



Financial Accounting
Standards Board

FASB ROUNDTABLE MEETING AGENDA
Mergers and Acquisitions by a
Not-for-Profit Organization

March 27, 2007
9 a.m.–12 p.m.

Norwalk, Connecticut

Focal Areas

1. “True mergers” among not-for-profit organizations
 - a. Appropriateness of the proposed acquisition method
 - b. Criteria to distinguish “true mergers” from acquisitions
 - c. Alternative methods suggested by respondents
2. Certain “small” not-for-profit organizations considerations
 - a. Appropriateness of the proposed acquisition method
 - b. Criteria to identify or define certain “small” not-for-profit organizations
 - c. Alternative methods suggested by respondents or other alternatives to reduce costs if acquisition method is required
3. Recognition of donor-related intangible assets
4. Recognition of goodwill
 - a. Net-deficit (“bailout”) transactions
 - b. Acquirees that are supported by contributions and returns on investment
 - c. Full goodwill (measuring the acquiree at fair value, as a whole) for business-like not-for-profit organizations
5. Accounting for acquired goodwill after the acquisition date
 - a. Write-off certain goodwill
 - b. Evaluate for impairment: Qualitative and Quantitative Methods

Other Key Areas

6. Definition of a *business* and a *nonprofit activity*
7. Unique not-for-profit organization considerations related to certain identifiable assets acquired and liabilities assumed
8. Reliance on existing consolidation requirements and use of *control*
 - a. Opt-out clauses
 - b. Conflicts between AICPA SOP 94-3 and the Health Care Guide
 - c. Noncontrolling interests in not-for-profit health care organizations
9. Use of the existing segment guidance to determine reporting units
10. Other issues or concerns of participants

NOT-FOR-PROFIT MERGERS AND ACQUISITIONS ROUNDTABLE MEETING
Norwalk, CT
March 27, 2007, 9 a.m.–12 p.m.

Participant List

<u>Participants</u>		<u>Comment Letter No.</u>
Elaine Allen	Ernst & Young	M&A #21, GW #20
Kenneth Euwema	United Way of America	M&A #4, GW #5
Garey Fuqua	Fitch Ratings (Health Care)	—
Martha Garner	AcSEC, PricewaterhouseCoopers	M&A #23, GW #21 M&A #16 (same as GW #16)
Ilene Kassman	KPMG	M&A #8 (same as GW #8)
Malvina Kay	Independent Sector	—
Ann McIntosh	Grant Thornton	M&A #13, GW #13
Rosanna O'Guynn	Individual	GW #1
Mark Pascaris	Moody's Investors Service (by phone)	—
Barb Potts	Ascension Health	M&A #22 (same as GW #12)
Bob Uhl	Deloitte	M&A #12, GW #9

FASB

Bob Herz	Board Chairman
Mike Crooch	Board Member
Leslie Seidman	Board Member
Ed Trott	Board Member
Donald Young	Board Member
Sue Bielstein	Director of Major Projects and Technical Activities
Ron Bossio	Senior Project Manager
Jeffrey Mechanick	Project Manager
Alicia Posta	Project Manager
Mike Tully	Fellow
Andrew Delmonico	Postgraduate Technical Assistant



FASB ROUNDTABLE MEETING DISCUSSION QUESTIONS
Mergers and Acquisitions by Not-for-Profit Organizations

March 27, 2007

The FASB's 2006 Exposure Drafts, *Not-for-Profit Organizations: Mergers and Acquisitions* (NFP M&A Exposure Draft), and *Not-for-Profit Organizations: Goodwill and Other Intangible Assets Acquired in a Merger or Acquisition* (NFP Goodwill Exposure Draft), were issued to solicit comments on proposed improvements to the accounting and disclosures for mergers and acquisitions by not-for-profit organizations. The proposals reflect the Board's commitment to the not-for-profit community's reporting needs and to ensure that financial statement users have access to decision-useful information.

The following discussion questions will be used as a guide for the roundtable meeting. However, the FASB will allow time for participants to raise additional issues at that meeting.

FOCAL AREAS

ISSUE 1—“TRUE MERGERS” AMONG NOT-FOR-PROFIT ORGANIZATIONS

The NFP M&A Exposure Draft reflects the FASB’s belief that virtually all mergers and acquisitions are, in substance, the acquisition of net assets. Paragraph 2 of the NFP M&A Exposure Draft proposes that the acquisition method be applied to “any event that results in the initial recognition of another business or nonprofit activity (acquiree) in the financial statements of a not-for-profit organization.” Those transactions include a merger of a not-for-profit organization’s net assets with those of one or more organizations, as well as an acquisition of a business or nonprofit activity by purchase, contribution, or other means. The Board concluded that using a single method of accounting—the acquisition method—results in similar transactions and events being accounted for similarly, improving the relevance, faithful representation, comparability, and understandability of financial information about mergers and acquisitions by not-for-profit organizations.

