

**Notice for Recipients of This Request
Related to the October 2006 FASB Exposure Draft,
*Not-for-Profit Organizations: Mergers and Acquisitions***

This is a request for additional comments on a potential revision to the October 2006 proposed Statement, *Not-for-Profit Organizations: Mergers and Acquisitions*, and for field visit volunteers.

Comments

The FASB staff is seeking additional comments from respondents to the proposed Statement about potential criteria for distinguishing a merger between two or more not-for-profit organizations from an acquisition of another entity (business or nonprofit activity) by a not-for-profit organization. Comments of others also are welcomed.

Interested parties should submit their written comments **by July 8, 2008**. Comments should be submitted by email to director@fasb.org, with a subject line of “File Reference No. 1500-100R.” Those without email may send their comments to “Technical Director—1500-100R” and addressed to:

FASB
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Field Visit Volunteers

The staff also is soliciting organizations that have recently merged that would be willing to participate, on a confidential basis, in field visits or interviews with the FASB staff. The purpose of the field visit is to test the workability of the proposed guidance and evaluate the costs and benefits of the proposed change. Those interested volunteers can contact Ronald J. Bossio, Senior Project Manager, at 203-956-5213 or rjbossio@fasb.org.

Purpose of This Paper

1. The Board has made a tentative decision to revise its proposed Statement, *Not-for-Profit Organizations: Mergers and Acquisitions*, to distinguish a **merger** of two or more not-for-profit organizations from an **acquisition** of another entity (business or nonprofit activity) by a not-for-profit organization. However, before finalizing its decision through the issuance of a final Statement, the Board has asked the staff to seek further input on this matter. The purpose of this Paper is to seek comments on the appropriateness and workability of potential criteria for distinguishing a merger from an acquisition.

2. In addition to seeking comments from respondents, the staff is also soliciting organizations that have recently merged that would be willing to participate in field visits or interviews with the FASB staff. The purpose of the field visit is to test the workability of the proposed guidance and evaluate the costs and benefits of the proposed change. Those interested volunteers can contact Ronald J. Bossio, Senior Project Manager, at 203-956-5213 or rjbossio@fasb.org.

Background

3. In October 2006, the Board issued its proposed Statement that would require that all mergers and acquisitions by not-for-profit organizations be accounted for as acquisitions. The proposal noted that the FASB “believes that virtually all mergers or acquisitions are, in substance, the acquisition of net assets.” It also noted the Board’s view that accounting for all of them as acquisitions would “produce financial information that better reflects the economic substance of a merger or acquisition”

4. The proposed Statement explained how the Board’s tentative decision at that time related to an earlier conclusion reached in FASB Statement No. 141, *Business Combinations* (June 2001), which applies to business entities.

B27. In developing Statement 141, the Board considered whether any business combinations are not acquisitions and, if so, whether a method other than the acquisition method should be used to account for them. Paragraph B42 of Statement 141 states:

The Board concluded that “true mergers” or “mergers of equals” are nonexistent or so rare as to be virtually nonexistent, and many respondents agreed. Other respondents stated that even if a true merger or merger of equals did occur, it would be so rare that a separate accounting treatment is not warranted. They also stated that developing the criteria necessary to identify those transactions simply would be a continuation of the same problems and potential for abuse evidenced by Opinion 16. . . . The Board further observed that respondents and other constituents were unable to suggest an unambiguous and nonarbitrary boundary for distinguishing true mergers or mergers of equals from other two-party

business combinations and concluded that developing such an operational boundary would not be feasible. Moreover, even if those mergers could feasibly be distinguished from other combinations, the Board concluded that it does not follow that such combinations should be accounted for on a carry-over basis. If they were to be accounted for using a method other than the purchase method, the Board believes that a better method would be the fresh-start method.

B28. The Board affirmed those conclusions in this proposed Statement and concluded that, generally, the economic substance of the merger or acquisition by a not-for-profit organization is that one organization acquires an integrated group of assets (by purchase or by gift). Therefore, because those transactions are generally acquisitions and because those that are not acquisitions cannot be distinguished using an unambiguous basis, all mergers and acquisitions by not-for-profit organizations should be accounted for using the acquisition method.

