

Applied GAAP: Intermediate Reporting Guidance

Continuing through the comprehensive GAAP guide, this section digs deeper into financial reporting standards that intermediate and advanced practitioners encounter in practice. Whether you're working through complex transactions or reviewing financial statements for compliance, this course helps reinforce your command of GAAP principles. It's well-suited for CPAs and accounting professionals who want to move beyond the basics and build confidence handling more nuanced reporting situations across a variety of industries and entity types.

CREDIT HOURS 2 | FIELD OF STUDY ACCOUNTING | EXAM QUESTIONS 10

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LEARNING ASSIGNMENTS AND OBJECTIVES

Assignment

- Study the full course materials included here.
- Complete the review questions after each chapter.
- Answer 10 final exam questions.
- Final exam is scored immediately, 70% or better passes.
- Certificate of completion is available in your account.
- Failed exams can be retaken free of charge.

Course Objectives

- Recognize some of the results from the net operating loss rules in tax reform.
- Understand how to account for the pass-through entity (PTE) tax in financial statements.

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Section 1

Chapter Objective

After completing this section, you should be able to:

- Recognize some of the results from the net operating loss rules in tax reform.
- Understand how to account for the pass-through entity (PTE) tax in financial statements.

K. PERSONAL FINANCIAL STATEMENTS

1. Income Taxes Related to Personal Financial Statements:

Question: Harry is preparing personal financial statements for Wilma and Fred Flintstone, both age 50. In preparing the statements, Harry plans to record an estimate of income taxes due in accordance with the requirements of ASC 274, *Personal Financial Statements*, as follows:

At statement date:

Assets and liabilities:

Estimated current value	xx
Tax basis	xx
Taxable gain	xx
Tax rate (s)	32% federal and state
Estimated taxes	xx (1)

(1) Presented on the statement of financial position as a liability.

One of the assets assumed sold is the couple's primary residence which has an unrealized gain of \$800,000 and, when sold, will be subject to \$500,000 gain exclusion on the sale of a primary residence. In computing the estimated tax liability, should Harry exclude the portion of the gain that will be eliminated from implementing these strategies?

Response: Yes. ASC 274 requires that an estimated income tax liability be recorded on the statement of net worth based on the assumption that the individual(s) sell all of the net assets on the balance sheet statement date. ASC 274 requires that the estimated tax liability should be based on two assumptions:

- a. All assets and liabilities are liquidated at their estimated current value as of the statement date, and

b. The provision should be based on applicable income tax laws and regulations.

The method and assumptions used to compute the estimated tax liability relate to existing tax law, *not on assumptions of future actions* of the individual after the financial statement date. In this case, if the residence had been sold on the date of the statement of net worth, the \$500,000 gain exclusion would apply. Therefore, up to \$500,000 of the unrealized gain on the primary residence should be excluded in computing the estimated tax with the remaining \$300,000 included.

Change the facts: The couple is performing effective estate planning under which all assets shall be gifted to each other or other family members with no income tax liability?

In computing the estimated tax liability, should the gain on those assets to be transferred be excluded?

Response: The estate planning is considered a *future action* (future transfers of assets), not an action taken as of the financial statement date. Therefore, these potential tax saving actions should not be considered in computing the estimated tax liability.

Consequently, the income tax liability on those assets still should be included on the financial statement even though the obligation will most likely not be paid.

Question: Should the couple accrue the estate tax that will be due upon death?

Response: No. Again, the estate tax is based on a future action (future death of one or both of the individuals). Thus, at the financial statement date, assuming both individuals are alive, there is no estate tax due. If, instead, one of the parties had died at the balance sheet date and there is an estate tax due, that estate tax would be shown on the statement of net worth as a liability, similar to any other liability that is owed.

2. Imputing Goodwill on Personal Financial Statements:

Question: John Perfect is a celebrity chef and real estate developer. The “Perfect” brand is on numerous products including cookbooks, underwear (“Perfect” Undies), a downtown NY City hotel (“Absolutely Perfect Hotel”), and several restaurants. John has also franchised use of the “perfect” name on two restaurants which John does not own. John even has the “perfect wife.”

John and his wife, Mary, are issuing personal financial statements for the year ended December 31, 20X1, which will be submitted to a bank.

John wants to record an asset on his statement of net worth for the “perfect” brand (personal goodwill) because he believes there is a separate value to the perfect name.

Because personal financial statements include assets at their estimated current amount, John believes that recording personal goodwill/brand value at estimated current amount is appropriate.

In preparing personal financial statements, is it appropriate to record an asset for a brand value/personal goodwill at estimated current value?

Response: The authority for personal financial statements is found in ASC 274, *Personal Financial Statements*, as follows:

ASC 274 requires that personal financial statements present assets at their estimated current value and liabilities at their estimated current amount.

For an asset, estimated current value is the amount at which the item could be exchanged between a buyer and seller.

ASC 274-10-35-10 states that:

“intangible assets shall be presented at the discounted amounts of projected cash receipts and payments arising from the planned use or sale of the assets if both the amounts and timing of the cash flows can be reasonably estimated.”

