

MINUTES



Financial Accounting
Standards Board

To: FASB Board Members

From: Not-for-Profit Team
(Clark, x443)

Subject: Minutes of the September 18, 2008 Board Meeting: Not-for-Profit Organizations—
Mergers and Acquisitions **Date:** September 25, 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 8 and 10

Length of Discussion: 9:00–10:00 a.m.

Attendance:

Board members present:	FASB: Herz, Linsmeier, Seidman
Board members participating by phone:	Smith
Board members absent:	Batavick
Staff in charge of topic:	Bossio
Other staff at Board table:	FASB: Clark, Prince, Willis (by phone)

Summary of Decisions Reached:

At the September 18, 2008 meeting, the Board discussed the input it received about the operability of the proposed criterion for distinguishing between a merger of not-for-profit organizations and an acquisition by a not-for-profit organization. That criterion is important because the Board previously decided that a merger should be accounted for differently than an acquisition—that is, by combining the carrying values of the merging organizations rather than by applying the acquisition method. The Board sought input on the proposed criterion through the May 2008 Request for Additional Comments (Request) on the potential revision to the October 2006 Exposure Draft, *Not-for-Profit Organizations: Mergers and Acquisitions* (posted to the FASB website), and through field visits with various not-for-profit organizations. This meeting was informational and no Board decisions were reached; however, the Board will continue its discussion on this topic at its September 24, 2008 meeting.

Objective of Meeting:

The objectives of the meeting were for the Board to discuss the input it received about (a) the appropriateness of making the distinction between a merger of not-for-profit organizations and an acquisition by a not-for-profit organization and (b) the operability and workability of the proposed criterion for distinguishing between a merger and an acquisition. Both items were to be discussed within the context of (a) the comment letters received in response to the Request and (b) the field visits held during July and August 2008. The objectives were met.

Matters Discussed and Decisions Reached

Issue 1: Appropriateness of the Distinction

1. Ms. Clark stated that nearly all the comment letter respondents said that it is appropriate to make the distinction between mergers among not-for-profit organizations and acquisitions by not-for-profit organizations. She added that the only respondent who did not express that view expressed no discernable positions on the issues raised in the Request.

2. Ms. Clark added that each of the five field visit participants stated that the distinction needs to be made and the Board's doing so is appropriate. She stated that the FASB staff and Board members had participated in field visits with Girl Scouts of Connecticut, Crittenton Women's Union, United Way for Southeastern Michigan, Trinity Health, and one anonymous participant.

She also emphasized that some field visit participants commented on why they think that acquisition accounting would not “work” for some transactions. She stated that some suggested that the application of acquisition accounting to true mergers (a) would result in financial statements so distorted that they would be of no use to users (both donors and credit rating agencies) and (b) would raise donor and community relations concerns because its use would require the arbitrary and forced designation of one of the merged entities as the acquiring or surviving corporation. The field visit participants suggested that such a phenomenon could have the unintended consequence of reducing the frequency with which worthwhile mergers of not-for-profit organizations occur.

Issue 1 Board Comments

3. Ms. Seidman expressed her confidence in pursuing the distinction. She stated that the field visits in which she participated involved transactions that were obvious mergers and, as such, she thinks pursuing the distinction is appropriate.

4. Mr. Smith added that those field visits in which he participated were of two different extremes. He stated that he thinks the Board should continue to move along the path of distinguishing between a not-for-profit merger and acquisition. He noted that one transaction was clearly a merger while the nature of the other was not as clear.

5. Mr. Linsmeier stated that he has concerns about moving forward with the distinction due to concerns about the workability, or lack thereof, of the merger definition. He expressed concern that if the Board moves forward, some transactions that in substance are acquisitions would be classified as mergers and, thus, would qualify for the carryover basis method of accounting. He added that guidance in the form of indicators also could be problematic if they are used as “check lists.” Mr. Bossio noted that the Request made clear that the Board’s tentative decision hinges on both the appropriateness and workability of the distinction and its definition (criterion).

Issue 2: Workability of Proposed Definition

6. Ms. Clark introduced the subject of workability by referring to paragraph 7 of the Request. She noted the distinguishing feature of a merger—the governing bodies of two or more not-for-profit organizations cede control of those organizations to create a new organization—and the

degree to which the current merger definition communicates the Board's intent to scope out joint ventures and joint-venture-like arrangements.

