needed to properly complete the Form 990.
3. What accounting method is used? Generally, Form 990 uses the same accounting method that is used regularly by the organization to maintain their books and records. However, the accounting method must clearly reflect income.

Support and Revenue

GAAP requires investments to be presented at fair market value (FMV), and unrealized gains and losses are included in total support and revenue. For tax, although investments are recorded at FMV on the balance sheet (Form 990, Part X), any adjustment to FMV is not included in revenue. An adjustment is reported in Form 990, Part XI, to reconcile net assets for the book/tax difference.

Prior period adjustments for grant expense reversals, losses from prior year

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uncollectible pledges, and refunds of contributions and program service revenue are reported for GAAP but are not included in revenue or expense for tax. These items are reported as a reconciling item in Form 990, Part XI, as other changes in net assets.

GAAP requires the free use of facilities and equipment to be recorded at the FMV at the date of donation, and under certain criteria, in-kind services must be similarly recorded. For tax purposes, these are generally excluded from income and expense unless they are provided by a government unit, in which case, they are included in support for public support test purposes.

Expenses

Direct costs are expenses that can be identified specifically with an organization's activity or project and can be assigned to an activity or project with a high degree of accuracy. Indirect costs are costs that cannot be identified specifically with an activity or project.

FASB ASU 2016-14 requires all exempt organizations to present an analysis of expenses by functional (i.e., program, management and general, and fundraising) and natural classifications (i.e., salaries, rent, and depreciation) for GAAP (see "Functional Expense Classification" article in the October 2018 edition of this newsletter for more information). The allocation of management and general activities among program or support functions is clarified in the guidance. Supporting activities are not directly identifiable with one or more program, fundraising, or membership development activities. The allocation method used is required to be disclosed. For Form 990, only 501(c)(3) and 501(c)(4) organizations are required to present these classifications.

Observation: Presenting functional expenses on the Form 990 consistent with ASU 2016-14 should not present a problem.

Change in Net Assets

FASB ASU 2016-14 simplified how exempt organizations classify their net assets for financial statement reporting. Net assets are now presented as either with or without donor restrictions.

The former categories of temporarily restricted and permanently restricted net assets are combined into *net assets with donor restrictions* and the former unrestricted net assets are now categorized as *net assets without donor restrictions* for GAAP.

The 2018 Form 990 instructions were updated for the effects of ASU 2016-14. However, likely due to budgetary constraints, the Form 990 has not yet been updated. The 2018 Form 990, Part X, lines 27–29, still reflect the former classifications so some tweaking in the presentation may be required.

Practical Consideration:

Tax preparers must keep up with changes in GAAP in order to understand an organization's audited financial statements and to identify book/tax differences.

Additional Guidance on Private College and University Net Investment Income Excise Tax

A 1.4% excise tax under IRC Sec. 4968 is imposed on the net investment income (NII) of certain private colleges and universities for tax years beginning after December 31, 2017. Whether the college or university is liable for the tax depends on the university's size and assets. The Department of the Treasury recently released proposed reliance regulations (Prop. Reg. 53.4968-1) providing additional guidance for the application of this excise tax. These regulations are intended to clarify (1) which educational institutions are subject to the excise tax and (2) how the NII is calculated. The regulations are proposed to be effective when published as final regulations; however, taxpayers may rely on them for tax years beginning before publication of the final regulations [Prop. Reg. 53.4968-1(c)(2)(ii)(B)].

Please refer to the August 2018 edition of this newsletter for the general rules on the excise tax as well as interim guidance provided by Notice 2018-55.

Definitions

Some clarification to definitions is necessary to properly compute the Section 4968 tax. The terms "student," "tuition-paying student," "applicable educational institution," and "assets used directly in carrying out the institution's exempt purpose" are now defined in the proposed regulations to generally mean the following [Prop. Reg. 53.4968-1(a)(2) through (4)]—

- **Applicable educational institution (AEI)**—an eligible educational institution [as defined in IRC Sec. 25A(f)(2)] with at least 500 tuition-paying students attending the institution during the preceding tax year, more than 50% of the tuition-paying students attending are located in the U.S., is not a state college or university, and the aggregate FMV of the assets at the end of the preceding tax year (other than those assets that are used directly in carrying out the institution's exempt purpose) is at least $500,000 per student attending the institution.