The ASC does not specifically address personal goodwill. However, if John is able to obtain a valuation of the “perfect” brand, it would appear that recording a brand value/personal goodwill asset at estimated current amount may be appropriate.

Observation

Prior to becoming President, Donald Trump recorded a \$3 billion asset labeled “brand value” on his personal financial statement published in his book, *Time to Get Tough*.³⁴

Donald J. Trump

Summary of Net Worth

As of June 30, 2010

ASSETS:

Cash and marketable securities- as reflected herein is after the acquisition of numerous assets (i.e., multiple aircraft, golf courses, etc.), the paying off of significant mortgages for cash and before the collection of significant receivables

\$270,300,000

Real and operating properties owned 100% by Donald J. Trump through various entities controlled by him:

Commercial properties (New York City)

1,370,650,000

Residential properties (New York City)	348,450,000
Club facilities & related real estate	1,220,000,000
Properties under development	261,000,000
Real properties owned less than 100% for Donald J. Trump:	
1290 Avenue of the Americas- New York City	
Bank of America Building- San Francisco, California and others- Total value	
net of debt	652,200,000
Real estate licensing deals	107,800,000
Miss Universe, Miss USA and Miss Teen USA Pageants	20,000,000
Other assets (net of debt)	133,160,000
Brand value (see below)	<u>3,000,000,000</u>
Total assets	<u>7,383,560,000</u>
<u>LIABILITIES:</u>	
Accounts payable	4,900,000
Loans and mortgages payable on real and operating properties as reflected above	<u>373,760,000</u>
Total liabilities	<u>378,660,000</u>
NET WORTH	<u>\$7,004,900,000</u>
Source: Page 182, <i>Time to Get Tough</i> , Donald J. Trump	
Note: Mr. Trump's Brand Value has been estimated at \$3 billion and is reflected herein. The Brand Value has been established by Predictiv, the highly respected brand valuation company. Predictiv assists Global 500 corporations and government agencies to improve management performance, marketing and strategy. Predictiv measures for financial Impact of Intangibles such as brand, strategy execution, innovation and post-merger integration.	

Observation

Presumably, former President Trump was able to measure the \$3 billion of brand value using some form of discounted cash flow or other method. ASC 274 states that *“intangible assets shall be presented at the discounted amounts of projected cash receipts and payments arising from the planned use or sale of the assets if both the amounts and timing can be reasonably estimated.”*

Assuming at the time he published his financial statement, former President Donald Trump was able to estimate cash flows and the timing of those cash flows, from use of the Donald Trump brand, ASC 274 would permit him to record an intangible asset using the discounted cash flow or other method.

What about recording a brand value or personal goodwill for a typical individual who does not have the expansive brand use?

Arguably, everyone has some amount of personal goodwill. But whether that goodwill, or brand name value, is measurable is another issue. ASC 274 states that an intangible is recorded using a discounted cash flow or other method, if both the amounts and timing of cash flows can be reasonably estimated.

In most situations, an individual is unable to measure both the amounts and timing of cash flows that would create the personal goodwill. Consequently, only in rare cases, such as the Donald Trump brand, will an individual be able to measure an intangible asset for the brand value or personal goodwill.

L. RELATED PARTY DISCLOSURES AND TRANSACTIONS

1. Officer's Salary

Question: Is a company required to disclose the salary of its officer and principal shareholder?

Response: No. ASC 850, *Related Party Disclosures*, requires disclosure of related party transactions; however, it explicitly excludes “*compensation arrangements*” when an individual is an owner-manager. As a practical point, some companies present officers’ compensation as a separate line item in the schedule of operating expenses in the supplementary information section. Of course, any information presented in supplementary information is not considered a disclosure.

2. Incorporation of a Sole Proprietor

Question: A sole proprietor incorporates her business, and transfers her net assets to a corporation in exchange for its common stock. For tax purposes, the transfer is made tax-free under Section 351 of the Internal Revenue Code under which the net assets are recorded on the corporation at the basis of the transferor. How should this transaction be handled for GAAP?

Response: Generally, such a transfer would be accounted for at fair value in accordance with nonmonetary exchanges. However, rules change with respect to exchanges and transfers between companies under common control (using a more than 50% common ownership test). Such a transfer is merely a change in legal organization which should be accounted for at historical cost. Consequently, with few exceptions, the transaction should be handled the same way for GAAP as it is for tax purposes, that is, at book value.

3. Shareholder Contribution of Assets

Question: A sole shareholder contributes land to its corporation. At what value should the land be recorded by the corporation?

Response: Because there is a controlling shareholder (more than 50%), the land should be recorded at historical cost (the basis in the hands of the shareholder).

If the shareholder owned 50% or less of the common stock, the transaction would be recorded at the fair value of the land given.

4. Use of Shareholder's Assets to Repay Corporate Loan

Question: A shareholder of a corporation collateralizes the company's bank loan with personal assets. The company defaults on the loan and, as a result, the shareholder's assets are used to satisfy the company's debt. How should this transaction be accounted for?

