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ASU Clarifies Grants and Contributions—Part 1

After the issuance of ASU 2014-09, *Revenue from Contracts with Customers*, one of the issues identified for nonprofit organizations was how to determine which grants are within the scope of the new revenue recognition standard. FASB noted that difficulty in characterizing grants and similar contracts with resource providers as either (a) exchange transactions or (b) contributions is a long-standing challenge, which results in diversity in practice.

The FASB also acknowledged that ASU 2014-09 placed a new focus on those difficulties. In addition, once a transaction was determined to be a contribution, difficulty in distinguishing between conditions on which a promised contribution depends and donor-imposed restrictions, which typically only place limits on a specific activity, create further diversity.

In response, in June 2018, FASB issued ASU 2018-08, *Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made*, to clarify the existing guidance to address these diversities.

This article covers:

- distinguishing an exchange transaction from a contribution,
- classifying contribution revenue,
- understanding disclosure requirements, and
- understanding the effective dates and transition requirements.

In an upcoming issue, we'll tackle distinguishing a donor-imposed condition from a donor-imposed restriction.

Distinguishing an Exchange Transaction from a Contribution

The basic approach to distinguishing an exchange transaction from a contribution is essentially unchanged. The transaction must be evaluated to determine whether the resource provider is receiving commensurate value in return for the resources transferred.

In this Issue:

In order to ensure this evaluation is more consistent from organization to organization, the ASU adds the following guidance:

- Explicitly states that a benefit received by the public as a result of the assets transferred is not equivalent to commensurate value received by the resource provider. Thus, when the potential benefits resulting from a transfer of assets are intended to serve the general public, such that the general public is receiving the primary benefit, that transfer of assets is considered a contribution.
- Explicitly states that execution of a resource provider's mission or the positive sentiment from acting as a donor is not equivalent to commensurate value received. The benefit from furthering a resource provider's mission or the positive sentiment from acting as a donor does not constitute commensurate value. Determining whether a transaction is an exchange should focus on whether reciprocal benefits flow between two parties to an agreement and not on the resource provider's role, mission, or obligation.
- Replaces the list of indicators table in FASB ASC 958-605-55-8 with a series of paragraphs in FASB ASC 958-605-15 (scope section), retaining the fundamental nature of the indicator in current GAAP but providing clarification.
- Reiterates that, consistent with current GAAP, a transfer of assets is neither a contribution made nor a contribution received if it is a payment from a third-party payer on behalf of an existing transaction between the nonprofit organization and an identified customer. Examples include Medicare, Medicaid, and Pell Grants.
- Reiterates the type of resource provider does not dictate whether a transfer is accounted for as an exchange transaction or a contribution. Consistent with current GAAP, regardless of whether a transfer of assets is from a government agency, a foundation, a corporation, or other entity, the difficulties in determining whether a transfer is an exchange transaction or a contribution are essentially the same.
- Reiterates that while the terms donation, gift, grant, award, and sponsorship may be used in referring to the transfer from a resource provider to a nonprofit organization, determining whether a transaction is a contribution depends on whether commensurate value was received in exchange, not upon the terminology used.

Classification of Contribution Revenue

Nonprofit organizations have the option to elect to have an accounting policy to report donor-restricted contributions—whose restrictions are met in the same period in which the corresponding revenue is recognized—as support without donor restrictions as long as the same policy election is elected for donor-restricted investment return. Often a condition and a restriction expire in the same period.

Implementation of ASU 2018-08 will likely result in more grants being reported as conditional contributions, which will significantly increase the amount reported in the release from the restrictions. As a result, ASU 2018-08 amends the current GAAP requirements to allow organizations to elect the policy to report restricted contributions that were initially conditional as increases in net assets without donor restrictions, independent of the elections for other donor-restricted contributions and investment return.

FASB noted that, in many instances, the condition could be met and the restriction satisfied at precisely the same time; and there essentially is no separate restriction that needs to be tracked by the organization. This is especially true for many governmental grants for which the recipient must incur qualifying expenses.

Disclosures

Although ASU 2018-08 does not add any additional disclosure requirements, the implementation of the new standards will most likely result in more agreements being classified as conditional. These agreements therefore will now be subject to the disclosure requirements for conditional promises to give in FASB ASC 958-310-50-2.

In addition, as noted at FASB ASC 720-25-50-1, donors, including grant-making organizations, are required by FASB ASC 450, *Contingencies*, and FASB ASC 470, *Debt*, to provide information about the conditional and unconditional promises to give that they make.