- **Student**—a person enrolled (and attending an institution) in a degree, certification, or other program (including a program of study abroad approved for credit by the eligible institution at which such student is enrolled) leading to a recognized educational credential at an institution, and who is not enrolled in an elementary or secondary school.
- **Tuition-paying**—the payment of any tuition or fees required for the enrollment or attendance of a student for a course of instruction at an educational institution but does not include separate payments for supplies or equipment required for a specific course once a student is enrolled in and attending the course. In addition, tuition-paying does not include room and board or other personal living expenses. If a student is required to pay a bundled fee to an AEI that combines charges for tuition with personal expenses, then the student is a tuition-paying student. Whether a student is tuition-paying is determined after scholarships and work study program benefits provided directly by the university are taken into account. However, scholarship payments provided by third parties are considered payment of tuition on behalf of the student.
- **Full and part-time students**—the determinations of full-time students, part-time students, full-time student equivalents, and daily average of students attending the institution would be made by each AEI if the determinations are consistent with the institution's practices in determining full-time and part-time status for other purposes.
- **Assets used directly in carrying out an institution's exempt purpose**—assets actually used by the institution in carrying out its exempt purpose. Whether an asset qualifies must be determined based on all the facts and circumstances. If the property's exempt use represents 95 percent or more of the total use, the property is considered to be used exclusively for an exempt purpose. If the exempt use of such property represents less than 95 percent of the total use, the institution must make a reasonable allocation between such exempt and nonexempt uses. Examples of these assets are included in Prop. Reg. 53.4968-1(a)(4)(ii). Exceptions (i.e., example of assets not used directly in carrying out exempt purpose) are provided at Prop. Reg. 53.4968-1(a)(4)(iii).

Related Organizations

The FMV of assets and NII of a related organization are treated as assets and NII of an AEI if certain requirements are met. The requirements are met if the organization controls or is controlled by the AEI, is controlled by one or more persons that also control the AEI, or is a supported or supporting organization of the AEI.

The proposed regulations define the term *control*, in the case of a corporation, a partnership, a trust, and a nonprofit organization or nonstock corporation. The proposed regulations apply the principles of IRC Sec. 318 for determining ownership of stock in a corporation and apply similar principles for determining ownership of an interest in any other entity [Prop. Regs. 53.4968-1(c)(1)(ii) and (iii)].

In addition, guidance is provided regarding the allocation of assets and NII to a related organization(s) [Prop. Reg. 53.4968-1(c)(2)(ii)(A)]. The proposed regulations further explain when assets and NII of the related organization are intended or available for the use and benefit of an educational institution and when they are not intended or available for the use and benefit of an educational institution [Prop. Regs. 53.4968-1(c)(1)(ii) and (iii)].

Calculating Net Investment Income (NII)

Clarification was needed to compute the Section 4968 excise tax. The Code states for purposes of the excise tax, NII is to be determined under rules "similar to" the Section 4940(c) rules (applying to private foundations) without defining "similar to" [IRC Sec. 4968(c)]. Prop. Reg. 53.4968-1(b) provides clarifying guidance about the necessary modifications to apply the private foundation NII regulations to IRC Sec. 4968, and includes the following—

1. An AEI is subject to the 1.4% tax on its NII, and also on certain amounts of NII of certain related organizations, for the tax year.
2. NII will be determined by substituting "applicable educational institution" for "private foundation" and "foundation" each place they appear and substituting "December 31, 2017" for "December 31, 1969" each place it appears in Reg. 53.4940-1(c)–(f). In addition, Reg. 53.4940-1(d)(3), relating to certain distributions in redemption of stock, does not apply.
3. If an AEI held an interest in a partnership (including through one or more tiers of partnerships) on December 31, 2017, and continuously thereafter, and the partnership held assets on December 31, 2017, and continuously thereafter to the date of disposition, the partnership's basis in its assets for determining the AEI's share of gain upon sale or disposition of the assets is not less than the FMV of such asset on December 31, 2017, plus or minus all adjustments under Reg. 53.4940-1(f)(2)(A) after December 31, 2017, and before the date of disposition.
4. For Reg. 53.4940-1(f), overall net losses from sales or other dispositions of property by one related organization (or by the AEI) reduce (but not below zero) overall net gains from such sales or other dispositions by other related organization (or by the AEI).

New Accounting Alternatives for Goodwill and Certain Intangible Assets

In May 2019, the FASB issued 2019-06, *Intangibles—Goodwill and Other* (Topic 350), *Business Combinations* (Topic 805), and *Not-for-Profit Entities* (Topic 958). The ASU extends the private company accounting alternatives provided in ASU 2014-02, *Intangibles—Goodwill and Other (Topic 350): Accounting for Goodwill*, and ASU 2014-18, *Business Combinations (Topic 805): Accounting for Identifiable Intangible Assets in a Business Combination*, to nonprofit organizations.