Comments of Respondents to the Proposal

5. A few respondents agreed with the conclusions reached in the quoted paragraph B28. However, most respondents, including participants in a March 2007 roundtable, said that mergers of not-for-profit organizations occur with greater frequency than they do among business entities, and most of those respondents also argued that mergers can and should be distinguished from acquisitions.¹

6. The Board discussed those comments with participants at a March 2007 roundtable and considered whether workable criteria can be established for making that distinction. Through those discussions, the Board learned that there is a considerable degree of agreement among the roundtable participants about certain potential criteria that could be used for making that distinction in practice.² In issuing this request for comments, the Board and its staff are seeking to learn more about the criteria under consideration and, particularly, whether those criteria would provide an unambiguous (workable) basis for distinguishing between a merger and the following types of transactions:

- a. An acquisition in which one entity acquires another entity by gift (that is, the acquired entity donates its net assets to the acquiring entity)

¹ For a fuller discussion of the comments received on this issue, see paragraphs 3 and 6–21 of the comment letter summary posted at the [FASB's project website](#). Individual comment letters of respondents also are available from the [FASB's website](#).

² At the March 2007 roundtable, the Board also heard that the views of participants are mixed as to the appropriate accounting method to be used for mergers. Some suggested that the fresh-start method should be applied, but others suggested that the Board retain the carry-over basis, as used in present practice. At its September 19, 2007 meeting, the Board tentatively decided, for pragmatic reasons, to retain the carry-over basis. For a fuller discussion of the reasons for the Board's decision to retain the carry-over basis, see paragraphs 1-23 of the minutes of the meeting, which are available at the [FASB's project website](#).

- b A “combination” that is in substance a joint venture in which the net assets of two nonprofit activities are joined together for a period of time with an expectation or possibility that the activities would revert back to the venture partners in the future.

Potential Criteria

A Tentative Criterion

7. At its meeting of September 19, 2007, the Board agreed that the feature that distinguishes a merger from an acquisition is that **the governing bodies of two or more not-for-profit organizations cede control of those organizations to create a new organization**. In an acquisition, one organization obtains control over the net assets of another organization, business or nonprofit activity by purchase, gift or otherwise. Paragraph 4(i) of the October 2006 proposal provides the following definition of *control*:

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).

8. At its September 2007 meeting, the Board also discussed guidance to clarify that a *new organization* is a combined organization with a *newly formed governing body*. That is, the substance carries more weight than the legal form and, thus, a new legal corporation is not a prerequisite to qualify as a merger. For example, in some mergers, the resulting combined organization may use the existing legal form of one of the merging organizations with modifications that include a *newly formed governing body*. That clarification is intended to allow for a reconstituted legal form that is a new economic organization, as well as a new legal organization, to qualify as a merger if the tentative criterion or other potential criteria are met.

Reservations about the tentative criterion

9. Despite supporting **ceding of control** as the determinative criterion for distinguishing a merger from an acquisition, Board members continue to have reservations. Those reservations center on whether preparers of financial statements and their auditors will be able to reach common judgments when applying that criterion in practice.

10. Some Board members are concerned that the ceding of control criterion and related definition of control, by themselves, may not provide a sufficient basis for distinguishing a merger from the formation of a joint venture (which is outside the scope of the proposal). They indicated that the ceding of control criterion or definition of control may require further clarifications or additional criteria. Two examples of their concerns were noted:

- a. When two not-for-profit organizations join their nonprofit activities by transferring them to a new organization with equal representation on its governing board; thus, each of the two organizations seemingly cedes its independent control

of an integrated set of net assets, but each retains **shared control** in the combined entity

- b. When two not-for-profit organizations seemingly combine their nonprofit activities, but one or both organizations hold an option to “opt-out” of the combined activity and thus regain independent control of the transferred nonprofit activity.

However, other Board members cautioned against adding detailed guidance or lists of criteria to consider in distinguishing a merger from an acquisition.

11. Some members also remain concerned that the tentative decision to retain the carry-over basis as the method of accounting could put undue pressure on practice. That is, organizations that prefer to avoid reporting the fair value of the assets and liabilities of an acquired organization may attempt to disguise an acquisition as a merger. For example, if one organization’s governing body donates the net assets of the organization to another organization, the parties to the merger may attempt to structure the Board composition of the acquiring organization to make it appear as if the acquisition was a merger.

12. The staff is seeking to learn whether the ceding control criterion and related definition of control are appropriate and can be applied in practice. If not, we seek to learn whether and how that criterion and definition might be modified or supplemented without creating a list of detailed and potentially complex rules.