The NFP M&A Exposure Draft proposes to eliminate the pooling-of-interests method (pooling method) for transactions in which an organization obtains control of and initially consolidates another business or nonprofit activity. The NFP M&A Exposure Draft proposes that the accounting for transactions and events in which an organization does **not** control and consolidate a business or nonprofit activity be unaffected. For example, an organization that participates in the formation of a joint venture would not apply the acquisition method to that formation because it does not control and consolidate the venture.

The Board considered whether the reasons that support the use of the acquisition method for business combinations also apply to all mergers and acquisitions by not-for-profit organizations. In developing this proposed Statement, the Board also studied transactions that some might describe as “true mergers” or “mergers of equals.” The Board acknowledged that the application of the fresh-start method in those “true merger” circumstances would be a more faithful representation, which would increase the benefits to users of the financial statements. However, the Board concluded that those benefits are outweighed by the disadvantages of creating and maintaining two different methods of accounting and the potential cost of constant revaluation for those organizations that undergo

a series of mergers. The Board's main concern about using two methods is the difficulty of drawing unambiguous and nonarbitrary boundaries between circumstances in which the acquisition method or the fresh-start method should be applied. Additionally, the Board is concerned that requiring two methods of accounting could maintain a potential for accounting arbitrage.

Question 1(a)—Do you agree with the FASB's decision to apply the acquisition method to all transactions in which an organization obtains control of and initially consolidate another business or nonprofit activity? If not, why?

Question 1(b)—If you support a different accounting method for certain mergers and acquisitions by not-for-profit organizations, what criteria would you use to define those transactions and what method do you believe would be more appropriate?

ISSUE 2—CERTAIN “SMALL” NOT-FOR-PROFIT ORGANIZATIONS CONSIDERATIONS

The NFP M&A Exposure Draft proposes that **all** not-for-profit organizations apply the acquisition method to any merger or acquisition, regardless of their size or primary source of support.

Question 2(a)—Do you agree with the FASB’s decision to require the same accounting for all mergers and acquisitions not-for-profit organizations, regardless of their size or primary source of support? If not, why?

Question 2(b)—If you support a different accounting method for certain mergers and acquisitions by not-for-profit organizations, what criteria would you use to define those organizations and what method do you believe would be more appropriate?

Question 2(c)—Are there ways that the FASB could reduce the costs of the application of the acquisition method for “smaller” not-for-profit organizations without substantially reducing the benefits of applying the acquisition method to those transactions?

ISSUE 3—RECOGNITION OF DONOR-RELATED INTANGIBLE ASSETS

The NFP M&A Exposure Draft proposes that the acquirer recognize separately the acquisition date fair values of **identifiable** intangible assets acquired in a merger or acquisition, with the exception of an assembled workforce. An intangible asset is identifiable if it either:

- a. Arises from contractual or other legal rights regardless of whether they are separable from the entity (the contractual-legal criterion); or
- b. Is capable of being separated or divided from the acquired entity and sold, transferred, licensed, rented, or exchanged (regardless of whether there is an intent to do so) either individually or in combination with a related contract, asset, or liability (the separability criterion).

That proposal includes separate recognition of donor-related intangible assets acquired in a merger or acquisition that meet either the contractual-legal criterion or the separability criterion.

Donor Lists

A donor list consists of information about donors, such as their names and contact information. Paragraph A23 of the NFP M&A Exposure Draft indicates “that a donor list acquired in a merger or acquisition by a not-for-profit organization would not meet the separability criterion if the terms of confidentiality or other agreements prohibit an entity from selling, leasing, or otherwise exchanging information about its donors.”

Donor Relationships

A donor relationship exists between an entity and its donor if the entity has information about the donor, has regular contact with the donor, and if the donor has the ability to make direct contact with the entity. Paragraph A26 of the NFP M&A Exposure Draft indicates that “generally both the donor and customer contracts and the related relationships acquired in a merger or acquisition meet the contractual-legal criterion. That will be the case even if confidentiality or other contractual terms prohibit the sale or transfer of a contract separately from the acquiree.”

Question 3(a)—Do you agree that donor-lists that meet either the contractual-legal criterion or the separability criterion should be recognized? If not, why?

Question 3(b)—Do you agree that donor-relationships that meet either the contractual-legal criterion or the separability criterion should be recognized? If not, why?

