New Guidance for Certain Intangible Assets and Noncontrolling Interests

In the past three issues of *The PPC Nonprofit Update* we’ve discussed how SFAS 164, *Not-for-Profit Entities: Mergers and Acquisitions*, affects the reporting and disclosure of business combinations involving nonprofit organizations. In this article, we’ll review how SFAS 164 could have an impact on an organization not currently involved in or planning a business combination because of the guidance it provides in two other areas: intangible assets acquired in a previous business combination and noncontrolling interests.

**Intangible Assets (Including Goodwill) Acquired in a Previous Business Combination**

When effective, SFAS 164 makes the guidance previously introduced in SFAS 142, *Goodwill and Other Intangible Assets* (codified in FASB ASC 350), applicable for nonprofit organizations. So in reporting periods beginning on or after December 15, 2009, organizations will apply the standard’s transition requirements for goodwill or other intangible assets that were recognized in a business combination that occurred before that date.

**Goodwill.** To transition to the new accounting for goodwill, SFAS 164 requires an organization that is predominantly supported by contributions and returns on investments to write off previously recognized goodwill. An organization that is not predominantly supported by contributions and returns on investments will have to test the previously recognized goodwill for impairment using a transitional impairment test that is based on the guidance in FASB ASC 350.

The write-off or impairment loss recognized as part of the transitional guidance in SFAS 164 should be recognized retrospectively and reported in the financial statements as a change in accounting principle. An impairment loss should be reported outside an intermediate measure of operations if one is used.

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Other Intangibles. An organization that has recorded intangible assets other than goodwill in a business combination using the purchase method allowed under prior guidance must transition to the requirements in FASB ASC 350 by reassessing the useful lives of those intangible assets and adjusting the remaining amortization periods as necessary. For example, the amortization period for a previously recognized intangible asset might be increased if its original useful life is estimated to be longer than the 40-year maximum amortization period allowed in prior GAAP. This evaluation should be completed before the end of the first interim period in which SFAS 164 is effective.

Any intangible assets that are determined to have indefinite useful lives have to be tested for impairment during the first interim period in which SFAS 164 is applied. If impairment has occurred, it should be reported separately as a change in accounting principle in the statement of activities, outside an intermediate measure of operations if one is used.

Noncontrolling Interests

A noncontrolling interest is the ownership interest (equity or net assets) in a subsidiary that is not attributable to the parent. Noncontrolling interests were often previously referred to as minority interests. For example, if a for-profit subsidiary has 10,000 shares of common stock outstanding and 9,000 shares are held by the parent and the remaining shares are held by other owners, the 10% ownership interest held by other owners is the noncontrolling interest. Before the guidance provided in SFAS 164, accountants sometimes presented noncontrolling interests in consolidated financial statements as a separate line item between liabilities and net assets; others presented the noncontrolling interests as a component of net assets. SFAS 164 eliminates the inconsistency by requiring noncontrolling interests to be displayed as a component of the appropriate class of net assets in financial statements for periods beginning on or after December 15, 2009.

SFAS 164 also states that when losses exceed the amount of equity attributable to the parent or the noncontrolling interest, the losses should continue to be attributed to those interests. In other words, losses should be attributed to a noncontrolling interest even if it results in a deficit balance for the noncontrolling interest. (Under prior guidance, the noncontrolling interest would not be reduced below zero and excess losses were charged against the controlling interest.)

Transition Guidance. To transition to the new guidance for noncontrolling interests, an organization should apply the presentation requirements of SFAS 164 retrospectively and report the noncontrolling interest in the net asset section of its statement of financial position, clearly identifying that interest to distinguish it from the net assets of the parent in all periods that are presented. Classification of the noncontrolling interest should reflect the effects of any donor-imposed restrictions on the noncontrolling interests. Special transition instructions are provided for presenting noncontrolling interests in comparative financial statements.

Disclosures. SFAS 164 also makes the disclosures about noncontrolling interests required by FASB ASC 810, Consolidation (previously introduced in SFAS 160, Noncontrolling Interests in Consolidated Financial Statements), effective for nonprofit organizations. The primary new disclosure requires a schedule of changes in consolidated net assets, reconciling beginning and ending balances attributable to the parent and to the noncontrolling interest by net asset class, to be presented either on the face of the consolidated financial statements or in the notes. Pro forma disclosures may also be required.

Practical Consideration:

SFAS 164 and its amendments to other standards were not yet included in the FASB Accounting Standards Codification when this issue of The PPC Nonprofit Update was completed. You can monitor the FASB’s website at www.fasb.org for an announcement of when an Accounting Standards Update including SFAS 164 in the FASB Codification is issued. The 2010 edition of PPC’s Guide to Nonprofit GAAP has been updated for this significant new standard and provides reliable, useful guidance for implementing its requirements.