Effective Date and Transition

ASU 2018-08 is effective as follows:

- Most nonprofit organizations should apply the amendments for transactions in which the entity serves as the resource recipient to annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019.
- Most nonprofit organizations should apply the amendments for transactions in which the entity serves as the resource provider to annual periods beginning after December 15, 2019, and interim periods within annual periods beginning after December 15, 2020.
- Early adoption is permitted.

An entity should apply the amendments in ASU 2018-08 on a modified prospective basis in the first set of financial statements following the effective date to agreements that either are not completed as of the effective date, or entered into after the effective date.

No prior-period results should be restated, and there should be no cumulative-effect adjustment to opening net assets at the beginning of the year of adoption. Retrospective application to each period presented in the financial statements in accordance with the guidance on accounting changes in FASB ASC 250-10-45-5 to 45-10 is permitted.

Practical Consideration:

In an upcoming issue of *The PPC Nonprofit Update*, look for information on distinguishing a donor-imposed condition from a donor-imposed restriction under ASU 2018-08.

Website of Interest

The following website may be of interest to the nonprofit sector.

https://www.google.com/grants

Google Ad Grants is offering $10,000 of in-kind advertising every month to qualifying nonprofit organizations through Google's online advertising solution, Google Ads.

Google Ad Grants works just like Google Ads online advertising, by displaying your message to people who are searching for nonprofits just like yours. Expand your reach…recruit more volunteers…attract more donations…share your story.

Qualifying organizations must hold a valid charity status (general guidelines and country-specific requirements are provided at **https://support.google.com/nonprofits**), be validated by TechSoup, acknowledge and agree to Google's required certifications regarding nondiscrimination and donation receipt and use, and have a live website with substantial content. Signing up with Google for Nonprofits is also required.

Accounting and Auditing Briefs

GOODWILL AND INTANGIBLE ASSETS EXPOSURE DRAFT. On December 20, 2018, the FASB issued an exposure draft of a proposed ASU, *Intangibles—Goodwill and Other (Topic 350), Business Combinations (Topic 805), and Not-for-Profit Entities (Topic 958): Extending the Private Company Accounting Alternatives on Goodwill and Certain Identifiable Intangible Assets to Not-for-Profit Entities*. The purpose of the Exposure Draft is to allow nonprofit organizations to utilize some of the practical expedients that private companies have had available since the issuance of 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*. The Exposure Draft doesn't change any of the guidance in ASU 2014-02 or ASU 2014-18; however, there's a separate project on the FASB's agenda to look at whether there should be additional changes to the accounting guidance in those ASUs.

The practical expedients being extended to nonprofit organizations include the ability to amortize goodwill on a straight-line basis over 10 years (or less if a shorter life is more appropriate) and to subsume certain customer-related intangible assets into goodwill following a business combination. Either, neither, or both practical expedients could be adopted by a nonprofit organization.

Practical Consideration:

The exposure draft and the current status of the project are available at **www.fasb.org**.

OMB COMPLIANCE SUPPLEMENT STATUS. The Office of Management and Budget (OMB) had planned to target the release of its annual edition of the OMB Compliance Supplement for early spring. However, the OMB has missed its target release period the last few years, even when the release was planned for later in the spring or early summer. So, understandably, most of us are not very hopeful for a very early release this year. And, with the government shutdown in late December going into January, many agencies and other stakeholders faced challenges in providing comments to OMB about key changes to their federal programs and the Compliance Supplement. The 2019 Compliance Supplement is expected to be issued as a complete Compliance Supplement (like the format previously issued by OMB). It will supersede the 2017 and 2018 Compliance Supplements that you are currently using together for single audits. We'll update you on the Compliance Supplement's contents when it is released. In the meantime, you can check for the new Compliance Supplement at **www.whitehouse.gov/omb/management/office-federal-financial-management/**.

IRS's Data-driven Approach

The IRS is increasing their reliance on data-driven approaches (including in the tax-exempt sector) to increase tax compliance. Due to many years of an increased work load and decreased funding, the IRS is working smarter and, like many businesses and organizations, leaning on technology.

Each year the Tax Exempt and Government Entities (TE/GE) Business Operating Division commissioner publishes a Program Letter highlighting the previous year's accomplishments and the current year's goals. Included in the recent Program Letter is a section on The Fiscal Year 2019 Compliance Program that contains a discussion of the data-driven approaches the IRS is leveraging to provide resources that focus on issues having the greatest impact. Using return data and historical information to identify the highest risk areas of non-compliance is one of TE/GE's priorities. TE/GE is committed to integrating data into its processes and procedures.

Note: Other highlights of the Program Letter were discussed in the January 2019 edition of this newsletter.