7. She noted that despite the consensus on appropriateness, comment letter respondents differed on whether the definition (a) is sufficient; (b) needs additional guidance, criteria, or both; or (c) needs substantive revision, clarification, or both to allow for more circumstances to qualify as mergers. She added that only one respondent stated that the definition of a merger, taken together with the definition of control, is sufficient and that only a few respondents suggested that additional criteria are needed. The overwhelming majority are in favor of the final Statement including implementation guidance in the form of indicators or examples with a focus on aiding practitioners in distinguishing between mergers and acquisitions and between mergers and joint ventures. She added that three respondents suggested that the definition move away from the ceding of control. Mr. Bossio clarified by stating that the definitions do not necessarily move away from, but instead move beyond, the ceding of control to allow for more transactions to be classified as mergers.

8. Ms. Clark also summarized the comments of field visit participants on the workability of the definition. She stated that most of the participants (both preparers and external auditors) said that indicators or examples would be helpful and additional guidance would be particularly helpful to auditors in using their professional judgment. She added that of the five field visit participants, the United Way most vigorously tested the workability of the proposed criterion.

Issue 2 Board Comments

9. Ms. Seidman stated that the mission-related idea suggested by a few respondents does not seem to be discriminating. She added that in most not-for-profit organization combinations, whether they are mergers or acquisitions, there is an element of mission. She continued that it would be reasonable to believe that organizations combine to further or continue the mission of one or both entities and to use that consideration as an indicator, but that consideration should not be a determinative factor for distinguishing between the two types of transactions.

10. Mr. Smith stated that the CEO of Crittenton Women's Union was adamant that the ceding of control must be to a new board of directors that was equally representative of each merging entity. She said that one entity having a majority of the representation would, in effect, indicate that an acquisition had occurred.

11. Mr. Linsmeier questioned why the notion of dominance is only applied to the process leading up to the merger and not the new entity at least in Year One or some time afterwards. Mr. Bossio stated that some field visit participants said that once the new organization was formed, the new board of directors owed a duty of loyalty to the new entity. He added that representatives of Trinity Health emphasized that idea. Ms. Clark added that the CEO of Crittenton Women's Union felt otherwise. The CEO feels that legally the new board may owe a fiduciary duty to the new entity, but for psychological reasons allegiances shift from the legacy entities to the new entity over time in much the same manner as the organizational cultures of the two legacy entities come to some sort of new equilibrium in the new entity.

12. Ms. Seidman commented on the frequency of concerns raised about the guidance for joint ventures that are outside the scope. She noted that it is not clear why it was such a prevalent issue and questioned why the guidance should not simply state that the transaction would fall outside the scope of the final Statement if one of the entities continues to operate. She stated that she thinks that doing so would alleviate some of the concerns surrounding the scope of the guidance without having to define *joint venture* and put tension on what is already a vague definition in the promulgated GAAP literature. Mr. Herz agreed and added that sometimes the more words that are added to the guidance, the worse the ambiguity.

13. Mr. Bossio noted that two entities could agree to merge by gifting themselves to a holding corporation that retains those entities in subsidiary form. He added that there may be good reasons to keep the corporate form. For example, the cost of asset title transfer and the duration of the process of integration, which can take more than a year, could lead two merging entities to retain their legal form. Ms. Seidman reiterated the fact that merely scoping out the formation of joint ventures and joint-venture-like arrangements by using the phrase *joint venture* is likely not to be clear because there is no clear definition of *joint venture* in current GAAP. She added that she would rather describe the phenomena of what is not included in the scope of the final Statement or the inverse. Mr. Linsmeier suggested the guidance state that "the two entities cease to exist as non-consolidated entities" to communicate the intent to scope out joint venture and joint-venture-like arrangements, which would deal with the holding company example. Mr. Herz agreed, as did Ms. Seidman.

14. Mr. Herz asked whether the staff thinks that the absence of consideration should be a criterion (as opposed to an indicator) in determining whether a merger has occurred. He stated that he thinks it is an important aspect of a merger because if the parties negotiate to transfer money, the transaction has taken on a different character. Mr. Bossio stated that some of the field visit participants stated that in a merger both parties are assuming each other's liabilities and so, in effect, no one party is transferring consideration to the other.

