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January 25, 2007

To: Ms. Sue Bielstein, Director of Major Projects and Technical Activities Financial Accounting Standards Board 401 Merritt 7, P.O. Box 5116 Norwalk, CT 06856

RE: File Reference 1500-100 & 1500-200

Dear Ms. Bielstein,

We would like to thank the Financial Accounting Standards Board for the opportunity to offer opinions on these Exposure Drafts and greatly appreciate the work that has been done in researching, discussing, and crafting guidance on the subject of Not-for-Profit mergers and acquisitions.

We have undertaken a detailed review of both exposure drafts and have endeavored to respond to your specific questions with specific answers. We found this task difficult however, given our overall disagreement with the Board's initial premise that there exists no genuine difference between a "Merger" and an "Acquisition".

In the *Notice for Recipients of This Exposure Draft* (No. 1500-100) the Board indicated that "The overall approach on this project has been that the standards for for-profit entities... are relevant to not-for-profit organizations unless circumstances unique to not-for-profit organizations justify a departure from those requirements". As you will see in our responses, we argue that the circumstances surrounding a not-for-profit "merger" are indeed unique to not-for-profit organizations and warrant continuation of the pooling method for such mergers. We agree with the AcSEC position where it correctly points out in previously issued guidance that "in certain circumstances, the pooling method better reflects the substance of a merger 'or' acquisition by a not-for-profit organization than does the acquisition method."

We are convinced that it is not in the best interest of the not-for-profit sector to eliminate the use of the pooling method when a merger is being executed and we respectfully request that the Board reconsider its position on this aspect of the proposed Standard and modify the related sections appropriately.

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We recommend that the board create separate definitions for a merger versus an acquisition using the following definitions as the basis for determination:

- Acquisition: Any event that results in the initial recognition of another business or nonprofit activity (acquiree) in the financial statements of another not-for-profit organization (acquirer), except when that event meets the criteria for classification as a merger.
- Merger: A combination of two or more not-for-profit organizations that meet the following criteria:
 - No consideration beyond assumption of liabilities is given in the form of tangible assets by the surviving organization in exchange for the assets of the other organizations.
 - 2. The Governing body of the surviving organization is structured in such a way that no one party to the combination has majority control of the combined organization.
 - 3. The process for selecting the Chief Executive Officer of the combined organization is structured in such a way that no one party to the combination has majority control of the selection process.
 - 4. The respective Missions of the combining organizations are similar before the combination and the Mission of the combined organization reflects the key components of those prior mission statements.
 - 5. The entity who initiated the combination and the relative size of the respective entities shall have no bearing on the determination provided the end result meets the four criteria above.

Such a differentiation between "merger" and "acquisition" will give the Board and the accounting profession sufficient basis for determining when to apply the pooling method and will limit use of pooling to those combinations of not-for-profits that are indeed contemplated primarily for purposes other than economics.

We see a not-for-profit sector riddled with redundancy due to the dramatic number of new notfor-profits formed over the past ten years and are greatly concerned with the lack of accountability and transparency that exists in many of these entities. We are convinced that the not-for-profit sector will benefit greatly from continued emphasis in execution of core mission work. Mergers allow that to happen more easily because all parties are treated as

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equals. Were mergers to be treated the same way as acquisitions (e.g. an acquirer is identified for accounting purposes and the accounting itself made to appear that all parties were "swallowed up" by the largest of the parties), many stake holders will discontinue merger discussions or not consider them at all. This will work contrary to the common goal of all not-for-profits, namely to do everything possible to ensure successful execution of their mission.

A second matter of concern for us is the Board's position that a donor list (not-for-profit sector) is sufficiently similar to a customer list (for-profit sector), that it can be classified as an identifiable intangible asset and therefore should be recorded during a merger or acquisition at its fair market value. This position ignores a key point of difference in that a customer relationship is based on supply and demand which creates an exchange transaction but the donor relationship is based on the desire to support a cause and generally does not create an exchange transaction.