Background of ASU 2014-02 and ASU 2014-18

In 2014, FASB issued ASU 2014-02 and ASU 2014-18 to simplify the subsequent accounting for goodwill and the accounting for certain identifiable intangible assets in a business combination. Those ASUs were issued in response to concerns from private company stakeholders that the requirements for accounting for goodwill and identifiable intangible assets that were acquired in a business combination was too costly and complex when considering the associated benefits.

Prior to the issuance of ASU 2014-02, under Topic 350, *Intangibles—Goodwill and Other*, entities were required to test goodwill for impairment annually at the reporting unit level. Prior to the issuance of 2014-18, under Topic 805, *Accounting for Identifiable Intangible Assets in a Business Combination*, an acquirer was required to recognize most assets acquired and liabilities assumed at their acquisition-date fair values. As part of that process, entities needed to consider identifiable intangible assets and measure the fair value for such items.

The issuance of ASU 2014-02 and 2014-18 provided an accounting alternative that simplified the subsequent accounting for goodwill and certain identifiable intangible assets in a business combination. Those ASUs applied to all entities except for public entities, nonprofit entities, and employee benefit plans.

Why Was the ASU Issued?

When ASU 2014-02 and 2014-18 were issued, the amendments excluded nonprofit entities, even though FASB acknowledged that the issues addressed in those ASUs were not limited to private companies. As a result, the FASB issued ASU 2019-06 to extend the accounting alternatives to nonprofit entities. The accounting alternatives will simplify the accounting and reporting for nonprofit organizations, which will reduce the costs of preparing financial statements and reduce the complexity associated with accounting for goodwill and the measurement of certain identifiable intangible assets. Additionally, the alternatives will allow financial statement users to focus more on a nonprofit organization's mission, operations, sustainability, and cash flows.

Accounting Alternative for Goodwill

Scope. The accounting alternative in Topic 350 only applies to the following transactions or activities: goodwill recognized in a business combination after initial recognition and measurement, amounts recognized as goodwill in applying the equity method of accounting, and the excess reorganization value recognized by entities that adopt *fresh-start reporting* under GAAP for reorganizations.

Once a nonprofit organization elects the accounting alternative, it must apply all of the requirements for subsequent measurement, derecognition, presentation, and disclosure upon election. The accounting alternative should also be applied to existing goodwill and all future additions to goodwill that fall within the scope of the accounting alternative.

Amortization of Goodwill. The accounting alternative requires the amortization of goodwill on a straight-line basis over ten years. A period of less than ten years may be used if the shorter useful life is more appropriate. A nonprofit organization may revise the remaining useful life of an amortizable unit of goodwill if events or changes in circumstances warrant a change, as long as the cumulative period of amortization does not exceed ten years. Once the remaining useful life is revised, the remaining carrying amount of goodwill should be amortized prospectively on a straight-line basis over the revised remaining useful life.

Testing for Impairment. Although goodwill is amortized under the accounting alternative, a nonprofit organization must test goodwill for impairment using qualitative and/or quantitative tests. Upon the adoption of ASU 2019-06, the nonprofit organization—

- must make an accounting policy election to test goodwill at either the entity level *or* the reporting unit level, and
- tests for impairment if a triggering event (an event or a change in circumstances) occurs that indicates that

the fair value of the nonprofit entity (or the reporting unit) may be below its carrying amount.

An annual impairment test is not required.

Other Presentation Matters and Disclosures. The accounting alternative clarifies that the aggregate amount of goodwill should be presented as a separate line item in the statement of financial position, net of accumulated amortization and impairment. If a nonprofit organization elects the accounting alternative, the organization is not required to present changes in goodwill in a tabular reconciliation. In addition, the accounting alternative requires additional disclosures about amortization periods, amortization expense, and accumulated amortization.

Accounting Alternative for Identifiable Intangible Assets in a Business Combination

Scope. The accounting alternative in Topic 805 applies to nonprofit organizations that are required to recognize or consider fair value of intangible assets as a result of the following:

- applying the acquisition method for a business combination,
- evaluating the nature of a difference between an investment's carrying amount and the underlying equity in the net asset of an investee when applying the equity method of accounting, or
- adopting *fresh start accounting* for reorganizations.

Simplifying Accounting. When elected, the accounting alternative allows a nonprofit organization to bypass the separate recognition of the following:

- customer-related intangible assets unless they can be sold or licensed independently from other assets of a business, and
- noncompetition agreements.

In other words, such items would be considered to be part of goodwill. Thus, as a result of electing the accounting alternative, entities would recognize fewer intangible assets in a business combination.