What Data Is Obtained?

To accomplish this goal, TE/GE has partnered with the Office of the Research, Applied Analytics, and Statistics (RAAS) of the IRS to identify noncompliance of the rules using data-driven approaches. During fiscal year 2018, RAAS reviewed such items as private benefit and private inurement, officer business partnerships, underreported credit card income, related employee issues, and partnerships with for-profit entities. RAAS will be testing new approaches to identify noncompliance during the current year. The IRS is also using data visualization tools and making them more widely available within the IRS to simplify the identification of opportunities to enhance its operations.

Focus of Examinations

According to Margaret Von Lienen, IRS Director—Exempt Organizations, in a December 2018 TE/GE webinar, over 50% of the fiscal year 2018 exams were selected for examination using the data-driven method. These exams focused on private inurement and private benefit issues. In evaluating the current compliance strategy process, they are considering the most appropriate, cost-effective, and least intrusive methods including—

- educational programs,
- soft letter compliance review,
- compliance checks,
- correspondence examinations, and
- field examinations.

It appears the IRS is using technology to focus on non-compliant organizations.

Practical Consideration:

The good news for compliant organizations is that a letter from the IRS does not necessarily signify a full-blown exam. An organization with a complete and well-prepared return may only be required to respond to a few targeted issues.

Reasonable Cause for Late Filing Penalty Abatement

The IRS is currently rejecting incomplete Form 990s. According to Margaret Von Lienen, IRS Director—Exempt Organizations, 10% of paper filed Form 990s were rejected in fiscal year 2018. Since the 2008 drastic revision of the form, the IRS had not been rejecting incomplete returns, providing preparers a grace period to get up to speed with the drastically revised form and the new schedules. That grace period has ended.

Late filing penalty exposure. Incomplete returns that are electronically filed are immediately rejected. Consequently, organizations are alerted, can immediately make any necessary corrections, and may resubmit the return timely. However, organizations that file paper returns close to the due date run the risk of not receiving the "bounced" (i.e., rejected) incomplete return in time to resubmit corrections and a complete return before the deadline. Bounced returns are considered filed on the date a complete and accurate return is received by the IRS [IRC Sec. 6652(c)(1)(A)(ii)].

A bounced return will begin accruing late filing penalties of $20 per day (for organizations with gross annual receipts or not more than $1 million), not to exceed the lesser of $10,000 or 5% of the organization's gross annual receipts. Organizations with gross annual receipts greater than $1 million are subject to a $100 per day penalty, not to exceed $50,000 [IRC Sec. 6652(c)(1)(A)]. These amounts are indexed for inflation.

Avoiding the Penalty—An Ounce of Prevention

The May 2018 edition of this newsletter included *Common Return Errors for Form 990 Series* that lists common errors causing a return to be considered incomplete. As mentioned in that article, check the entire heading of the form carefully for completeness. Schedule O narratives may be required for certain responses throughout the Form 900, and are mandatory for Part VI, Line 11b (describing the organization's process for reviewing the Form 990) and Part VI, Line 19 (describing whether and how the organization made certain governing documents available to the public during the year). Omitting the required narrative on Schedule O may render a return incomplete.

Abating the Penalty—Reasonable Cause

Before paying any late filing penalty, submit a letter requesting reasonable cause penalty abatement under IRC Sec. 6652(c)(5). Be sure to mail the letter using certified or registered mail and request a return receipt.

A clean compliance history is required to receive penalty abatement. If the organization has not been subject to late filing penalties in the past three years, more favorable consideration will be received.

A reasonable cause penalty abatement request should:

