



National Association of College and University Business Officers
2501 M Street, NW, Suite 400, Washington, DC 20037-1324
T 202.861.2500 F 202.861.2583
www.nacubo.org

January 29, 2007

Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116



LETTER OF COMMENT NO. 7

Re: File Reference No. 1500-100 *Not-for-Profit Organizations: Mergers and Acquisitions*
File Reference No. 1500-200 *Not-for-Profit Organizations: Goodwill and Other Intangible Assets*
Acquired in a Merger or Acquisition

Dear Sir/Madam:

The National Association of College and University Business Officers (NACUBO) appreciates the opportunity to provide input to the Board's Exposure Drafts. We value the considerable effort that the Board and the staff have invested in these projects.

NACUBO's comments on the proposals were developed by members of our Accounting Principles Council (APC). The council consists of experienced volunteers from member institutions who, collectively, possess a thorough knowledge of higher education accounting and reporting issues and practices.

Project No. 1500-100

ED – Not for Profit Organizations: Mergers and Acquisitions

The comments that follow focus on Exposure Draft (ED) questions that the higher education accounting community considers most significant.

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 appreciate the use of examples that are not mergers and acquisitions. Although the examples in 6c refer readers to the Implementation Guidance A2-A7, we think further clarification of what would **not** constitute a business or nonprofit activity would be helpful. Several comments follow regarding the Implementation Guidance section referenced in 6c.

A very helpful annotation is made in A2 and A3 *that a business or nonprofit activity consists of inputs and processes applied to those inputs that have the ability to create outputs.... An*

integrated set of activities and assets requires two essential elements - inputs and processes that are applied to those inputs. The linkage of processes to assets provides a useful guide.

However, this useful definition is somewhat obscured by the statement in A3 which states that *a business or nonprofit activity need not include all of the inputs or processes that the seller used in operating that business or nonprofit activity.* This could be understood to imply that all you need are assets with the capability of applying processes and outputs. It would be helpful to state that “some processes, but not all, must exist.” An example illustrating when a purchase of assets does not constitute a business or nonprofit activity would be helpful, particularly if it described an exclusion when the “processes” applied to assets are insubstantial.

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?

The Implementation Guide A26 states, “*A written promise to contribute (for example, a completed contribution form), even if cancelable, represents a contractual right. Therefore, generally both the donor and customer contracts and the related relationships acquired in a merger or acquisition meet the contractual-legal criterion.*”

There is no disagreement that a promise to give represents a contractual right; however, it is questionable that this would extend to the “donor relationship” itself. The ED makes reference to Statement 116, paragraphs 96-99, in which contractual and legal rights arise from “promises to give.” However, pledges are “past” transaction or events. Meanwhile the basis for the value of any donor relationship intangible asset is solely dependent on “future” events. This difference is significant.

In addition, FAS 116, Paragraph 96 states that the second essential characteristic of an asset is that *“a particular entity can obtain the benefit and control others’ access to it”* (Concepts Statement 6, paragraphs 26). Seldom, if ever, would a nonprofit entity control others’ access to the donor relationship. Some may wish that were possible, but it is not likely.

Accordingly, we recommend that “donor relationships” be removed from the list of intangible assets that may arise with the merger or acquisition of not-for-profit activities, as further discussed in our response to Question 7.

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 do not believe donor relationship intangible assets could be measured with sufficient reliability without incurring significant cost. Valuation of donor relationships presumes that the factors that motivated the prior gifts will continue into the future. However, donor motivation can be characterized as identity driven and personal. By identity driven we mean that donors

often want to be “worthwhile members of a worthwhile group.” When a NFP is acquired or merged with another NFP, the donor will likely question whether the mission is to continue as before. One should not presume that the intangible elements that motivated the donor remain unchanged after a merger or acquisition. In the donor’s eyes, the effect of the merger could significantly change the mission, scope, strategy, tactics or effectiveness. The donor may ask if the “worthwhile group” still exists. This uncertainty can be sufficient reason to redirect their giving. Whether a change is for the better doesn’t really matter, the potential for change, as perceived by a donor, may be sufficient to make any fair value measurement unreliable, if not extremely difficult.

Donor relationships are also personal. The axiom that “people give to people” has always been factored into fundraising strategies. NFP staff work to create personal relationships with donors. It is difficult to identify where these relationships reside; they could be the acquiree’s president, fundraising staff, or other key employees; and these staff may or may not remain with the new entity.

