Practical Landscape of ASU 2018-08

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Discussion of Accounting Standards Update 2018-08

Topic before us is the **IMPACT** of FASB's June 2018 release of ASU 2018-08, "*Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made.*" Materials here cover –

- The scope of the update's clarifications (four-fold):
  1. Proper characterization of revenue as either –
     - Exchange Transaction OR Grant
     - If Grant, Conditional Grant or Not
  2. Key elements of the pertinent definitions
  3. Required disclosures
  4. Effective dates and implementation
- The resulting tax effects and potential issues thereunder
  - Form 990 and 990-PF presentation
  - Qualifying distributions
- Summarizing key points

Scope

- Clarifies **proper characterization of revenue** under Accounting Standards Codification (ASC) 958 *Not-for-Profit Entities* specific to revenue recognition of contributions (and, by extension, revenues from exchange transactions although these are accounted for under ASC 606).
- The relevant clarifications, unless otherwise indicated, affect **both** NFP and business entities regardless of which side of a putative contribution they are on (i.e., whether receiving OR providing the dollars at issue).
- Per ASC 958-605, **when** a contribution is to be recognized on the organization's books depends on whether it is conditional or not.
  - Not required to mirror judgment/accounting treatment between grantor and grantee entities
  - But both grantor and grantee must apply the same accounting guidance
- The term used to describe the dollars at issue (grant, gift, donation, contribution, support) is irrelevant for purposes of ASC 958-605.

Key Elements

- ASU 2018-08 did not significantly change the underlying principles of prior-existing GAAP guidance for grants and contributions
- But it DID provide clarity on both
  - Exchange vs. non-exchange transactions
    - Specifically, how to determine which of these GAAP revenue categories applies
  - Conditional vs. unconditional grants
    - The results here affect the timing of the revenue (or expense) being recognized
- ASU 2018-08 updates GAAP definitions of some key terms

Contribution vs. Exchange (ASC 958-605-15)

- This part was greatly expanded with 958-605-15-5 having a new "-15A" with five sub-parts
- Focus of add-ons here is detailing how "commensurate value" received by the resource provider is what signifies an EXCHANGE.
- Clarifies that a resource provider (whether a foundation, government agency, etc.) is not synonymous with the general public.
- **Sets out that unless a government agency payor *directly* receives goods or services of commensurate value (to the resources it has provided), the transaction typically will be considered a contribution**

Contribution – Components	Exchange – Components
A benefit received by the public. Only incidental or indirect value is received by the resource provider.	A resource provider (including a foundation, a government agency, or other) is not synonymous with the general public.
Execution of a resource provider's mission or the positive sentiment from acting as a donor does not constitute commensurate value received by a resource provider for purposes of determining whether a transfer of assets is a contribution or an exchange.	Expressed intent by both the recipient and the resource provider is to exchange resources for goods or services that are of commensurate value.
The resource provider has full discretion in determining the amount of the transferred assets.	Both the recipient and resource provider agree on the amount and that the goods or services are of commensurate value.
Penalties for failure to comply with the terms of the agreement are limited to the delivery of assets or services already provided and the return of unspent amounts.	Penalties for failure to comply with the terms of the agreement may include economic forfeiture beyond the amount of assets transferred by the resource provider.
Activity is to be planned and carried out by the NFP, and the NFP has the right to the benefits of carrying out the activity.	The resource provider provides materials to be tested and retains the right to any patents or other results of the activity.
	Transfers of assets that are part of an existing exchange transaction between a recipient and an identified customer (for example, Medicare, Medicaid, Pell Grants, tuition).

Ramifications

- Government agency funding under ASU 2018-18's changes are now more consistently determined to be contributions or grants, rather than exchange transactions.
- The same criteria for differentiating exchange transactions from contributions or grants is to be applied to all resource providers (for example, foundations and other grantmaking entities).

In the Case of Contributions, Promises to Give Must be Categorized – They are Either Conditional or Unconditional

- A donor-imposed condition "exists" only if **both** of the following are in place (all this is set out in ASC 958-605-25-5A):
  - One or more **barriers** are present that must be overcome before a recipient is entitled to the assets that are transferred or promised, and
  - There exists a **right of return** to the promisor for:
    - ❑ Assets they have transferred (or to any reduction, settlement, or cancellation of the recipient's liabilities); OR
    - ❑ A right of release of the promisor from its obligation to transfer assets (or to reduce, settle, or cancel the recipient's liabilities).