- Note the notice name and date in the subject line if this is in response to a notice.
- State the (1) organization's name, (2) employer identification number, (3) return form number, and (4) year. If applicable, provide the professional service provider's name and the date (month/day/year) of Form 2848 (Power of Attorney).
- State that abatement is requested for the failure to file penalty because the taxpayer meets the reasonable cause criteria [as stated in IRC Sec. 6652(c)(5) and Reg. 301.6652-1(f), failure to file certain information returns; showing of reasonable cause].
- Provide an explanation for any penalties that have been assessed and/or abated in the past three years (it is best to include this in the introduction because the IRS agent may stop reading the letter if a prior penalty issue is noted).
- State, if this penalty relief request is denied, that a hearing with the IRS Office of Appeals is requested.
- Discuss the facts and circumstances that merit penalty relief, including the following:
    - What happened and when.
    - Note a quick response once the organization was notified the return was rejected.
    - Note the reasons that comprise reasonable cause (see Internal Revenue Manual 20.1.1.3.2), including (but not limited to) if the error/omissions were due to death, serious illness, or unavoidable absence; fire, casualty, or other disaster; inability to obtain records; mistake; erroneous advice or reliance on others (written or oral); ignorance of the law; or undue hardship.
    - Discuss how the facts and circumstances resulted in the taxpayer not complying with the filing requirements.
- Note that this is an isolated event and that the organization has a clean compliance history (if applicable) and has promptly attempted to comply with the IRS. If true, note that no penalties have been added to or abated from the taxpayer's account during any of the previous three tax years.
- Discuss how the organization's facts and circumstances relate to the previously referenced law and authority. Include how the situation demonstrates that the noncompliance was not due to willful neglect and was due to reasonable cause. Note that the organization's immediate efforts to comply prove that ordinary business care and prudence was exercised. Also explain any steps the organization has taken to ensure future compliance.
- State the applicable law and authority supporting the relief from the failure to file penalties including IRC Sec. 6652(c)(5), Reg. 301.6652-1(f), and the Internal Revenue Manual 20.1.1.3.2.
- Provide a contact phone number for the individual signing the letter.
- Include a true and correct statement above the signature line. The letter should be signed by either the appropriate officer of the organization, or the professional with power of attorney.

For more guidance, tools, and an easy-to-complete sample penalty abatement letter, see Chapter 62 of *PPC's IRS Response Library*.

Practical Consideration:

Electronic filing can mitigate the risk of filing an incomplete return. Paper-filed returns should be carefully reviewed for completeness. However, if a return is rejected and consequently filed late, consider if the failure-to-file penalties might be abated due to reasonable cause before paying the penalty.

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Form 990-T for 2018 Is Revised

The January 2019 issue of this newsletter indicated that Schedule M is new for 2018. As mentioned in the article, it is used to report the separate unrelated trade or business (UTB) activities for an exempt organization with more than one unrelated activity. However, it is not the only change to the form for 2018.

Revisions Needed to Comply with TCJA

The changes are required so that an exempt organization can report its UTB and/or transportation fringe benefits as provided in the 2017 Tax Cuts and Jobs Act (TCJA). These revisions include:

- *Heading Item H.* Exempt organizations must now indicate the number of UTBs.
- *Specific Deduction.* The $1,000 specific deduction allowed by IRC Sec. 512(b)(12) is reported on Form 990-T, Part III. Previously, it was included in Part II.
- *Net Operating Loss (NOL).* Part II and Part III include lines for net operating losses. NOLs originating on or after January 1, 2018, are reported in Part II. An NOL arising before January 1, 2018, is reported in Part III.
- *Transportation Fringe Benefits.* These are added back to UBTI in Part III.
- *Organizations Taxable as Corporations.* The tax computation, currently included in Part IV, reflects the corporate tax rate of 21%.
- *Alternative Minimum Tax (AMT).* The tax computation in Part IV also reflects the law change for AMT. AMT does not apply for corporate organizations in 2018.
- *Election to Pay Section 965 Net Tax Liability in Installments.* Part V, Tax and Payments, has added a line for an organization to pay the tax from Form 965-A or 965-B. Generally, Form 965 is used to compute deemed taxes on deferred foreign income.

For those organizations familiar with Form 990-T, Part III was added for 2018. Parts III, IV, and V from previous years are now Parts IV, V, and VI. For more in-depth discussion on preparation of Form 990-T, see *PPC's 990 Deskbook*.

Tax Brief

2019 MILEAGE RATES. The optional standard mileage rate for the business use of an automobile has increased from 54.5 cents to 58 cents per mile for 2019 (Notice 2019-2, 2019-2 IRB 281). The new rate also applies to mileage allowances that are paid both to an employee and for transportation expenses paid or incurred by the employee. The allowance for medical mileage is increased from 18 cents to 20 cents. The mileage rate for charitable contributions [fixed under IRC Sec. 170(i)] remains unchanged at 14 cents per mile.

EXTENDERS THAT HAVE NOT (YET) BEEN EXTENDED. As of the date of this publication, dozens of temporary tax provisions that expired December 31, 2017, have not yet been extended to 2018 or 2019. These are typically extended for one or two years at a time by Congress. The expired provisions include individual, business, and energy provisions, including some credits that can be claimed on Form 990-T. The list of expired provisions can be found at **www.jct.gov/publications.html?func=startdown&id=5157**. Senator Grassley, Chairman of the Senate Finance Committee, indicated that he intends to guide extenders legislation to final enactment. If successful, the IRS will need to reprogram its processing systems to handle 2018 returns with retroactively extended provisions. Practitioners should monitor legislation.