ISSUE 4—RECOGNITION OF GOODWILL

The NFP M&A Exposure Draft proposes that the acquirer recognize either the goodwill purchased or the contribution inherent in the merger or acquisition. The requirement to recognize inherent contributions is consistent with FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made*, which requires that contributions received be recognized as assets (or reductions in liabilities). In some mergers or acquisitions, an acquirer may receive either a full contribution or a partial contribution of an acquiree. Current practice often results in no recognition of goodwill or contributions received in a merger or acquisition. Thus, the application of this proposed Statement would result in additional information about the goodwill acquired and contributions received.

The NFP M&A Exposure Draft proposes that goodwill and the contribution received be calculated and measured as a residual value, rather than measured at fair value:

Goodwill would be measured as the amount by which the fair value of the consideration transferred (if any) exceeds the net of the acquisition date values of the identifiable assets acquired and liabilities assumed. For transactions that occur without any transfer of consideration, goodwill would be measured as the amount by which the acquisition date value of the liabilities assumed exceed the identifiable assets acquired.

The **contribution** received in the merger or acquisition would be measured as the amount by which the acquisition date values of the identifiable assets acquired exceed the consideration transferred (if any) and the liabilities assumed.

The acquirer would not be required to measure the fair value of the acquiree as a whole, which is a departure from the proposed requirements for for-profit business combinations. The Board decided that departure is appropriate to avoid the difficulties and costs that otherwise would be incurred to measure the acquisition date fair values of certain acquired organizations and for simplicity. For example, the application of other valuation approaches could be significantly more problematic for acquired organizations with an absence of available and comprehensive comparable market transactions for similar nonprofit activities and an absence of a profit-driven “business” motive. The departure for not-for-profit organizations could result in recognition of less goodwill and less contribution revenue in those acquisitions that are in the form of a contribution.

Question 4(a)—In mergers and acquisitions in which consideration is transferred, do you agree that the acquirer should limit its recognition of goodwill to the amount that is purchased? If not, what would you suggest and why?

Question 4(b)—Do you agree that the acquirer should recognize goodwill in a net-deficit merger or acquisition (a merger or acquisition in which the liabilities assumed exceed the identifiable assets acquired)? If not, what would you suggest and why?

Question 4(c)—Do you agree that the acquirer should recognize goodwill in a merger or acquisition in which the acquiree is primarily supported by contributions and returns on investments? If not, what would you suggest and why?

ISSUE 5—ACCOUNTING FOR ACQUIRED GOODWILL AFTER THE ACQUISITION DATE

For purposes of evaluating goodwill for impairment, the NFP Goodwill Exposure Draft proposes that a not-for-profit organization determine and assign acquired assets and assumed liabilities to reporting units. The NFP Goodwill Exposure Draft proposes that goodwill that is assigned to reporting units be evaluated for impairment using one of the following evaluations:

Qualitative Evaluation—For those reporting units that are primarily supported by contributions and returns on investments, a qualitative evaluation described in the NFP Goodwill Exposure Draft would apply. That impairment evaluation would require a not-for-profit organization to:

- a. Identify the reasons why goodwill arose in the merger or acquisition at the acquisition date and identify specific events that would indicate that the acquired goodwill subsequently has become impaired.
- b. Determine whether any identified events occurred. If any identified events occurred, an organization would recognize an impairment loss equal to the carrying amount of goodwill related to that acquisition. If no identified impairment event has occurred, an organization would not recognize a change to the carrying amount of goodwill assigned to a reporting unit for that acquisition.

Fair-Value-Based Evaluation—For those reporting units that are primarily supported by resources other than contributions and returns on investments, a fair-value-based evaluation (the impairment evaluation currently required for business entities by FASB Statement No. 142, *Goodwill and Other Intangible Assets*) would apply.

Therefore, for reporting units that are primarily supported by contributions and returns on investments, the goodwill impairment evaluation would depart from the approach in Statement 142 and a different impairment evaluation would be required. The Board is considering that departure primarily for cost-benefit reasons.

Question 5(a)—Do you agree with the departure from the goodwill impairment evaluation in Statement 142 for reporting units that are primarily supported by contributions and returns on investments? If not, what would you suggest and why?

Question 5(b)—Do you agree that the proposed qualitative evaluation is operational for the intended reporting units and will adequately identify a significant impairment of goodwill in the correct period? If not, what would you suggest (for example, improvements to the guidance, write-off of certain goodwill) and why?

