



LETTER OF COMMENT NO. 21

February 22, 2007

Ms. Suzanne Bielstein
Director – Major Projects and Technical Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Proposed Statement of Financial Accounting Standards, *Not-for-Profit
Organizations: Mergers and Acquisitions*
(File Reference No.1500-100)

Dear Ms. Bielstein:

Ernst & Young appreciates the opportunity to comment on the above-referenced Exposure Draft. We support the Board's decision to provide specific guidance on mergers and acquisitions of not-for-profit organizations (NPOs). We also support the differences-based approach used by the Board in developing this guidance. However, we have certain comments about specific aspects of the Exposure Draft, the most significant of which are summarized below:

Requirement to Identify an Acquirer - The Exposure Draft requires that an acquirer be identified for all mergers and acquisitions; however, in many NPO mergers and acquisitions, an acquirer cannot be identified. In fact, the parties to certain transactions go to great lengths to ensure that the transaction is a "merger of equals" with no one party controlling the other after the transaction is completed. In those circumstances where an acquirer cannot be clearly identified and until the Board fully explores when and how an entity should record a new basis in its financial statements, we believe carry-over basis of accounting is most appropriate.

Scope Exception for Small Traditional NPOs - For small traditional nonpublic NPOs (i.e., those NPOs primarily supported by contributions and returns on investments), we believe the costs to satisfy the Exposure Draft's requirement to measure the assets of the acquiree at fair value outweigh the benefits. In addition, such costs are not an effective use of scarce donor resources. We believe such organizations should be given the option to record the assets of the acquiree at carry-over basis.

Consistency with Statement 141(R) – While many of the concepts included in the Exposure Draft are consistent with the concepts in the Proposed FASB Statement No. 141(R), *Business Combinations; a replacement of FASB Statement No. 141* (Statement 141(R)), there are certain concepts that are not (e.g., the amount of goodwill recognized in a combination of NPOs). Because of the extensive changes that are contemplated in the Board’s business combinations project, and because of similarities among issues in the Exposure Draft and the business combinations project, we suggest that the Board not conclude on the Exposure Draft until redeliberations in that project are complete. Further, we believe that the effective date of the Exposure Draft should not be sooner than the effective date of Statement 141(R).

Please refer to Appendix A to this letter for our detailed comments and suggestions on the Exposure Draft.

We would be pleased to discuss our comments with Board members or the FASB staff.

Very truly yours,

Ernst + Young LLP

Appendix A

Responses to Questions in the Proposed Statement of Financial Accounting Standards, *Not-for-Profit Organizations: Mergers and Acquisitions*

Scope and Definitions

Question 1—Are the objectives in this proposed Statement appropriate for all mergers and acquisitions by a not-for-profit organizations? If not, for which mergers or acquisitions are those objectives inappropriate, why are they inappropriate, and what alternative objectives do you suggest? What criteria do you suggest to distinguish those transactions to which a different financial reporting objective should apply?

In general, we support the Board’s decision that fair value should be the measurement objective for NPO mergers and acquisitions. However, we believe there should be exceptions provided and the Board should further refine the model proposed in the Exposure Draft as follows:

- A scope exception should be included in the final Statement for smaller traditional NPOs (i.e., those NPOs primarily supported by contributions and returns on investments) that do not meet the definition of a public entity under FSP FAS 126-1, *Applicability of Certain Disclosure and Interim Reporting Requirements for Obligors for Conduit Debt Securities*. We suggest that smaller traditional NPOs, defined as nonpublic NPOs with total assets less than \$10 million and total annual expenses less than \$5 million, be allowed the option of recording the assets of the acquiree at fair value or at carry-over basis. The relative costs for these smaller traditional NPOs to implement the provisions of the Exposure Draft would be greater than for larger traditional NPOs or business oriented NPOs (i.e., those NPOs not primarily supported by contributions and returns on investment) without a proportionate increase in benefits. Many smaller traditional NPOs do not have the internal resources required to implement the standard. Furthermore, incurring implementation costs would not be the most effective use of scarce donor resources.
- We believe that the Board should include a rebuttable presumption that an acquirer can be identified in all mergers and acquisitions unless certain criteria, (that we suggest the Board develop) are met. Further, while we agree with the Board’s assertion in paragraph B27 (quoting from paragraph B42 of Statement 141) that “mergers of equals” are rare among business enterprises, we disagree that this is the case in the NPO sector. In fact, mergers or acquisitions among both traditional and business-oriented NPOs are often structured so that neither party to the transaction is viewed as the acquirer. For a variety of reasons (e.g., to pursue a joint mission), the transactions are structured as a “merger of equals,” rather than an acquisition or contribution. In these circumstances, consistent with the minority view expressed in paragraph B185, we believe that the identification of an acquirer is arbitrary and to revalue a portion of the merged entity is not appropriate. For those mergers and acquisitions described in paragraph B185, and

until the Board fully explores when and how an entity should record a new basis in its financial statements, we believe carry-over basis is the most appropriate measurement basis.