Subsequent Events Guidance Released for Auditors

As a result of the recent change in GAAP that moved accounting guidance for subsequent events from the auditing standards to the FASB Accounting Standards Codification, you may have wondered whether your auditor responsibilities have changed. The AICPA recently came out with two technical practice aids addressing the issue.
Effect of FASB Accounting Standards Codification

FASB ASC 855, Subsequent Events, contains the authoritative accounting guidance for subsequent events. That guidance was previously contained in the SASs at AU 560. A TPA at TIS 8700.01 clarifies that accounting guidance in AU 560 is no longer applicable for auditors of nongovernmental entities. Those entities should follow FASB ASC 855 for subsequent events accounting.

In addition, AU 560 is no longer applicable for auditors of governmental entities that follow GASB accounting standards. Those entities should look to GASB 56 for subsequent events accounting. However, governmental entities that follow accounting principles issued by the Federal Accounting Standards Advisory Board (FASAB) should continue to apply the accounting guidance in AU 560 until the FASAB issues subsequent events accounting standards or until AU 560 is amended.

Auditor Responsibilities for Subsequent Events

Accounting guidance for subsequent events in FASB ASC 855 requires organizations to disclose in the footnotes the date through which they have evaluated subsequent events for inclusion or disclosure in the financial statements. Questions have arisen about the relationship between that date, the date of the management representation letter obtained for the audit, and the date of the auditor’s report. A new TPA at TIS 8700.02 clarifies that those three dates should be the same. Therefore, you might need to coordinate the dates by discussing the dating requirements with management when planning your audit. Also, in the audit engagement letter, you might clarify your understanding that the date disclosed in the subsequent events footnote will be the same as the date of the management representation letter requested for the audit.

Practical Consideration:
The 2010 editions of your PPC audit guides will include suggested language for your engagement letters.

Subsequent Events Implementation

At the November 4, 2009, Board meeting, the FASB discussed implementation issues relating to accounting and reporting for subsequent events. The Board clarified that in accordance with FASB ASC 855-10-50-1 and FASB ASC 855-10-50-4, all entities would be required to disclose the date through which subsequent events have been evaluated in both originally issued and reissued financial statements—unless the entity is subject to a regulatory requirement to review subsequent events up through the filing or furnishing of financial statements with the SEC. The Board further clarified the requirement for entities that file or furnish financial statements with the SEC.

Practical Consideration:
The FASB will draft an Exposure Draft of a proposed Accounting Standards Update, with a 30-day comment period. The Exposure Draft will propose that the Accounting Standards Update be effective prospectively upon issuance of a final document.

Auditing Brief

AICPA Issues Recovery Act Auditing Interpretations. In November, the AICPA issued three new auditing interpretations on interim communication of control deficiencies in a single audit involving Recovery Act awards. These new interpretations of SAS 112 (AU 325A), Communicating Internal Control Related Matters Identified in an Audit, explain the circumstances under which the interim communications may be made. They provide guidance for nonfederal entities participating in a pilot project that expend Recovery Act awards, their auditors, and the federal government, and those which are not, are as follows:

- Interpretation 2 of AU 325A: Communication of Significant Deficiencies and Material Weaknesses Prior to the Completion of the Compliance Audit for Participants in Office of Management and Budget Single Audit Pilot Project
- Interpretation 3 of AU 325A: Communication of Significant Deficiencies and Material Weaknesses Prior to the Completion of the Compliance Audit for Auditors That Are Not Participants in Office of Management and Budget Pilot Project
- Interpretation 4 of AU 325A: Appropriateness of Identifying No Significant Deficiencies or No Material Weaknesses in an Interim Communication

Auditors of entities in the pilot project must issue an interim written communication of significant deficiencies in internal control over compliance for certain Recovery Act programs.
IRS Answers Questions on Form 990, Schedules A and L

Background

The IRS recently posted on its website answers to Frequently Asked Questions (FAQs) concerning Schedules A and L of the 2008 Form 990. Schedule A (Public Charity Status and Public Support) and Schedule L (Transactions With Interested Persons) are covered in detail in PPC’s 990 Deskbook in Key Issues 8A, 8B, and 8H. This article discusses several of the IRS’s responses that elaborate upon the Deskbook discussions.

Schedule A

Schedule A requires certain information and data designed to support (or refute) the filing organization’s qualification as a public charity.

Public Support Requirements. There are two public support tests (PSTs):

1. Organizations described in IRC Sec. 509(a)(1) or 170(b)(1)(A)(vi) (the 509(a)(1) test) must receive at least one-third of their support from contributions from the general public. An organization whose public support is below the one-third level but at least 10% can still qualify as a public charity by satisfying certain facts and circumstances.