15. Mr. Herz rephrased his question by asking if something that otherwise qualifies as a merger—has a transfer of consideration by one party—would still be considered a merger. Mr. Bossio stated that the transfer of consideration is an indicator that an acquisition has occurred and that, in addition, there likely would be other obvious signs that the transaction was an acquisition. He noted the example of an acquirer making a payment to a newly formed foundation in the community of an “acquired” hospital.

16. Mr. Smith stated that he is currently aware of a national not-for-profit (with chapters throughout the country) that is considering creating a structure that involves local chapters returning any excess of operating results to the national organization for some type of research. He added that he could see situations, in later years, in which one local affiliate might be in a deficit position and there exists a movement toward merging local chapters statewide. He is concerned that adding the idea that no consideration could be transferred might be interpreted as meaning that assuming the assets and liabilities of an entity in a net asset deficit position would mean that there had been a transfer of consideration. In that case, if that entity was in a deficit position and combined, the combination would be an acquisition. However, the combination would be a merger in another year without the net deficit. He thinks the idea that no consideration is transferred should not be a determinative factor as to the classification of a given transaction as a merger or acquisition. Ms. Seidman added that in one of the field visits in which she participated, local councils merged. Representatives from the new entity formed by the merger among the councils, made the point that some of the merging entities were in deficits and some were not. Ms. Seidman stated that she thinks the fact that some entities were in deficits while others were not indicated that the transaction was more likely to be a merger.

17. Mr. Smith then asked whether the organization to which he had referred to earlier would be under common control. He stated that the organization does not think that it is under common

control. Mr. Bossio added that several field visit participants do not consider themselves to be under common control. The participants stated that their councils and affiliates are separate entities with independent, self-perpetuating boards whose members were not nominated by the national organization. Mr. Bossio added that the councils have franchise arrangements with and pay fees to the national organization. He also noted that entities under common control are excluded from the scope of the proposal.

18. Ms. Seidman, responding to concerns about a check list of indicators, suggested the staff determine whether a principle could be extracted from any potential indicators. Ms. Seidman proposed that the principle state that “there is no dominance in terms of governance or financial wherewithal.” She questioned whether the idea that one is financially strong is in opposition to the idea of no transfer of consideration. Mr. Bossio stated that a merger between two financially strong entities would not really be a problem because he thinks an organization that is financially strong combining with one that is financially weak would likely be an indicator that an acquisition had occurred. Most times, the weaker is at the mercy of the stronger entity, which suggests that the stronger has dominated the weaker entity. However, he added that the indicator alone would not necessarily signify the occurrence of an acquisition. He added that at the September 24 Board meeting, the Board will be asked to discuss the staff proposed list of indicators, which is not intended to be a check list. Mr. Herz stated that the Board needs to state that it is not a check list.

19. Mr. Linsmeier asked if there was sympathy for including the presumption of acquisition method accounting as a starting point. He thinks people would weigh evidence more strongly depending on their biases and that there would be a tendency, because of accounting implications, to be biased toward thinking that combinations were mergers. As such, he added that people would go looking for evidence of a merger and more heavily weigh such evidence. Mr. Bossio stated that some of the respondents suggested that the Board add a presumption that a combination is an acquisition. He thinks it would be useful to include some discussion that helps an auditor get a sense of what it means for both entities to cede control.

20. Mr. Linsmeier reiterated the fact that having a bulleted check list is different from having a principle and writing paragraphs that communicate things to consider in applying that principle. Ms. Seidman stated that the indicators could easily be grouped into governance issues and

financial issues and that there is a way to write those notions in paragraph form so as not to be definitive. Mr. Linsmeier added that an acquisition would be indicated if either the governance control or financial control predominately resided with one of the parties. Mr. Bossio questioned whether the Board was stating that the staff should write the list of potential indicators in narrative form. Ms. Seidman and Mr. Herz agreed.

Follow-Up Items:

The Board instructed the staff to attempt to articulate, in narrative form, the list of indicators that the staff plans to present next week. The staff hopes to circulate a draft of the narrative for discussion at the next Board meeting.

General Announcements:

None.