Question 2—Is the definition of a merger or acquisition by a not-for-profit organization appropriate? If not, why and how would you modify or clarify the definition?

We believe the definition of a merger or acquisition in paragraph 2 is appropriate.

Question 3—Is the retention of and reliance on the existing guidance on consolidation in SOP 94-3 and the Health Care Guide appropriate? If not, why and what alternative do you suggest?

Yes, we believe the retention of and reliance on the existing guidance on consolidation in SOP 94-3 and the Health Care Guide is appropriate. Furthermore, we believe the Board should take this opportunity to revise the definition of a *majority voting interest in the board of another entity* in the Glossary of SOP 94-3 and footnote 6 of paragraph 11.11 of the Health Care Guide to eliminate confusion that has developed in practice.

The definition currently is as follows (from the Glossary of SOP 94-3):

For purposes of this SOP, a majority voting interest in the board of another entity is illustrated by the following example. Entity B has a five-member board, and a simple voting majority is required to approve board actions. Entity A will have a majority voting interest in the board of entity B if three or more entity A board members, officers, or employees serve on or may be appointed at entity A's discretion to the board of entity B. However, if three of entity A's board members serve on the board of entity B but entity A does not have the ability to require that those members serve on the entity B board, entity A does not have a majority voting interest in the board of entity B.

We believe the definition of majority voting interest in the board of another entity should be revised to include individuals beyond board members, officers, or employees as the intent of the guidance is to determine whether Entity A has the ability to appoint a majority of the Board members of Entity B, regardless of the relationship between Entity A and those appointed Board members of Entity B. Accordingly, we suggest that the definition of *majority voting interest in the board of another entity* in SOP 94-3 be revised to read as follows (with the same revisions made to footnote 6 of paragraph 11.11 of the health care Guide):

For purposes of this SOP, a majority voting interest in the board of another entity is illustrated by the following example. Entity B has a five-member board, and a simple voting majority is required to approve board actions. Entity A will have a majority voting interest in the board of entity B if entity A has the ability to appoint three or more of entity B's board members (if three of entity A's board members, employees, or officers serve on the board of entity B but entity A does not have the ability to

require that those members serve on the entity B board, entity A does not have a majority voting interest in the board of entity B).

Question 4—Are the definitions of a business and a nonprofit activity appropriate for distinguishing between a merger or acquisition subject to the provisions of this proposed Statement and a purchase of assets that would be accounted for in accordance with other generally accepted accounting principles (GAAP)? If not, why and how would you modify or clarify the definitions or the related guidance?

We believe that the definition of a nonprofit activity is appropriate. In the definition of a *business*, we recommend that the “directly and proportionately” language be removed as it does not appear to be needed and is too restrictive. There have been and will continue to be cases where an investor realizes indirect and/or disproportionate returns (in relation to other investors) from an investment in a business.

Goodwill

We do not agree that if goodwill is present in a particular set of assets and activities then, in the absence of evidence to the contrary, the set should be *presumed* to be a business. We believe that the definition of a business (including our suggested edits and comments above) has been appropriately articulated and that the exercise of measuring the acquisition-date fair values of the assets acquired and liabilities assumed (which would indicate whether or not goodwill is present) should not drive the assessment as to whether a business has been acquired. Instead, we recommend that paragraph A7 either be removed in its entirety or modified such that the existence of goodwill may be viewed as a *possible indicator* that a set of activities and assets is a business.

Examples

We believe the final Standards should include several detailed examples to illustrate the types of integrated activities and assets that would (and would not) be considered businesses. We believe this additional guidance would reduce the inconsistencies that would otherwise result from applying the new definition in practice.

Identifying an Acquirer

Question 5—Do you believe control and those factors are appropriate for determining the acquirer in a merger or acquisition by a not-for-profit organization? If not, why and what additional factors or guidance should be considered?

Yes, we believe control as described in existing literature is appropriate for determining the acquirer in a merger or acquisition by a NPO. However, as noted in our response to Question 1, there are circumstances in the NPO sector where the acquirer cannot be clearly identified, even after considering the factors in paragraph 11.