2. Organizations described in IRC Sec. 509(a)(2) (the 509(a)(2) test) must receive (a) more than one-third of their support from contributions from the general public and/or gross receipts from activities that are substantially related to its exempt purpose, and (b) no more than one-third of their support from gross investment income and unrelated business income.

Interchangeable Rules. An organization is not required to use the same PST specified in its determination letter from the IRS. It can annually use the support test that best reflects its sources of support and that retains public charity status.

Support Changes for 2008. There are two material changes in calculating public support under both the 509(a)(1) test and the 509(a)(2) test for years beginning in 2008. First, the public support measuring period has been extended to include the current and four preceding tax years instead of only the four preceding years. Second, the calculation must now be made using the organization’s regular accounting method (i.e., the method checked on Form 990, Part XI, line 1, or Form 990-EZ, item G). Previously, the cash method had to be used to calculate public support, even if the bookkeeping was done on the accrual method. Consequently for the 2008 return, accrual method taxpayers must recalculate the support reported on their 2007 Schedule A for 2006 and prior years using the accrual method.

An organization that meets a public support test for a tax year is treated as publicly supported for that year and the succeeding year, regardless of its actual support for the succeeding year.

Suppose, for example, that an organization satisfied a PST for its 2007 tax year (based on public support received over the four-year period 2003–2006), but does not meet a PST for its first year beginning in 2008 using the five-year computation period. Because of the grace period rule, the organization will still be deemed a public charity for its 2008 tax year. However, it will be treated as publicly supported for its 2009 tax year only if it satisfies the PST over the five-year period from 2005–2009.

Reporting Pledges. The amount of a pledge included in the public support calculation depends on the organization’s accounting method. For example, a donor makes a charitable pledge in 2009 that will be paid in 2009, 2010, and 2011. If the donee organization uses the cash method, it includes only the amount of the pledge actually received in each of the three years. On the other hand, if it uses the accrual method, it discounts the pledge to present value and includes the discounted amount in 2009. It would include accruals to the present value increments to the unpaid pledge in 2010 and 2011.

Contributions of Services and Property. In-kind contributions of property are included in the calculation of public support. They should be reported in Schedule A, Parts II and III, on line 1; on Form 990, Part VIII, line 1g; in Schedule B, Part II; and in Schedule M column (c), if applicable. Generally, any reasonable method can be used to determine the value of noncash contributions.

The value of volunteer services cannot be counted as support. Volunteer time may, however, be described in Form 990, Part III, Statement of Program Service Accomplishments.

Schedule L

Schedule L must be used to report excess benefit transactions, loans between the filing organization and interested persons, grants or other financial assistance to interested persons, and business transactions between
the organization and interested persons. Reportable transactions generally include those between the organization and an interested person’s family members or affiliated entities. There are various thresholds and exceptions that govern whether a transaction is reportable.

Who’s Independent, Who’s Not? Part VI, line 1b, of Form 990 asks for the number of independent voting members of the organization’s governing body. A governing body member’s involvement in a reportable transaction precludes independent status. Therefore, before answering the line 1b question, determine whether a governing body member (or his or her family member) was a party to a transaction that is reportable on the organization’s Schedule L or would be reportable on the Schedule L of a related organization.

Moving Targets. Whether a person is an interested person depends upon the part of Schedule L that is being completed. For example, Parts II–IV each use the term interested persons in their headings, which implies a single definition of the term, which is not true. According to the IRS, the different definitions for each part of Schedule L are necessary to reflect the different objectives of each part. Therefore Schedule L preparers must review each definition carefully.

Similar Terms, Different Applications. Form 990, Part VI, Question 2, asks about business relationships, while Schedule L, Part IV (which references Form 990, Part IV, line 28a, 28b, or 28c) requires the disclosure of business transactions. These terms appear similar and have some overlap. For example, contracts of sale, leases, licenses, and the performance of services can be the basis of either a business relationship or a business transaction. However, each involves different parties and different reporting thresholds and exceptions.

To illustrate, business relationships refers only to transactions between the organization and current trustees, directors, officers, and key employees (TDOKEs), other than in the ordinary course of either party’s business on the same terms as are generally offered to the public. Business transactions refer to dealings between the organization and a substantially broader group (i.e., interested persons for Part IV purposes), without an ordinary course of business exception. Another example is that an organization is not required to report a transaction in Schedule L, Part IV, if the aggregate dollar amount doesn’t exceed the greater of $10,000 or 1% of the organization’s total revenue for its tax year, whereas the dollar threshold for Part VI, line 2, is $10,000.

