

MEMORANDUM



**To:** Board Members

**From:** Not-for-Profit Team  
(Budak 847-891-6081  
Maffei, ext. 273)

**Subject:** Minutes of November 20, 2002                      **Date:** November 22, 2002  
Board Meeting

**cc:** NFP Combinations Team, Bielstein, Smith, Leisenring, Swift, Polley,  
Gabriele, Sutay, Thompson, Schermann (GASB), FASB Intranet

**Topic:** Combinations of Not-for-Profit Organizations: Goodwill

**Basis for Discussion:** Staff Memorandums dated November 11 and 19, 2002

**Length of Discussion:**    **Starting Time:** 10:15 am    **Concluding Time:** 11:15 am

**Attendance:**

Board members present: Herz, Foster, Schieneman, Trott, Wulff  
Crooch (by phone)

Board members absent: Schipper

Staff in charge of topic: Budak

Other staff at Board table: Bielstein, Bossio, Maffei

**Matters Discussed, Decisions Reached, and Follow-Up Action:**

The Board discussed the initial and subsequent recognition of goodwill in combinations in which a not-for-profit organization is the acquiring organization. For a combination in which a not-for-profit organization acquires a business enterprise that will continue to be operated as a business enterprise, the Board decided that goodwill should be recognized subsequent to acquisition in accordance with FASB Statement No. 142, *Goodwill and Other Intangible Assets*.

For a combination in which the acquired entity is another not-for-profit organization or is a business entity that is subsequently converted to a not-for-profit organization, certain Board members favor an alternative in which the acquiring organization would write off recognized goodwill immediately upon recording the acquisition. Other Board members support recording goodwill as an asset and identifying specific events that, should they occur, would result in the write-off of the recorded goodwill. The Board directed the staff to investigate the operationality of the latter alternative, and will continue to discuss the issue at the December 18, 2002 Board meeting.

Sue Budak began by reviewing the types of combinations in which goodwill would be recognized. Based on Board decisions made to date, an acquiring not-for-profit organization would record goodwill in the following circumstances:

1. **Acquisition of a business enterprise in a reciprocal combination**—Goodwill is recognized in an acquisition of a business enterprise if the consideration paid for the acquired entity exceeds the net fair value of the assets acquired and liabilities assumed. (Goodwill would be recognized in the amount of that excess.)
2. **Acquisition of a business enterprise in a nonreciprocal combination**—If the acquisition of a business enterprise is in part exchange and in part contribution, goodwill is recognized in that acquisition even if the consideration paid for the acquired entity is less than the net fair value of the assets acquired and liabilities assumed. (That is, the contribution would be computed based upon the excess of the fair value of the acquired business enterprise taken as a whole, which includes goodwill, over the consideration paid.)
3. **Acquisition of a not-for-profit organization in a reciprocal combination**—Goodwill is recognized in a combination of two not-for-profit organizations if the combination is reciprocal (that is, the acquiring organization and the acquired organization exchange equal or commensurate value in a bargained exchange in which the acquiring organization transfers cash or other assets to the acquired organization or its designees) and the fair value of the consideration exceeds the net fair value of the assets acquired and the liabilities assumed. (Goodwill would be recognized in the amount of that excess.)
4. **Acquisition of a not-for-profit organization in a nonreciprocal combination**—Goodwill is recognized in a combination of two not-for-profit organizations if the combination is nonreciprocal and the fair value of the consideration paid (which may be zero or nominal) exceeds the net fair value of the assets acquired and the liabilities assumed. (Goodwill would be recognized in the amount of that excess.)

Ms. Budak explained that the staff believes that there may be valid reasons for departing from Statement 142's standards for accounting for goodwill in this project for certain combinations.

However, the staff could not identify any valid reason for departing from those standards if the acquired entity is a business enterprise that will continue to be operated as a business enterprise after acquisition. The Board members agreed that if the acquired entity is a business enterprise and remains a business enterprise, neither concerns about how to perform impairment tests nor concerns about the relevance of the resulting information are compelling enough to justify a departure from Statement 142.

For a combination in which the acquired entity is a not-for-profit organization or is a business enterprise that is subsequently converted to a not-for-profit organization, the staff noted several concerns regarding the application of Statement 142 and developed four alternatives in the memo for the Board's consideration. They are:

1. Test the recorded goodwill for impairment in accordance with Statement 142.
2. Test the recorded goodwill for impairment using the method described in Statement 142, but conduct the tests only upon the occurrence of certain trigger events.
3. Amortize the recorded goodwill over its useful life.
4. Write off goodwill at date of acquisition.

Some Board members (Herz, Schieneman, and Wulff) prefer alternative 4, citing that because performance measures for not-for-profit organizations differ from those used to evaluate business enterprises, the benefits of information about goodwill may not be great enough to justify the costs of conducting periodic impairment tests. For example, because a not-for-profit organization is not operated with the goal of maximizing return in the typical sense, many of their performance measures do not focus on return on assets, return on net assets, or on a single performance measure similar to net income. Mr. Wulff posited that an immediate application of the impairment tests of Statement 142 would often result in a write-off of goodwill.

Other Board members (Foster and Trott) disagreed, pointing out that goodwill is an asset and writing it off would result in the understatement of the entity's assets. Mr. Trott stated that while an immediate write-off was not representationally faithful, alternatives 1 and 2, which call for the goodwill to be tested for impairment, are also flawed. He said that the Board has already acknowledged the difficulty of measuring the fair value of an acquired not-for-profit organization outside of a reciprocal transaction. Further, estimating fair value using cash flows at the reporting unit level is not possible. He believes that it is impossible to conduct the impairment tests of Statement 142 to determine if goodwill is impaired or the amount of the impairment.

Mr. Trott proposed a modification to alternative 2. He said that goodwill would be recorded and reported as an asset in the financial statements until a specific event (trigger event) related to the acquisition occurs. Upon the occurrence of a trigger event, the full amount of goodwill related to that acquisition would be written off. He added that the acquiring organization might be required to disclose the reasons that goodwill was recorded at the date of acquisition, and those reasons would provide the basis for identifying the trigger events that would lead to a write off. He noted that this method would maintain accountability for the acquisition decisions made.

Some Board members (Foster, Herz, and Crooch) said that the alternative 2 approach, as modified by Mr. Trott, appears promising. Mr. Crooch questioned whether the approach is operational, since the trigger events would likely have to be specific to the transaction and catastrophic enough in nature to merit the complete write off of the goodwill. The Board directed the staff to investigate the modified approach in order to assess its operability, and specifically, to develop a list of potential trigger events that would lead an entity to write off goodwill.

The Board then discussed whether goodwill should be recognized in a nonreciprocal combination in which no consideration is paid and the sum of the fair values of liabilities assumed exceeds the sum of the fair values of the assets acquired (that is, a net deficit is

acquired). The Board initially had discussed recognition of goodwill in net deficit combinations at the June 7, 2000 Board meeting and concluded that the excess was goodwill. At the January 30, 2002 meeting, the Board asked to revisit that decision.

Several Board members said that a decision on this issue is so closely tied to a decision on accounting for goodwill after acquisition that the decision on net-deficit combinations should be delayed until after the Board determines whether the alternative 2 approach, as modified by Mr. Trott, is operational. The Board directed the staff to bring the issue back at the meeting of December 18, 2002.

**Summary for ACTION ALERT:**

Same as first two paragraphs under Matters Discussed, Decisions Reached, and Follow-Up Action.