The reasons for a customer to cease to purchase a product or service from a company is primarily driven by that customer's demand for the product and changes in the ownership of the entity that supplies it do not necessarily affect the relationship. In contrast, there are a vast number of reasons, why donors change their patterns of contribution and times of "uncertainty" head that list. Subsequent to a merger or acquisition donors are generally apprehensive about the true impact that the change will have upon mission and often times reduce or withhold contributions, taking a "wait and see" attitude. Thus, determining a reasonable basis for valuing a donor list with any sense of reliability is all but impossible.

Additionally, the Board's assumption that there exists a "market" for donor lists that can be used as a reference point for valuation (because from time to time donor lists are exchanged) is simply untrue. Unlike the for-profit sector, most non-profit organizations are bound by non-disclosure covenants with their donors so active exchange of donor information is not usually done. Even the IRS has recognized this point and does not require not-for-profit organizations to make public individual donor information (e.g. the law requires that not-for-profits release copies of their IRS Form 990 upon request to anyone who requests it but, Schedule B, "List of Contributors", is not required to be included).

Thus, it is our recommendation that the valuation of donor-related intangible assets (such as donor lists) should not be included as a separately identifiable intangible asset.

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To summarize, our position is:

- Mergers are generally good for the not-for-profit sector and such activities should be encouraged as much as possible.
- Elimination of the option of accounting for merger in the not-for-profit sector using the pooling method will serve as a disincentive and prevent many from taking place.
- The Board ought to apply the acquisition method of accounting as proposed in these standards to acquisitions only, allowing mergers to be treated differently.
- Donor lists are <u>not</u> equivalent to customer lists so they should not be valued and subsequently recorded as Identifiable Intangible Assets.

Attached to this cover letter are two letters in response to the specific questions raised in the introductions to each exposure draft.

We have also included an outlines of additional comments, observations, and suggestions relative to specific sections of each of the exposure drafts. We offer these as additional support for our responses.

United Way of America also hereby requests the opportunity to participate in the Public Roundtable Meetings in Norwalk, Connecticut on March 27, 2007 where we will provide additional observations for the Board's consideration as they continue to review and modify the proposed Statement.

If the Board would like to discuss our responses further, prior to the Public Roundtable meetings, please contact Kenneth C. Euwema, Vice President of Membership Accountability, United Way of America.

Thank you for your consideration of our comments. We look forward to the opportunity to discuss them further.

Sincerely,

Kenneth C. Euwema, for

Juneth C. Euwene

The United Way of America Financial Issues Committee

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January 25, 2007

To: Ms. Sue Bielstein, Director of Major Projects and Technical Activities Financial Accounting Standards Board 401 Merritt 7, P.O. Box 5116 Norwalk, CT 06856

RE: File Reference 1500-200

Dear Ms. Bielstein,

As we indicated in our response to the Exposure draft 1500-100, we believe that the circumstances surrounding a not-for-profit "merger" are unique to not-for-profit organizations and warrant continuation of the pooling method for such mergers.

We would like to note at the onset that we concur that the circumstances when an "acquisition" is contemplated are indeed relevant to the for-profit world and that the standards for not-for-profit acquisition should be similar.

However, we do not agree with the Board's conclusion that there is no substantial difference between an "acquisition" and a "merger". Rather, we have argued (see our cover letter) that there exists a distinct difference between the two types of not-for-profit combinations and that the accounting for each should be treated differently.

Thus, our responses to this Exposure draft do <u>not</u> apply to situations where the organizations have met our proposed criteria for recording the combination as a "merger" (using the pooling method), they only apply in a situation where a true acquisition has taken place and it is being recorded using the acquisition method.

Question 1: Are the accounting requirements for intangible assets appropriate, understandable and sufficient for identifiable intangible assets acquired by a not-for-profit organization in a merger or acquisition? Yes, with the specific exception of donor lists. (See United Way of America Response to Exposure Draft No. 1500-100, question #7, for more details on our position relative to classification of donor lists as an identifiable intangible asset)

If not, why and what alternative do you suggest? Donor lists should be excluded from recognition as a separately identifiable intangible asset and goodwill should only be recognized to the extent that the liabilities of the acquired entity exceed tangible & other identifiable intangible assets.