Other suggestions considered but tentatively rejected

13. Respondents to the October 2006 proposal and participants in the March 2007 roundtable offered several other suggestions for distinguishing between a merger and an acquisition. Paragraph 5 of that proposal, which did not make a distinction, stated that “a merger or acquisition is any transaction or other event that result in a not-for-profit organization initially recognizing a business or nonprofit activity in its financial statements.”

14. Many of the respondents suggested that one or both of the following criteria also must be present to qualify for merger accounting:

- a. **Common or Similar Missions:** The combining organizations must have similar missions before the combination, and the combined organization must reflect the key components of those prior mission statements. That circumstance is said to often exist among merging parties and may be an important aspect of the motivation for a merger. Respondents noted that this often occurs among contiguous or affiliated organizations that serve similar constituents and seek opportunities to provide their services more cost-effectively (for example, achieve cost savings through economies of scale). However, if mergers occur between not-for-profit organizations that have different (perhaps complementary) missions, this factor could preclude accounting for those transactions as mergers. Moreover, past experiences suggest that differing views of the meaning of *similar* often lead to repeated requests for more detailed guidance. Thus, Board members are not convinced that a criterion related to the organizations’ missions is

determinative or that it would provide an unambiguous basis for distinguishing a merger.

- b. **No Consideration Exchanged:** There must be (1) no monetary consideration paid or received or (2) no consideration exchanged beyond assumption of liabilities. Either of those two similar, but slightly different, criteria could be useful as an indicator since the existence of monetary consideration exchanged between the combining parties generally suggests that the combination is an acquisition by purchase. However, the absence of monetary consideration could be associated with either a merger or an acquisition by gift in which the acquired entity donates all of its assets and liabilities and receives no payment in return. Thus, the Board did not find that criterion to be determinative in distinguishing a merger from an acquisition by gift.

15. A few respondents who supported different accounting for “true mergers” (or mergers of equals) suggested that the Board develop criteria to rebut a presumption that a combination is an acquisition. Such presumptions often are suggested as a means of mitigating concerns about inconsistent reporting, particularly when alternative methods of accounting exist for similar but not identical economic circumstances. Although such a presumptive attitude could help mitigate the concern expressed in paragraph 10, it still would require a definition or description of a merger that distinguishes it from other combinations. Moreover, this approach also could generate requests to provide criteria to rebut the presumption, which seems contrary to the desires of some Board members to avoid lists of indicators and detailed rules.

Request for Comments

16. As noted in paragraph 7, the Board has tentatively agreed that (a) in a merger, the governing bodies of two or more not-for-profit organizations cede control of those organizations to create a new organization, and (b) control is defined as the direct or indirect ability to determine the direction of management and policies through ownership, contract, or otherwise.

Question 1: Is the definition of a merger appropriate for distinguishing mergers from acquisitions by not-for-profit organizations? If not, why?

Question 2: Would the definition of a merger, together with the definition of control, be workable in practice? That is, can it be applied in practice with a reasonable degree of consistency, particularly in distinguishing a merger from the transactions noted in paragraph 6(a) and 6(b)? If not, why, and how might it be improved?

Question 3: Do the definitions of a merger and control, taken together, make it sufficiently clear that transferring an integrated set of net assets to a newly created joint venture in which the transferor retains shared control is not the equivalent of ceding control? If not, how might the Board clarify the definitions or make it clear that the creation of a joint venture is beyond the scope of the proposal?

Question 4: Does the definition of a merger require any additional criteria or guidance to address the concern noted in paragraph 10? That is, in general, will the

ceding of control be discernable in practice from the surrounding facts and circumstances, despite the possibility that some entities may attempt to structure the new organization's Board composition, senior management, or charter to disguise circumstances in which one of the governing bodies retains control over the newly created organization?

Question 5: If one or more parties to a potential combination retains an opt-out clause, would that alone be sufficient evidence to determine that that party has not ceded control? Some respondents asked the Board to consider whether retention of so-called opt-out clauses by the parties to a combination would indicate that a merger or acquisition had not occurred. The staff has been told that such contingent provisions sometimes are included in acquisitions of physician practices by not-for-profit organizations. However, presumably, such provisions could occur in mergers or acquisitions of other private practices, including acquisitions by business entities. The staff thinks that the specific terms of each contractual arrangement need to be assessed to determine whether the definition of a merger or acquisition has been met and would not expect a unique interpretation for mergers or acquisitions by not-for-profit organizations.