What Indicates the Presence of a Barrier? 958-605-25-5 Gives Indicators

- Three "indicators" are provided with the statement that these "may be helpful in determining whether an agreement contains a barrier":

  1. Measurable performance-related barrier or another measurable barrier is typically contingent upon achieving within a specific timeframe:
     - A specified level of service
     - An identified number of units of output
     - **A specified outcome**
     - **Occurrence of a stipulated event (for example, a match being achieved)**
  2. Limited discretion by the recipient on the conduct of an activity is another potential indicator of a barrier:
     - Requirement to follow specific guidelines re: qualifying or allowable expenses
     - Requirement to hire specific individuals
     - A specific protocol that must be adhered to
  3. Stipulations that are related to the purpose of the agreement:
     - Generally excluded here are administrative tasks such as reporting (e.g., having to make annual report or updates re performance)

- **However,** no single indicator is determinative
- Also, a probability assessment *as to whether the recipient is likely to meet the stipulation* **is NOT a factor**!

Conditions (i.e., Barrier)? ASK yourself if in these situations a barrier IS present:

- A private foundation makes a grant to a humane society to build a new shelter in a rural township. The shelter will be built in accordance with the budget submitted by the humane society in its grant proposal.
- Consider the same grant as above, and in addition, the shelter must house at least 100 animals and the shelter must be operational and at 50% occupancy within 2 years.
- NEW scenario(s) for evaluation – what if the following clauses are part of a Grant Agreement:
  - ❑ Grant funds may only be used for the Project.
  - ❑ Budget cost category changes of more than 10% must be approved in writing by the Grantor.

Conditions (i.e., Barrier), continued hypotheticals

- Grantee may not use grant funds for any expenses incurred before the start date of the grant.
- You must provide the Grantor with annual progress reports.
- Further grant payments are contingent on the satisfaction of “specified outputs, milestones, and/or reporting deliverables.”

958-605-25-5B Sets out Right of Return/Release

- It must be determinable from the agreement (or other document referenced in the agreement) **that a recipient is only entitled to the transferred assets or a future transfer of assets if it has overcome the barrier.**
- The agreement does NOT need to include the specific phrase “right of return” or “release from obligation.”
- The agreement must be sufficiently clear to support a reasonable conclusion.
- Examples of right of return being expressed:
  - Any grant funds unexpended or uncommitted at the end of the grant period must be returned to the Foundation.
  - The Foundation’s payment is contingent on satisfaction of the listed milestone and/or reporting deliverable.

GAAP Revenue Recognition With Respect to Receipt of a Conditional Contribution is Set out in ASC 958-605-25-11

- Revenue is recognized when the condition or conditions on which they depend are substantially met
- Funds received in advance of substantially meeting donor-imposed conditions are recorded as a refundable advance (liability)
- Effect
  - Revenue for multiple year grants may be recognized over the term of the grant as conditions are satisfied, extending the revenue recognition to multiple periods.
  - This may change the revenue patterns for recipients that previously determined conditions were “more likely than not” to be met, which resulted in recognizing grant revenue entirely at the time the grant was received.

GAAP Expense Recognition With Respect to a Provider Having Made a Conditional Grant (ASC 720-25-25)

- Unconditional contributions made are recognized as expenses in the period made.
- But funds provided by a resource provider in favor of a conditional contribution to the grantee before conditions are substantially satisfied are not an expense of the resource provider (for GAAP purposes).
- Until the conditions have been substantially satisfied, the funds advanced would be recorded as an asset, such as a prepaid grant or refundable grant.
- Resource providers are not required to obtain information from grantees relating to their overcoming the barriers but can use their own judgement.
- Resource providers are not required to mirror accounting treatment used by the grantee organization. *THIS IS A BIG DEAL and also helpful!*

Required Disclosures in GAAP Audit on Part of…

Recipients	Resource Providers
No additional recurring disclosures were added by ASU 2018-08	No additional recurring disclosure were added by ASU 2018-08
Guidance in ASC 958 includes disclosures for both unconditional and conditional promises to give	Guidance in ASC 958 includes a cross reference to the disclosures set out in ASC 450, Contingencies, and in ASC 470, Debt
For conditional promises to give need disclose: • Total of amounts promised • A description and amount for each group of promises having similar characteristics	
Disclose adoption of ASU 2018-08	Disclose adoption of ASU 2018-08

Effective Dates Differed Depending on Whether Providing or Receiving
(Resource Providers generally implemented 1 year later than Recipients!)

Recipients	Annual periods beginning after 12/15/18 (Calendar 2019, FYE 2020)
	Interim periods beginning after 12/15/19 (Calendar 2020, FYE 2021)
	Public Business Entities**: annual periods beginning after 6/15/18, including interim periods
Resource Providers	Annual periods beginning after 12/15/19 (Calendar 2020, FYE 2021)
	Interim periods beginning after 12/15/20 (Calendar 2021, FYE 2022
	Public Business Entities**: annual periods beginning after 12/15/18, including interim periods

** A "Public Business Entity" is a NFP that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market.

Implementation/Transition

- Modified Prospective Approach
  - Applies to all agreements that were/are:
    - Existing at the ASU's effective date (but only applies *to the portion of existing agreements* not previously recognized)
    - Entered into after the ASU's effective date
  - But no restatement is required for prior amounts recognized