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Question 2: Is the departure from the goodwill impairment evaluation in Statement 142 appropriate for reporting units that are primarily supported by contributions and returns on investments? No, using such a method is too subjective and will not promote consistency in reporting across the not-for-profit sector. The specific identification of portions of value sounds easy but is in reality completely subjective. If the combined organization wants to decrease the intangible asset value quickly, it will likely assign most value to that attribute that is likely to be impaired most quickly. Surely the Board does not want to encourage manipulation of the numbers but this approach will allow that to happen with impunity. In addition, continuing annual qualitative evaluation will prove costly for not-for-profits with very little apparent benefit to financial reporting (in years subsequent to a combination, the specifics of the transaction are of less and less importance to stakeholders).

If not, why and how should goodwill be evaluated for impairment? We recommend utilization of a simple amortization method (i.e.: straight line) as it appears to be the most cost/benefit appropriate solution.

Question 3: Are the criteria for determining which impairment evaluation to apply appropriate, understandable, and sufficient? Understandable, yes but we still question whether this is sufficient justification for creating a very subjective impairment rule so we do not agree that it is appropriate. In addition, we do not agree that it is more transparent to record impairment as a "loss" as opposed to "amortization expense".

If not why and how should the guidance be modified or clarified? We recommend that impairment be recorded as an "expense" rather than a "loss". A gain or loss generally identifies a situation where something outside the plans of management has transpired which either benefited or harmed asset values. However, an expense generally identifies something that occurred as a result of normal business activity. Because one can expect that assets (current, fixed, or intangible) will generally be impaired in years subsequent to acquisition, we recommend that the Board require some form of simple amortization to reflect impairment over time. This is already the standard with regard to fixed assets, so we recommend utilization of a simple amortization method (i.e.: straight line) as it appears to be the most cost/benefit appropriate solution.

Question 4: Is the proposed qualitative evaluation operational for the intended reporting units and will it adequately identify an impairment of goodwill in the correct period? No. The qualitative evaluation would rely too exclusively on identification of significant events that negatively impact asset value while in many cases the value will simply decline as a result of the passage of time. For example, the greatest loss in value of assets is likely to occur in the year following the combination of the not-for-profit if the community is not convinced that the mission of the combined organization adequately reflects the mission of the separate organizations, prior to combination. In addition, in subsequent years the value of assets will

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be impaired by simple attrition over time as stakeholders tend to withdraw support of an organization for a variety of reasons.

The qualitative evaluation method would require significant additional work (cost) for not-for-profits such as data mining to substantiate impairment values and that work will become less and less relevant the further away from the date of combination. The result will be that organizations will decide that qualitative evaluation is too costly and thus stop recording impairment (which leaves assets on their books at values that do not reflect impaired value) or be forced to spend limited resources to perform the qualitative evaluation thereby limiting their ability to devote resources to mission related work.

If not, why and how should the guidance be modified or what alternative evaluation would capture an impairment of goodwill on a more timely basis? We do not recommend use of a qualitative evaluation. We recommend utilization of a simple amortization method (i.e.: straight line) as it will result in capturing impairment on a more timely basis.

Question 5: Is the guidance for identifying the triggering events appropriate, understandable, and sufficient? Yes, the guidance is appropriate and understandable but not sufficient if donor related assets remain as identifiable intangible assets. (See United Way of America Response to Exposure Draft No. 1500-100, question #7, for more details on our position relative to classification of donor lists as an identifiable intangible asset). If donor related assets are to be included as identifiable intangible assets, then several examples should be included as to the proper application of the principle to donor lists specifically. Not-for-profits will need guidance on how to determine initial value of a donor list, with identification of how to value the components such that subsequent events that impair the initial value can be easily identified and be consistently applied across varying not-for-profit operating models.

If not, why and how should the guidance be modified and are there additional examples that should be included? NA

Question 6: If an identified triggering event occurs, do you agree with the measurement of the impairment loss (equal to the carrying amount of goodwill related to the acquisition, within the reporting unit)? Yes, assuming that reliable, consistent guidance is available on how to fairly estimate the value of the impairment. The proposed standards fail to establish a method for measuring the actual value of the impairment, thus leaving it to the subjective opinion of the organization. This will lead to inconsistency of application so the standard must offer guidance on how to fairly measure the impact of events.