Also, we note that GAAP other than SOP 94-3 and the Health Care Guide provide guidance relating to consolidation (e.g., ARB 51). We believe the Exposure Draft should reference consolidation guidance in other GAAP as well to ensure appropriate application of the proposed Statement’s model.

Recognizing and Measuring the Identifiable Assets Acquired and Liabilities Assumed

Question 6 - Is the requirement of this proposed Statement to recognize and measure the identifiable assets acquired and liabilities assumed at their acquisition date fair values appropriate and does it provide more complete and relevant financial information? If not, why and what alternative do you suggest?

As noted in our response to Question 1, while we believe that carry-over basis is more appropriate in certain circumstances, we generally agree with the Board that recognizing and measuring the identified assets acquired and liabilities assumed at their acquisition date fair value is appropriate and provides more complete and relevant financial information for many mergers and acquisitions entered into by NPOs.

Recognition of Identifiable Assets Apart from Goodwill and Departures from Those Requirements

Question 7—Do you agree that identifiable donor-related intangible assets can be measured with sufficient reliability to be recognized separately from goodwill? If not, which identifiable donor-related intangible assets would not be measurable with sufficient reliability and why?

We agree that identifiable donor-related intangible assets can be measured with sufficient reliability to be recognized separately from goodwill.

Question 8—Are the departures from recognition and measurement requirements in this proposed Statement appropriate accommodations to avoid the added difficulties and costs that would be incurred? If those accommodations are not appropriate, which exceptions would you add or eliminate and why?

Except as discussed in the following paragraphs, we believe the proposed exceptions to the recognition requirements and the fair value measurement requirements are appropriate. Our support for these exceptions is principally because of the complexities associated with deviating from salient and current generally accepted accounting principles that otherwise apply to these items.

We do not support the proposed recognition exception for conditional promises to give, as discussed in paragraph 27 of the Exposure Draft. We believe that the fair value of conditional promises to give should be recognized in a manner similar to that of contingent assets or liabilities. We believe that an acquirer considers the probability of collecting on conditional promises to give in determining the fair value of the acquiree. We do not believe that creating an exception is consistent with the concept of recognizing the fair value of all assets acquired and liabilities assumed.

We do not support the proposed fair value measurement exception for assets held for sale. We note that in its redeliberations of the proposed FASB Statement No. 141(R), *Business Combinations; a replacement of FASB Statement No. 141 (Statement 141(R))*,

the Board decided to require assets held for sale to be recorded at fair value as opposed to fair value less cost to sell. We believe the requirements of the Exposure Draft should be consistent with proposed Statement 141(R).

Question 9—Are there other types of identifiable intangible assets that are prevalent in not-for-profit organizations that should be included as examples in Appendix A?

Yes. Examples of other types of identifiable intangible assets include:

- Certificates of need, which are required in certain jurisdictions to construct a new health care facility, or required for other significant purchases.
- Required operating licenses.
- Accreditations or designations or certifications (e.g. JCAOH, Level I trauma center, sole community hospital status, Medicare dependant hospital status, etc.).
- Provider contracts, networks, and relationships.
- Electronic medical records and other data bases (e.g., disease management, longitudinal data).

These identifiable intangible assets have characteristics and attributes that are unique to health care and may meet either or both of the legal/contractual or the separability criterion. The Statement should include the above listed assets as examples of identifiable intangible assets in paragraph A22 and include guidance to assist NPOs in determining whether these identifiable intangible assets meet either or both of the criterions.

Recognizing and Measuring the Goodwill or the Contribution Received

Question 10—Is the requirement of this proposed Statement that the acquirer limit its recognition of goodwill to the amount that is purchased (either through the transfer of consideration or assumption of the acquiree’s liabilities) appropriate? If not, why and what alternative do you suggest?

As is discussed in more detail in our separate comment letter on Proposed Statement of Financial Accounting Standards, *Not-for-Profit Organizations: Goodwill and Other Intangible Assets Acquired in a Merger or Acquisition*, we believe that any goodwill resulting from a merger or acquisition in which the acquiree is a traditional NPO (i.e., NPOs primarily supported by contributions and returns on investments) should be written off immediately as it is inherently a contribution made by the acquirer to the seller. Further the recognition of goodwill by traditional NPOs does not enhance the decision usefulness of their financial statements. The primary users of the financial statements of traditional NPOs’ include current and prospective donors and creditors. Recorded goodwill will be of limited use to donors (and worse, confusing to them) and generally is ignored by creditors. While we recognize the Board’s position that goodwill meets the definition of an asset, we believe the lack of its decision usefulness and the guidance in FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made* (Statement 116) support our position that goodwill relating to traditional NPO mergers and acquisitions above should be written off immediately.