- Also, Note that Retrospective Application was Permitted

Tax Impact = Grantor versus Grantor "Sides"

Grantor (PF)-Side: IRC section 4942(g)(1) Defines "Qualified Distributions" for Private Foundations

- QD is any amount (including that portion of reasonable and necessary administrative expenses) "***paid*** to accomplish one or more purposes described in section 170(c)(1) or (2)(B) . . . ." This includes:
  - contributions
  - asset acquisitions
  - PRIs
- NOT included are grants to certain PFs and grants to an organization *controlled by* the contributing PF or its disqualified persons:
  - ➢ Pertinent Regulation (53.4942(a)-3(a)(3); also *see,* overall, 1.507-2) notes that "control" relates NOT to the presence of "restrictions" on the amounts or property paid, *but to whether* the grantee organization is controlled
  - ➢ Earmarked use of funds is also an issue if same voids grant going to section 4945-permitted recipient

What Does “Paid” Mean?

- IRC section 4942 is different than IRC section 170. Section 4942 does not generally apply the concept of an “incomplete” gift, and it specifically utilizes the “cash receipts and disbursements method of accounting” per Regs. 53.4942(a)-3(a)(1).
- Instead, section 4942 requires that the amount “paid” must be able to be used toward accomplishing one or more purposes described in section 170(c)(2)(B). **Regs. 53.4942(a)-3(a)(2)(i).**

Discussion Example #1

Private foundation makes a cash grant to a public charity of $1M as an incentive and capacity building grant. The public charity can deposit the $1M in any financial institution(s) of its choice but may only invest in a way in which the principal is 100% protected and all earnings are separately accounted for. The charity may keep and spend the $1M and all of the earnings for any capacity building purpose of its choice once it has raised $1M from new previously unrealized funding sources. If they fail after 5 years the grantee must return the $1M plus any earnings realized from the temporary investment of the funds.

GAAP treatment? Easy . . . this IS a conditional grant . . .

Form 990-PF treatment?

What about community foundation's (or other public charity's) Form 990 treatment?

- When can the PF take the $1M as a qualifying distribution?
- Are you sure this is a grant and not a loan/PRI?
- How about treating this as a "refundable loan?"

Discussion Example #2

Private foundation puts $1M on deposit at a rural nonprofit credit union for the purpose of increasing the assets on deposit so the institution has an increased ability to make more local loans and assist with local economic development.

- Can the foundation take a qualifying distribution when it puts the money on deposit with the credit union?

  GAAP treatment? Easy

  Form 990-PF treatment?

  What about community foundation's (or other public charity's) Form 990 treatment?

Program Related Investment Characterization ….

Might a private foundation treat a conditional grant as a PRI (i.e., as a “refundable grant”) and record it as a loan on the balance sheet?

Considerations:

- A PRI is certainly more work in many cases than a grant
- A PRI could be a jeopardizing investment
- Need to impute interest on a below market loan
- Potential for OID on loans over $250k for tax purposes
- Treating as something other than what it is? always potentially problematic

Grantee Side

- Per GAAP books and records, a conditional grant is only recognized when the pertinent condition(s) are satisfied
  - Thus, for public support test (PST) purposes, an accrual-based taxpayer's grant receipt only occurs in the year in which satisfaction occurs
  - For entities who prior-recorded a grant "as revenue" when originally received, any GAAP adjustment (note though, that such an adjustment is NOT required) altering the recording of revenue achieved in one or more back years would also be reflected in the PST "scheduling" of the affected back year(s)
  - Grantees desiring "more public support" (for example, desiring to book a grant from a 509(a)(1)/170(b)(1)(A)(vi) public charity such as a community foundation immediately since same will count as 100% public support) should be aware of need to have such grant NOT be conditional!

Summarizing Points/Reminders

- ASU 2018-08 is generally “clarifying” guidance and does not change existing GAAP principles.
- Neither GAAP nor 990-annual information return reporting require the grantor and grantee treatment of the same transaction to match.
- Prospective application of ASU 2018-08 was permitted, and thus no prior period restatements needed to be undertaken.
- Clarifications here via the more “objective” criteria set out in ASU 2018-08 provide an opportunity/incentive to review grant agreements currently in use and to modify language if needed to reflect the actual intention of the grant (as one which is conditional or unconditional, as the grantor desires).

Issue Spotting This Triggers for You?

- How is all this going for Grantees of yours? Are less-sophisticated Grantees aware of impacts here?
- Those of you representing non-profit Grantors? Same question?
- Bringing value to clients?

Thanks for your work assisting tax-exempt organizations – it is much needed!

Eve Borenstein, J.D. – two contexts in which I provide services:

- Harmon, Curran, Spielberg & Eisenberg, LLP (legal advice, albeit I am just now going on semi-retired status but will stay *Of Counsel*)
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