Bank Deposits. An organization may maintain check-ings, savings, or other accounts at a financial institution where one of its governing board members is an officer. The bank is an interested person for purposes of Part IV because of the board member’s status as a bank officer. Consequently, the filing organization should report in Part IV any payments of fees and interest between itself and the bank during the tax year if such payments exceed the lesser of (1) $100,000, or (2) the greater of $10,000 or 1% of the organization’s total revenue for its tax year.

The IRS states that it is currently considering whether placing funds on deposit with a bank constitutes a “loan” for purposes of Schedule L, Part II. However, this transaction need not be reported as a loan for tax years 2008 and 2009, unless the bank is a disqualified person within the meaning of IRC Sec. 4958(f)(1).

The IRS is also considering whether deposits into, and withdrawals from, a bank account constitute payments or business transactions for purposes of Part IV. They will also not be reported for tax years 2008 and 2009.

Payments to Family Members. Suppose an organization pays its chief financial officer $110,000 and his/herspouse $20,000 as an employee. The spouse is a family member of an officer (i.e., is an interested person) and the compensation exceeds $10,000. Therefore, the spouse’s compensation is reported in Schedule L, Part IV (assuming it is not reportable as an excess benefit transaction in Part I).

Practical Consideration:
The IRS continues to acknowledge through the FAQ postings that there are reporting issues that are not clear in the Form 990 instructions. EO officials have recently stated that the IRS remains open to suggestions for improving the new form (or the instructions) and encourages practitioners to communicate their observations or criticisms.

Tax Briefs

CONSIDER 990-EZ IN LIEU OF 990. An EO official recently stated that about 66% of those organizations that filed the 2008 Form 990 through November 15 were eligible to file the shorter Form 990-EZ. A Form 990-EZ can be used for 2008 provided an organization’s receipts are less than $1 million, assets are less than $2.5 million, and it is not a sponsoring organiza-
tion of a donor advised fund. For 2009, the Form 990-EZ thresholds are gross receipts of less than $500,000 and assets of less than $1.25 million.

Some organizations may, of course, be intentionally opting to file Form 990 rather than Form 990-EZ to satisfy state filing requirements. Others may have decided to tackle the new form now rather than waiting until later when the transitional revenue and assets thresholds are reduced thus requiring the Form 990 to be filed.

NEW UBIT NOL CARRYBACK RULES. The Worker, Homeownership, and Business Assistance Act of 2009 (the Act) allows exempt organizations to carry back an applicable net operating loss (NOL) from unrelated business activities for a period of 3, 4, or 5 years, rather than the usual 2-year period [IRC Sec. 172(b)(1)(H)], as amended by the Act. The term applicable net operating loss means the taxpayer’s NOL for a tax year ending after December 31, 2007, and beginning before January 1, 2010. NOLs carried back to the 5th year preceding the year of the loss are limited to 50% of the taxable income of that year.

The carryback election (which is irrevocable) can be made only for one applicable NOL year and is made in one of two ways (Rev. Proc. 2009-52, 2009-49 IRB 744).

1. On a federal income tax return for the tax year of the applicable NOL, by attaching a statement containing the following declarations: (a) the taxpayer is electing to apply IRC Sec. 172(b)(1)(H) under Rev. Proc. 2009-52; (b) the taxpayer is neither a Troubled Asset Relief Program (TARP) recipient nor, in 2008 or 2009, an affiliate of a TARP recipient; and (c) the length of the NOL carryback period elected (3, 4, or 5 years).

This election statement must be filed with the organization’s original or amended return for the tax year of the NOL on or before the due date (including extensions) for filing Form 990-T for the last tax year beginning in 2009.

If the election is made as described above, a copy of the election statement must be attached to the organization’s claim for tentative carryback adjustment. The claim is made either on Form 1139 (Corporation Application for Tentative Refund), or an amended Form 990-T applying the applicable NOL to the carryback year. The due date for timely filing a refund claim on Form 1139 is the due date (including extensions) for filing the return for the organization’s last tax year beginning in 2009.

2. Alternatively, the organization can attach the above statement to Form 1139 or an amended Form 990-T.

An organization that has previously filed a carryback application or claim (under either the usual two-year carryback rules or the special rules applicable to 2008 NOLs of eligible small businesses) can now make the 3, 4, or 5-year election. It can do so even if the IRS has already acted on the prior claim. The election statement must include the information above and further state that the election amends a previous carryback application or claim.

Under previous rules, an organization could elect to forgo the 2-year carryback period and carry the loss to subsequent years. If advantageous, an organization can revoke its election to forgo the NOL carryback period by following the procedures described above and including in the attached statement the further declaration that it is revoking an NOL carryback waiver and electing to apply IRC Sec. 172(b)(1)(H) under Rev. Proc. 2009-52. This revocation must be filed before the due date (including extensions) for filing the return for the taxpayer’s last tax year beginning in 2009.

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