Response: The monies used to repay the bank loan are *in substance a capital contribution by the shareholder*. Therefore, the company should eliminate the bank loan and credit additional paid-in capital.

5. Intercompany Receivables

Question: A common issue encountered in peer review is the fact that accountants and auditors don't scrutinize the collectibility of intercompany accounts. How should the following scenario be handled?

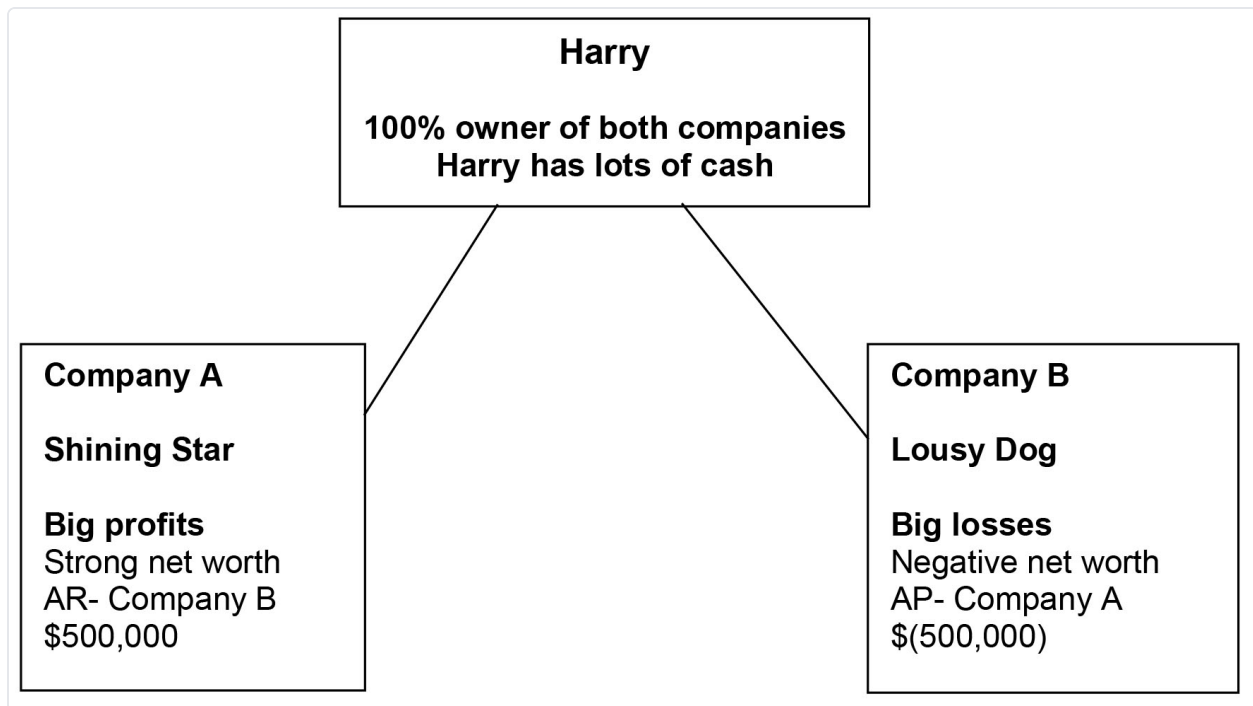
Facts: Harry owns 100% of the common stock of Company A and Company B. A and B have minimal transactions between each other except that A has lent \$500,000 to B as an unsecured demand note.

Harry has a significant net worth and the ability to fund either company, as needed. He says he will fund any company as needed but has not confirmed that fact in writing.

Company A is a cash cow. In fact, it "prints money" for Harry.

Conversely, Company B is a dog (that is, D. O. G.). It is losing money and is in financial trouble.

You, as the accountant/auditor are preparing financial statements for both companies. Both companies have banks that will rely on your financial statements.



Question: What are the issues that the accountant should be concerned about?

Response: The accountant has several issues to consider.

First, what is the financial viability of Company B. Does B have the ability to function as a going concern? As part of that concern is whether Harry is willing to fund enough cash for B to survive for at least *one year* from the balance sheet date, the time frame that generally determines going concern.

Second, the accountant has to be concerned about the collectibility of Company A's receivable due from Company B. Even though both companies are affiliates with Harry as the common owner, they legally function as two separate and distinct entities. Therefore, the accountant should not make the error of considering them as being one entity under the ownership of Harry. For example, Harry could decide to have B file bankruptcy, while keeping A as a viable operating entity. In such a case, A would be one of many unsecured creditors of Company B.

Because the accountant is fully aware of the troubled financial position of B, the accountant must take action on Company A's receivable from B. It appears that there are *two options*:

Option 1: Company A should set up an allowance against the \$500,000 receivable.

Option 2: Company A can have Harry personally guarantee the note due from B, in which case A will not be required to set up an allowance against the note.