

MINUTES



Financial Accounting
Standards Board

To: FASB Board Members

From: Not-for-Profit Team
(Prince, x229)

Subject: Minutes of the October 8, 2008 Board Meeting: Not-for-Profit Organizations—
Mergers and Acquisitions

Date: October 20, 2008

cc: FASB: Golden, Bielstein, Proestakes, Stoklosa, Bossio, Mechanick, Clark, Prince, Anderson, Willis (consultant), Glotzer, Lott, C. Smith, Lapolla, Gabriele, Sutay, FASB Intranet, Chookaszian, Posta, Klimek, Allen; GASB: Reese, Schermann; IASB: Leisenring

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement, Interpretation, or FASB Staff Position.

Topic: Not-for-Profit Organizations: Mergers and Acquisitions

Basis for Discussion: Board Memorandums 9 and 9A

Length of Discussion: 9:00–9:40 a.m.

Attendance:

Board members present: FASB: Herz, Seidman, and Smith

Board members participating by phone: FASB: Batavick and Linsmeier

Board members absent: None

Staff in charge of topic: Bossio

Other staff at Board table: FASB: Golden, Mechanick, Clark, Prince, and Willis (by phone)

Summary of Decisions Reached:

The Board continued its September 24, 2008 discussion on whether to retain or modify the proposed requirements for (1) initial recognition and measurement of acquisitions by not-for-profit organizations and (2) subsequent accounting for any goodwill recognized as a result of the acquisition.

Initial recognition and measurement—The Board decided that when a not-for-profit organization acquires an organization, business, or nonprofit activity that is expected to be predominantly supported by contributions and returns on investments and the amount for the liabilities assumed (and any consideration paid) exceeds the assets acquired, that excess amount should be recognized as a separate charge in the statement of activities rather than as goodwill. In other circumstances, that excess amount should be recognized as *goodwill*.

The Board also decided that if the amount of the assets acquired exceeds the liabilities assumed (and any consideration paid), the provisions of the final Statement should not require a distinction as to whether the transaction is a contribution received or bargain purchase.

In addition, the Board affirmed its decision that a noncontrolling interest in an acquiree should be measured at fair value on the date of acquisition.

Subsequent accounting for goodwill—The Board decided that those not-for-profit organizations that recognize acquired goodwill should apply the guidance in FASB Statement No. 142, *Goodwill and Other Intangible Assets*, for subsequent testing and impairment.

At a future meeting, the Board plans to discuss disclosures pertaining to mergers and acquisitions, the transition guidance and effective date of the final Statement, and other issues that may arise during drafting.

Objective of Meeting:

The objective of the meeting was for the Board to discuss whether to retain or modify the proposed requirements for (1) initial recognition and measurement of acquisitions by not-for-profit organizations and (2) subsequent accounting for any goodwill recognized as a result of the acquisition. The objective was met.

Matters Discussed and Decisions Reached

Issue 1—Initial Recognition and Measurement of Acquisitions

1. Mr. Bossio commented that constituents and Board members have questioned whether, in certain circumstances, the usefulness of information that results from recognizing goodwill acquired in an acquisition, subsequently subjecting it to impairment testing, and reporting it in financial statements is outweighed by the cost to provide that information. At the September 24, 2008 Board meeting, the staff offered several alternatives for the Board’s consideration, which included alternatives directed at ways to reduce the costs of the proposed subsequent impairment testing of goodwill.¹ Board members also offered additional alternatives for the Board’s consideration, including alternatives for initial recognition of goodwill or what could be referred to as the residual excess of liabilities assumed over assets acquired.

2. Mr. Bossio noted that at the September 24 meeting, the Board tentatively decided (a) to require that a noncontrolling interest in an acquiree be measured at its acquisition-date fair value and (b) not to distinguish between circumstances in which the “residual excess credit” arising from an acquisition might be recognized as a bargain purchase rather than as a contribution received.² Some Board members also had expressed a preference not to distinguish between circumstances in which the “residual excess debit” might be recognized as a contribution made rather than as goodwill.

3. Mr. Bossio then reported on the results of the staff’s further outreach efforts since the September 24 meeting. Specifically, the staff sought additional information from two groups: (a) users of financial statements of not-for-profit organizations and (b) resource group members and other not-for-profit organization experts. Based on its discussions with users, the staff thinks it is fair to say that the consensus view of grant-makers, regulators, and credit analysts is that eliminating the proposed qualitative approach for subsequent impairment testing for acquisitions of contribution-based not-for-profit organizations (business/nonprofit activities) would not result

¹ The minutes of the September 24, 2008 Board meeting are available at http://www.fasb.org/board_meeting_minutes/09-24-08_nfp.pdf.

² See paragraphs 27–30 of the September 24 minutes for the Board’s discussion on measuring noncontrolling interests at fair value. See paragraph 45 of the September 24 minutes for the Board’s decision not to distinguish between circumstances in which the residual excess credit arising from an acquisition might be recognized as a bargain purchase rather than as a contribution received.

in a significant loss of useful information.³ Rather, each of the users indicated that recognizing goodwill and testing it for impairment under the qualitative approach provides information of marginal utility. Moreover, they seem to agree that the benefits of that information would not warrant the costs to provide that information for acquisitions of what the staff has been calling “contribution-based” not-for-profit organizations or activities.

4. Mr. Bossio noted that resource group members seem to agree that if the Board provides any exception to recognizing goodwill, that exception should be a requirement rather than a permitted alternative.