If the Board does not concur with our conclusion that goodwill resulting from mergers or acquisitions in which the acquiree is a traditional NPO should be recognized as an expense on the acquisition date, we suggest that the Board reconsider the requirement to limit the recognition of goodwill to the amount purchased. We believe an acquirer becomes responsible for all of the assets, liabilities and operations of an acquired entity as of the date control is obtained (not just the proportionate share). Therefore, we believe the fair value of the acquired entity as a whole should be recognized and measured as of the acquisition date, regardless of the percentage ownership acquired. However, we do not believe a conclusion on this issue should be reached prior to the conclusion of the redeliberations of the business combinations project and, ultimately, if goodwill is to be recognized in the post-combinations traditional NPO financial statements, we believe that its associated recognition and measurement principles should be consistent with those of for-profit entities.

Finally, and again, only if the Board decides that goodwill arising in a merger or acquisition in which a traditional NPO is the acquiree should not be recognized as an expense on the acquisition date, we believe paragraph A74b.(3) should be clarified such that the concept applies to all NPO acquisitions, whether or not consideration is transferred in exchange for a controlling interests, in which the acquisition date values of 100 percent of the identifiable assets acquired exceed 100 percent of the liabilities assumed.

Question 11—Is the requirement of this proposed Statement that the acquirer recognize a contribution inherent in the merger or acquisition, measured as a residual, appropriate? If not, why and what alternative do you suggest?

We agree that in those circumstances where the acquirer can be clearly identified, the recognition of a contribution inherent in the merger or acquisition, measured as a residual, is appropriate.

Measurement Period

Question 12—Do you agree that a measurement period should be provided? Do you agree that a limit of one year following the acquisition date is appropriate? If not, why and what alternative do you suggest?

We agree that a measurement period should be provided and that a limit of one year following the acquisition date is appropriate.

Question 13—Do you agree that the guidance provided for assessing whether any portion of the transaction price or any assets acquired and liabilities assumed are not part of the acquisition accounting is appropriate? If not, why and what alternative do you suggest?

Overall, we believe that the proposed guidance is sufficient for making an assessment of whether any portion of the transaction price or any assets acquired and liabilities assumed or incurred are not part of the exchange for the acquiree. We do not believe that it is

practicable (or desirable) to develop comprehensive guidance that anticipates all possible circumstances that may arise. Therefore, we support the approach adopted in the Exposure Drafts of providing a range of examples with supporting reasons.

Disclosures

Question 14—Do you agree with the disclosure objectives? Do you agree with the specified minimum disclosure requirements? If not, why and what alternative do you suggest?

We agree with the disclosure objectives and the specified minimum disclosure requirements. However, we believe the minimum disclosure requirements also should include the disclosure of any payments or other arrangements that are not part of the merger or acquisition, as discussed in paragraphs 58 through 60 of the Exposure Draft.

Disclosures by Public Entities

Question 15—Do you agree that those disclosures for public entities would be useful to the users (donors, creditors, and other users) of a not-for-profit organization's financial statements? If not, why and what alternative do you suggest?

We agree that those disclosures for public entities would be useful to the users of a NPO's financial statements.

Noncontrolling Interests in a Subsidiary

Question 16—How prevalent are noncontrolling ownership interests in a not-for-profit organization's consolidated financial statements? Is the guidance provided necessary and helpful? If not, why and what alternative do you suggest?

While not common among traditional NPOs, noncontrolling ownership interests are prevalent in the business-oriented NPOs (particularly in the health care sector). Please see our comments with respect to noncontrolling ownership interests in the Other Comments and Suggestions section of this Appendix.

Question 17—Do you agree with the presentation requirements for noncontrolling ownership interests in a not-for-profit organization's consolidated financial statements? Do you agree with the accounting for noncontrolling ownership interests in a not-for-profit organization's consolidated financial statements and for the loss of control of subsidiaries? If not, why and what alternative do you suggest?

We agree with the presentation requirements for noncontrolling ownership interests in a NPO's consolidated financial statements, as well as the accounting for loss of control of subsidiaries in those circumstances.