If not, why and what alternative do you suggest? NA

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Question 7: Is the guidance for determining what method of impairment should be applied when there is a change in the nature of a reporting unit's primary support appropriate, understandable, and sufficient? No, we question the value to users of the financial statements of changing the impairment methods mid-stream. Inconsistency in general breeds confusion and the further away from the date of combination of the entities, the less value there is to making a change. As we have indicated various times in this response and our response to Exposure Draft No. 1500-100, in a not-for-profit sector combination, the issue of values is generally only important as a factor during the "due diligence" phase leading up to consummation of a combination. It is valuable information at that point to help the respective parties determine if the other parties are indeed going to be able to contribute to the furtherance of their mission. Once the decision is made to consummate a combination, the focus shifts to ongoing operations and the tangible assets that can be dedicated to that mission work. Recognition of intangible assets and the subsequent impairment of those assets add little to the decision making processes of the organization because intangible assets can not be converted to cash and deployed to carry out the mission work.

If not, why and how should the guidance be modified or clarified? We recommend that the Board remove the requirement to apply a different impairment method when subsequent events change the source of revenue for an organization. While we understand fully the Board's desire to allow users of financial information to be able to see consistency between forprofit and not-for-profit accounting, the fact is that there exists a genuine difference between the purposes of each type of organization and those purposes demand different approaches to certain components of financial reporting. In the not-for-profit sector, there is no value added for financial statement users.

Question 8: What costs do you expect to incur if the requirements of the proposed statement were issued as a final Statement? As we have indicated throughout, there are a variety of costs that would be associated with implementation of the proposed standards including, but not limited to:

- Additional audit costs in years subsequent to combination to test the validity of assumptions used in qualitative evaluations for impairment
- Costs associated with engaging outside expertise (which currently does not exist) to assist in valuation and evaluation
- Additional staff cost associated with maintaining records in sufficient detail to be able to maintain the identity of specific intangible assets
- Additional staff cost associated with data mining to establish impairment values

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Most importantly, since these additional costs would be administrative costs, they will serve as a disincentive to stakeholders and reduce both current and future resources available for mission work.

<u>What benefits do you expect?</u> Some consistency in reporting could be achieved, but not if approved in the current form. This approach also does not achieve the objective of greater clarity of financial statements for stakeholders.

How could the Board further reduce the related costs of applying the requirements of the proposed Statement without significantly reducing the benefits? See previous comments. Overall, we contend that the costs of implementation of this standard in its current form far outweigh the benefits and we challenge the Board to consider whether promulgating such standards for the sake of consistency alone is a good use of mission related funds.

We are including an outline of additional comments, observations, and suggestions relative to specific sections of this exposure draft. We offer these as additional support for our responses.

United Way of America also hereby requests the opportunity to participate in the Public Roundtable Meetings in Norwalk, Connecticut on March 27, 2007 where we will provide additional observations for the Board's consideration as they continue to review and modify the proposed Statement.

If the Board would like to discuss our responses further prior to the Public Roundtable meetings, please contact Kenneth C. Euwema, Vice President of Membership Accountability, United Way of America.

Thank you for your consideration of our comments. We look forward to the opportunity to discuss them further.

Sincerely,

Kenneth C. Euwema, for

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The United Way of America Financial Issues Committee

United Way of America Financial Issues Committee Outline of FASB Exposure Draft #1500-200 Goodwill and Other Intangible Assets

I. Introduction

- A. The primary aspect of this standard (requiring valuation of donor lists as identifiable intangible assets which affect the value of goodwill or contribution under the acquisition method for recording both mergers and acquisitions) will prove detrimental to the current movement within the Not-For-Profit sector toward greater collaboration and consolidation
- B. Determining/establishing the fair market value of a donor list is costly and takes valuable resources away from organizations that could be better devoted to mission related work.
- C. Unlike the for-profit sector, the not-for-profit sector does not have a "market" for donor lists (e.g. donor lists are not often exchanged) so attempting to locate examples of similar transactions to use a guide for a new transaction will be difficult, if not impossible.
- D. Recording a value for donor lists will do little to add clarity to financial reports and may indeed prove to confuse stake holders as they seek to determine the value of assets available to be devoted to mission related work.
- II. Intangible Assets Other Than Goodwill (Paragraph 5b): An intangible asset with an indefinite useful life shall not be amortized. In 1500-100 the Board indicates that Donor lists are included in Identifiable Intangible Assets, separate from Goodwill. We contend that while some donors will return year after year to contribute, many do not return in subsequent years which would seem to indicate that there is a definite useful life. Therefore, should the Board not agree with our position that Donor Lists should not be recorded as Intangible Assets, we would argue that they should be amortized and not subject to annual impairment testing to determine remaining value.