5. Mr. Bossio stated that, for cost-benefit reasons, the staff now recommends that when the acquired organization, business, or nonprofit activity is expected to be predominantly supported by contributions and returns on investments, the residual excess debit:

- a. Not be recognized as goodwill; and
- b. Be reported instead as a separate charge in the statement of activities that might be labeled as *the excess of liabilities assumed (and consideration transferred) over assets acquired in the acquisition of NEWCO* with disclosure surrounding the acquisition and the nature of the separate charge.

Issue 1 Board Vote

6. The Board unanimously decided that when a not-for-profit organization acquires an organization, business, or nonprofit activity that is expected to be predominantly supported by contributions and returns on investments and the amount for the liabilities assumed (and any consideration paid) exceeds the assets acquired, that excess amount should be recognized as a separate charge in the statement of activities rather than as goodwill.⁴ In other circumstances, that excess amount should be recognized as goodwill.

Issue 1 Board Comments

7. Mr. Smith asked the staff whether those individuals with whom the staff had consulted all agree that the proposed qualitative impairment test would have marginal utility. Mr. Bossio noted that was the case and added that some indicated that the signaling information provided by the qualitative impairment test could be obtained from other available information. Those

³ The staff spoke with two private foundations, a consultant to grant makers, three state regulators, and two credit analysts.

⁴ Hereafter referred to as the *goodwill exception*.

individuals also indicated that the signaling information provided by Statement 142 impairment testing would be useful for healthcare providers and higher education institutions.

8. Mr. Linsmeier inquired as to whether, as part of its outreach efforts, the staff had asked individuals to comment on the idea of establishing an additional criterion (above and beyond the contribution-based criterion) in order for organizations to qualify for the goodwill exception.⁵ Mr. Bossio stated that that particular issue came up in the staff's discussions with some users (credit analysts) but not all users (particularly foundation grant-makers that showed little interest in requiring capitalization of goodwill by charities). He added, however, that based on feedback from some resource group members, the public entity criterion could be useful in resolving ambiguities if the Board decides that the threshold for the contribution-based criterion would only require an acquiree to be **primarily** supported by contributions and investment income. However, based on feedback from a credit analyst for the higher education sector, the staff thinks that additional criterion is unnecessary if the Board decides that the threshold should be set at the level of **predominantly** supported by contributions and investment income.

9. Mr. Smith observed that Mr. Bossio was stating that if the Board were to allow the goodwill exception in circumstances in which an acquirer acquires an entity that is predominantly supported by contributions and investment income, then there would be no need to establish a further criterion as to whether the acquiring organization is a public or nonpublic entity because public entities—typically, healthcare providers and higher education institutions—generally would not appear to meet the contribution-based criterion for exception.⁶

10. Mr. Linsmeier asked the other Board members what they thought about establishing an additional criterion that would require that no payment of cash or other assets as consideration for the acquired organization be made in order for the acquisition to qualify for the goodwill exception. Ms. Seidman commented that she thinks basing the criterion on whether or not an acquiree is predominantly supported by contributions and investment income is most appropriate because the other two possible bases for the criterion (whether or not cash consideration is

⁵ The two alternatives for the possible additional criterion are listed in paragraph 4(b)(2) of the Board meeting handout. They are: (a) “the acquiring organization is not a public entity” and (b) “there is no payment of cash or other assets as consideration for the acquired organization.”

⁶ A nonpublic entity is an entity that has no publicly traded securities or conduit debt (see paragraph 4(q) of the October 2006 Exposure Draft, *Not-for-Profit Organizations: Mergers and Acquisitions*).

involved and whether or not the acquirer is a public entity) are not unique to the not-for-profit sector. Mr. Herz agreed.

11. Mr. Batavick observed that basing the criterion on whether or not an acquiree is predominantly supported by contributions and investment income would make the goodwill exception available to those not-for-profit organizations that he thinks should benefit from that exception based on the relative cost-benefit considerations.

Issue 2—Subsequent Accounting for Goodwill

12. Mr. Bossio stated that the staff recommends that in all circumstances in which an acquisition by a not-for-profit organization does not qualify for the Day 1 goodwill exception (see Issue 1 above), the provisions of Statement 142 should be applied for the subsequent accounting for goodwill recognized as an asset. Mr. Bossio noted that in some circumstances a not-for-profit organization will not have any reporting units (as defined by Statement 142) other than the entity itself and, therefore, the goodwill impairment test would be performed at the entity-wide level. Although that point was acknowledged in the October 2006 Exposure Draft, *Not-for-Profit Organizations: Mergers and Acquisitions*, it is a matter that may require additional emphasis or guidance.

Issue 2 Board Vote

13. The Board unanimously decided that those not-for-profit organizations that recognize acquired goodwill should apply the guidance in Statement 142 for subsequent testing and impairment.

Issue 2 Board Comments

14. Mr. Batavick asked the staff to explain the disclosure requirements that would be associated with the goodwill exception. Mr. Bossio stated that for those acquisitions that qualify for the exception, the charge to the statement of activities will be presented separately and transparently and that the reporting organization will be required to disclose the nature of the charge. Mr. Bossio also noted that the staff plans to discuss other disclosures pertaining to mergers and acquisitions with the Board at a future meeting.

Other Matters Discussed

15. Mr. Bossio commented that at its September 24 meeting, the Board accepted the staff's recommendation to conform to FASB Statement No. 141 (revised 2007), *Business Combinations*, and require that a noncontrolling interest in an acquiree be measured at its acquisition-date fair value. He noted that the staff does not see a need for further discussion of that particular sub-issue at this meeting. Mr. Bossio also observed that at the September 24 meeting, the Board agreed not to distinguish between circumstances in which the residual excess debit might be a bargain purchase rather than a contribution received.

Follow-Up Items:

None.

General Announcements:

None.