Benefits and Costs of the Proposed Requirements

Question 18—What costs and benefits do you expect to incur if the requirements of the proposed Statement were issued as a final Statement? How could the Board further reduce the related costs of applying the requirements of the proposed Statement without significantly reducing the benefits?

Transactions within the scope of the proposed Statement are more prevalent among business-oriented NPOs. We do not expect such organizations to incur significant additional costs in implementing the requirements of the proposed Statement. Mergers and acquisitions among traditional NPOs are less common. The costs to implement the proposed Statement could be significant for these organizations; however, we believe the cost of applying the proposed Statement could be reduced by providing a scope exception for small traditional NPOs (as defined in our response to Question 1). For all other NPOs, we believe the benefits of applying the proposed Statement outweigh the costs and will result in improved financial reporting.

Other Comments and Suggestions

We have the following other comments and suggestions for the Board's consideration.

Scope

To avoid diversity in practice, we believe the Board should clarify the appropriate accounting guidance to be applied when a for-profit subsidiary of a not-for-profit parent acquires or merges with another entity. In this situation, some might apply the provisions of Statement 141 (or Statement 141(R) once effective) because the acquirer is a for-profit entity. Because the resulting accounting can be significantly different under the model in the proposed Statement compared to Statement 141 (and ultimately Statement 141(R)), we suggest that the Board require that the transaction be accounted for based upon the guidance that is applicable to the ultimate parent.

Opt-Out Clauses

In certain cases, transactions within the scope of the Exposure Draft may contain an opt-out clause. Such a clause allows one entity to terminate the merger or acquisition without cause within a certain period of time. We suggest that the Board provide guidance regarding the affect of opt-out clauses on the accounting for NPO mergers and acquisitions (e.g., does the existence of an opt-out clause preclude accounting for the transaction as a merger or acquisition, should a portion of the purchase price be allocated to the opt-out clause).

Performance Indicator

In several paragraphs (e.g., paragraphs 40, 45a, A75), the proposed Statement requires that changes in the value of assets and liabilities be recognized in the statement of activities. To avoid diversity in practice, we suggest that in each such case the Board specify whether such changes are to be included in or excluded from the performance indicator (for organizations that present a performance indicator, such as NPO health care

organizations in accordance with the Health Care Guide).

Accounting for Noncontrolling Ownership Interests

Currently, there is diversity in practice in accounting for noncontrolling interests by NPOs and we believe Appendix D of the Exposure Draft will result in continued diversity. We believe the determination of whether a noncontrolling interest exists (and should therefore be reflected in the consolidated financial statements) should be driven by whether that noncontrolling interest is entitled to share in the operating results of the entity or its net assets upon dissolution. This concept is allowed for in paragraph 11.16 of the Health Care Guide, even if the subsidiary is another NPO.

Therefore, we disagree with paragraphs D5a. and D5b that a noncontrolling interest does not exist if the subsidiary is entitled to share in the operating results of the entity or its net assets upon dissolution. Also, although less common among traditional NPOs, we believe the guidance in the NPO audit guide and the health care Guide regarding noncontrolling ownership interests should be consistent.

Finally, paragraph 4j defines *equity interests* to “include ownership interests in the net assets of not-for-profit organizations.” Consistent with the discussion in this section, we believe “ownership interests” in the definition above should be replaced with “residual interests.” We suggest a similar change be made the definition of *owner* in paragraph 4r.

Other Comments

- Paragraph 51 references paragraphs A74 and A75 for guidance in applying the acquisition method when an organization acquires less than 100% of the equity interests of a business. Consistent with our comments above relating to accounting for noncontrolling ownership interests, one NPO may obtain control of less than 100% of the residual interests of another NPO (a nonprofit activity) after a merger or acquisition. Therefore, we believe the guidance in paragraphs A74 and A75 should be applied in those situations also.
- Paragraph 61 states that “if an acquirer is within the scope of the health care Guide, the recognized contributions received shall be presented separately from the performance indicator unless the acquired business or nonprofit activity meets the criteria in paragraph 32 of Statement 144 to be classified as held for sale.” We are unclear as to why the classification of the acquired business or nonprofit activity would impact the classification of the contribution with respect to the performance indicator.
- Paragraph 65c requires disclosure of the percentage of ownership interest acquired, such as voting equity instruments (if applicable). While this disclosure is relevant and useful if the acquiree is a business enterprise, it is not does not address the situation where the acquiree is another NPO. Where one NPO acquires another NPO, we suggest that the final Statement require disclosure of the acquirer’s voting interest in the acquiree’s board (unless the acquirer is the sole member, which also should be disclosed).