III. Applying the Qualitative Evaluation (Paragraphs 33 – 36)

A. Paragraph 33: A not-for-profit organization that assigns goodwill to a reporting unit that is primarily supported by contributions... shall...identify the reasons why goodwill arose in the acquisition. The Board does not make a case for why the source of funding should determine which method is used for valuation. It appears that it is in this standard for the express purpose of make the case for recording a value for donor lists. Then the Board is recommending that the organization shall identify a comprehensive list of events and circumstances that would indicate that goodwill assigned to the reporting unit is impaired. With donor lists, impairment is the result of donors not repeating their gift in a subsequent year. Thus to someone outside this sector it would appear that the impairment can be quantified easily by comparing donor lists year over year.

However, this task can be incredibly time consuming and doesn't appear to add much to transparency. If the Board persists in this position, they need to offer an explanation of what value is gained by commencing with this exercise rather than simply allowing for amortization.

- B. Paragraph 35: It is interesting to note that the examples do not indicate that the reasons apply to both merger and acquisition. Rather, three of the points are applicable only to mergers and two are applicable only to acquisitions. This seems to contradict the Board's position in #1500-100 where they contend that there is "no such thing as a merger" and all combinations are in fact acquisitions. We disagree with the Board on that point and these arguments seem to support our position.
- C. Paragraph 36: The qualitative evaluation requires judgment, and there may be circumstances in which an impairment event occurs that was unidentified at the acquisition date. Judgment is always subjective (ie: people look at things differently) and does not lend itself to consistency. Such opportunity for inconsistency seems to be contradictory to the Board stated purpose of creating greater consistency in reporting.
- IV. Implementation Guidance (Paragraphs A1 A17) This section is primarily examples to support the other sections... not comments needed at this time.
- V. Background Information and Basis for Conclusions (Paragraphs B1 B48)
 - A. Paragraph B10: The proposed Statement on mergers and acquisitions by not-for-profit organizations would require that the acquirer separately recognize the acquisition date fair value of identifiable intangible assets (with certain exceptions) acquired in a merger or acquisition. We argue that donor lists should be one of the exceptions because they are not comparable to customer lists in the for-profit sector. Without this exception, this proposed Statement is not acceptable and will be detrimental to the not-for-profit sectors movement toward consolidation.
 - B. Paragraph B11: In accordance with that Statement (142), the acquirer would need to determine the useful life of intangible assets, amortize finite-lived intangible assets over that life, and assess both finite-lived and indefinite-lived intangible assets for impairment. If the Board does not accept our argument that donor lists should not be considered identifiable intangible assets, then we would argue that the lists are indeed finite-lives assets (see paragraph 33) and should be amortized and not subject to a qualitative evaluation for determination of impairment.
 - C. Paragraph B20: The Board concluded that the fair-value-based evaluation often is impracticable for reporting units that are primarily supported by contributions...the continued existence of its related goodwill primarily rely on continuing support from contributions. Consistent with its reasons for not requiring a not-for-profit organization to measure fair value for a note-for-profit acquiree in a merger or acquisition, the Board believes that it may be

difficult to forecast future gifts for the purpose of determining the fair value of a reporting unit and evaluation goodwill for impairment. Moreover, identifying and allocating future unrestricted income would be problematic in those circumstances because those contributions and investment income generally are identified with the entity rather than any particular reporting unit. This makes our case precisely... When a merger is executed (as we have defined it in #1500-100) allocating future unrestricted income is problematic. If this is the case for "reporting units", then does it not also follow that valuing and determining subsequent impairment of a donor list is equally problematic and therefore should be an exception?