OTHER KEY AREAS

ISSUE 6—DEFINITION OF A *BUSINESS* AND A *NONPROFIT ACTIVITY*

The NFP M&A Exposure Draft distinguishes between an acquisition of a business or nonprofit activity and a purchase or contribution of a group of assets. The NFP M&A Exposure Draft proposes to define a business and a nonprofit activity as follows:

A business is an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing economic benefits in the form of a return to investors. Those returns are reflected in the market price of the equity interests or through dividends or through other forms, such as lower costs that are provided directly and proportionately to owners, members, or participants. A business often is, but need not be, a separate legal entity. [paragraph 4(d)]

A nonprofit activity is an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing benefits, other than goods or services at a profit or profit equivalent, as a fulfillment of an organization's purpose or mission (for example, goods or services to beneficiaries, customers, or members). As with a not-for-profit organization, a nonprofit activity possesses characteristics that distinguish it from a business or a for-profit business entity. A nonprofit activity often is, but need not be, a separate legal entity. [paragraph 4(p)]

The definition of a business is consistent with the definition in the guidance proposed for for-profit acquirers. Currently, the definition of a business in EITF Issue No. 98-3, "Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business," is used to determine whether the net assets acquired constitute a business. The definition proposed in the NFP M&A Exposure Draft is broader than the Issue 98-3 definition and would result in more transactions being accounted for as mergers and acquisitions.

Question 6—Do you agree with the broader definition of a business (and the corresponding definition of a nonprofit activity)? If not, why?

ISSUE 7—UNIQUE NOT-FOR-PROFIT ORGANIZATION CONSIDERATIONS RELATED TO CERTAIN IDENTIFIABLE ASSETS ACQUIRED AND LIABILITIES ASSUMED

The NFP M&A Exposure Draft proposes to require a not-for-profit acquirer to recognize (with certain exceptions) the identifiable assets acquired and liabilities assumed that compose the acquiree and to measure them at their acquisition date fair values.

Question 7—Are there specific types or unique aspects of intangible assets (other than donor-relationships), tangible assets, or liabilities that are prevalent in not-for-profit organizations that the Board should further consider?

ISSUE 8—RELIANCE ON EXISTING CONSOLIDATION REQUIREMENTS AND USE OF CONTROL

The NFP M&A Exposure Draft proposed to require a not-for-profit organization to account for any event that requires an organization to consolidate a previously unconsolidated entity as a merger or acquisition. It also proposed to retain the existing guidance used by a not-for-profit organization in determining whether another entity should be consolidated. That guidance, which includes AICPA Statement of Position (SOP) 94-3, *Reporting of Related Entities by Not-for-Profit Organizations*, and AICPA Audit and Accounting Guide, *Health Care Organizations*, describes circumstances in which consolidation is not required or is prohibited. This proposed Statement would **not** change that existing guidance.

Consistent with the approach in FASB Statement No. 136, *Transfers of Assets to a Not-for-Profit Organization or Charitable Trust That Raises or Holds Contributions for Others*, the NFP M&A Exposure Draft proposes **no** changes to the definition of control. Rather, the NFP M&A Exposure Draft includes references to existing consolidation guidance and includes the definition of control from that existing guidance:

Control is “the direct or indirect ability to determine the direction of management and policies through ownership, contract, or otherwise” (paragraph 20 of AICPA Statement of Position (SOP) 94-3, *Reporting of Related Entities by Not-for-Profit Organizations*, and paragraph 11.08 of AICPA Audit and Accounting Guide, *Health Care Organizations*). [paragraph 4(i)]

Question 8(a)—Are there conflicts in or necessary clarifications or improvements in the existing consolidation guidance that you believe the Board should consider within this project?

Question 8(b)—Several comment letters referred to “opt-out clauses” in mergers and acquisitions by not-for-profit organizations. How do those clauses affect the current accounting in practice and, more specifically, the determination of the initial consolidation date? What suggestions, if any, would you recommend the Board consider in applying the proposed requirements to mergers and acquisitions with opt-out clauses?

ISSUE 9— USE OF THE EXISTING SEGMENT GUIDANCE TO DETERMINE REPORTING UNITS

For purposes of evaluating goodwill for impairment, the NFP Goodwill Exposure Draft proposes to require that a not-for-profit organization determine and assign acquired assets and assumed liabilities to reporting units.

Statement 142 requires that the relevant provisions of FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*, and related interpretive literature be used to determine the reporting units in evaluating goodwill. Statement 131 excludes not-for-profit organizations from its requirements to report information about its operating segments. Nevertheless, the NFP Goodwill Exposure Draft proposes that a not-for-profit organization apply the guidance in Statement 131 for determining its reporting units because the Board concluded that such guidance is relevant to not-for-profit organizations and is helpful in determining their operating segments.

Question 9—Do you agree with the proposed requirement to assign acquired assets and assumed liabilities to reporting units based on the operating segments of a not-for-profit organization? If not, why and what alternative would you suggest?