Finally, not all donors give equal amounts or in a regular pattern. In the valuation process judgments will be made regarding which donors will continue and at what amount. Also, it will be difficult separating the cash flows that result only from the donor relationship from the cash flows derived from other assets, e.g., future donor cultivation activities or added fund raising efforts. Verifying these assumptions will be difficult, if not impossible, and will bring the resulting asset value into question.

Granted, it might be possible to measure donor’s post-merger or post-acquisition attitudes and perceptions through market research studies thus increasing the reliability of the valuation. However, this is costly and it is unlikely the costs would outweigh the benefits. We learned from senior analysts at Moody’s Investor Services and Standard and Poor’s, that they would completely remove these intangibles from their calculations. In addition, the Department of Education removes intangible assets from the ratios it uses to establish financial viability for purposes of Title IV funding (student loans). Accordingly, it is unclear whether financial statement users would benefit from this potentially costly and unreliable reduction in the amount of goodwill that would otherwise be recorded.

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?

It was very helpful that paragraph 66a allows aggregation of disclosures *for individually immaterial mergers and acquisitions that collectively are material*. It would be beneficial if the board could expand on what it considers immaterial within this context. Would the purchase of business type real estate assets for the NFP investment portfolio need special consideration, other than assessing the amount? An expanded discussion on when an acquisition is individually immaterial would help. In addition, an example of disclosure of aggregated immaterial mergers and acquisitions would be helpful, given that some of the information required to be disclosed is specific to each individual acquisition (for example, the date of the acquisition).

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?

Noncontrolling ownership interests are infrequent but they do occur. We found the guidance in this area to be helpful.

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?

If noncontrolling ownership interests are not material to the organization's consolidated financial statements, we would suggest the option of disclosing such interests in the footnotes, rather than on the face of the statement of position.

Project No. 1500-200

ED – Not-for-Profit Organizations: Goodwill and Other Intangible Assets
Acquired in a Merger or Acquisition

The comments that follow focus on Exposure Draft (ED) questions that the higher education accounting community considers most significant.

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? If not, why and how should goodwill be evaluated for impairment?

We are very supportive of the departure and of the availability of the option to use a qualitative approach for reporting units that are primarily supported by contributions and returns on investments. The guidance on identifying the triggering events seems appropriate, understandable and sufficient.

Use of the quantitative two-step fair value evaluation method to test for the impairment of goodwill is problematic in higher education for several reasons. First, reporting units rarely involve full cost accounting. For example, "plant" or "facilities" is often a reporting unit even though the associated revenues would be an unspecified portion of tuition and fees. In fact, cash flows are rarely associated with reporting units with the possible exception of auxiliary services. Second, cross-subsidization between colleges is widely accepted: students pay the same tuition for both expensive (engineering) and less expensive (history) programs. Third, there is

essentially no market for the exchange of educational units and any attempt to determine the “fair value” of the College of Education, for example, would be of questionable relevance or reliability. Accordingly, we suggest that the Board reconsider limiting the use of the qualitative method to reporting units “primarily supported by contributions and returns on investments.” We suggest the following definition change for Paragraphs 4c and 4g (with corresponding changes to the rest of the document):

- 4c. The fair-value-based evaluation is an impairment evaluation method that identifies and analyzes goodwill for impairment based on a two-step quantitative analysis. A not-for-profit organization uses that method to evaluate goodwill for impairment and to measure the amount of goodwill impairment loss to be recognized (if any) for a reporting unit that is **(i) primarily a business activity or (ii) a not-for-profit activity that would be substantially self-supporting even without contributions or investment income.** Statement 142 requires the application of that impairment evaluation for a for-profit business entity.
- 4g. The qualitative evaluation is an impairment evaluation method that identifies and analyzes goodwill for impairment based on a qualitative analysis. A not-for-profit organization uses that method to evaluate goodwill for reporting units that **would operate at a substantial deficit if there were no contributions or investment income. Only reporting units that are primarily comprised of not-for-profit activities may use the qualitative method. All other reporting units must use the two-step fair-value-based evaluation method described in Statement 142.**

In closing, we again wish to express our appreciation for the opportunity to comment. We look forward to answering any questions the Board or the staff may have about our response. Please direct your questions to Sue Menditto at 202-861-2542 or sue.menditto@nacubo.org.

Sincerely,

NACUBO Accounting Principles Council

and

Sue Menditto
Director, Accounting Policy
NACUBO