Practical Consideration:

If a nonprofit organization elects the accounting alternative for identifiable intangible assets, it must also adopt the accounting alternative for goodwill. However, an organization that elects to adopt the accounting alternative for goodwill is not required to adopt the accounting alternative for identifiable intangible assets.

Effective Date and Transition

The guidance in ASU 2019-06 was effective upon issuance. If elected, a nonprofit organization should apply the goodwill accounting alternative prospectively for all existing goodwill and for all new goodwill generated in acquisitions. If the nonprofit organization elects to apply the accounting alternative for accounting for identifiable intangible assets, it should be applied prospectively upon the occurrence of the first transaction within the scope of the alternative.

FASB Staff Q&A on Grant Agreements—Part 1

In June 2018, the FASB issued ASU 2018-08, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. In June 2019, the FASB issued Staff Q&A, *Subtopic 958-605, Application of the Limited Discretion Indicator and Accounting for Cost-Sharing Provisions in a Grant Agreement*, to address a few issues implementing ASU 2018-08.

Subtopic 958-605, *Not-for-Profit Entities—Revenue Recognition*, provides guidance for entities when determining whether a contribution is conditional based on whether an agreement includes a barrier that must be overcome to be entitled to funds and either a right of return of assets transferred or a right of release of a promisor's obligation to transfer assets. The following indicators help an entity assess whether an agreement contains a barrier to entitlement:

- The inclusion of a measurable performance-related barrier or other measurable barrier.
- The extent to which a stipulation limits discretion by the recipient on the conduct of an activity.
- Whether a stipulation is related to the purpose of the agreement.

FASB ASC 958-605-25-5D provides a table that lists indicators that may help in determining if an agreement contains a barrier. Stakeholders indicated that additional guidance might be useful in the areas of the limited discretion indicator discussed below and cost-sharing provisions that will be covered in Part 2 of this article.

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Limited Discretion Indicator

The Q&A addresses if the limited discretion indicator is applicable as a barrier to entitlement when a grant agreement includes a budget and related stipulations. The Q&A states that entities should primarily consider if a requirement within an agreement limits the ability of the recipient to conduct an activity at their discretion and represents a barrier to entitlement of the assets. This type of limitation is more specific than a donor-imposed restriction that limits the use of a contribution to a particular activity or time period but does not really place requirements on how to perform the activity for the recipient to be entitled to the assets. The Q&A also states that the existence of a budget, which is typically produced by a nonprofit organization in the process of submitting a grant proposal, and a requirement to keep to the budget within certain limits would not be factors for considering whether a barrier exists. Requirements other than adhering to a budget, such as the need to incur qualifying expenses, would typically need to be present for a barrier to entitlement to exist as a limited discretion indicator.

Auditing Briefs

OMB RELEASES THE 2019 COMPLIANCE SUPPLEMENT. As we went to press, the OMB released the 2019 edition of the *OMB Compliance Supplement*. The Compliance Supplement can be accessed at **www.whitehouse.gov/omb/management/office-federal-financial-management/** (single pdf file) or at **www.aicpa.org/interestareas/governmentalauditquality/resources/singleaudit/2019-omb-compliance-supplement.html** (separate pdf files by section as split out by the AICPA). There are a significant number of changes in the new Compliance Supplement. Pay particular attention to the revised guidance on determining which compliance requirements are subject to audit (versus being applicable compliance requirements). Each federal agency has been mandated by OMB to limit the number of compliance requirements subject to the audit to six, with the exception of the Research and Development cluster, which has been permitted to identify seven compliance requirements as subject to the audit. (For this purpose, the requirements relating to A. Activities Allowed and Unallowed and B. Allowable Costs and Cost Principles are treated as one requirement.) The Part 2 matrix has been revised to reflect this change for all programs, as well as the related program sections in Parts 4 and 5. Additionally, *this six-requirement mandate does not apply to programs not included in this Supplement*.

Carefully review the instructions in Part 1, the changes in the matrix in Part 2, new guidance on internal control in Part 6, and the list of changes in Appendix V. We'll provide more details on the Compliance Supplement in next month's edition of *The PPC Nonprofit Update*. Remember that the 2019 Compliance Supplement is effective for audits of fiscal years that began after June 30, 2018, and supersedes the Compliance Supplements dated June 2018 and June 2017.

2019 AICPA GUIDE ON YELLOW BOOK AND SINGLE AUDITS RELEASED. The AICPA released the 2019 of its Audit Guide, *Government Auditing Standards and Single Audits*, in early July. We'll provide more details on the Audit Guide in next month's edition of *The PPC Nonprofit Update*.