

January 29, 2007

Ms. Suzanne Bielstein  
Director of Major Projects and Technical Activities  
Financial Accounting Standards Board  
401 Merritt 7  
Norwalk, Connecticut 06856-5116



LETTER OF COMMENT NO. 16

Dear Ms. Bielstein:

PricewaterhouseCoopers appreciates the opportunity to provide comments on the Financial Accounting Standards Board's (the "Board") Exposure Drafts (EDs), *Not-For-Profit Organizations: Mergers and Acquisitions* ("M&A ED"), and *Not-For-Profit Organizations: Goodwill and Other Intangible Assets Acquired in a Merger or Acquisition* ("Goodwill ED"). We recognize the importance of these projects and commend the Board and staff for their efforts.

As stated in our responses to the specific questions raised in the "Notice for Recipients" section of each ED (see Appendix A), we believe that many aspects of the proposals would improve the current guidance on accounting for combinations of not-for-profit organizations (NPOs). Please consider the comments that follow, along with our responses to the specific questions.

#### *Unique aspects of NPO transactions*

We believe that the unique aspects of not-for-profit transactions, which necessitated consideration of these transactions separately from the FASB's business combinations project, are to some extent obscured within the M&A ED by the volume of information related to FAS 141 (and its impending successor). The result is a dilution of the unique nature of the NPO specific issues and conclusions.

We recommend that the final standard present in a prominent way the unique aspects of not-for-profit transactions and the unique model developed for reporting those transactions. This might be done by (1) discussing the unique nature of the NPO-specific issues and conclusions (which are described in the Summary of Tentative Decisions posted on the FASB's website) in an introductory section to the final standard; (2) moving details of guidance relating to recognition and measurement of assets, liabilities, and consideration into the section on "Additional Guidance for Applying the Acquisition Method; (3) removing references to intangible assets being recognized "separately from goodwill," as goodwill will rarely be recognized; (4) acknowledging that recognition of goodwill in transactions where no monetary consideration is exchanged will be rare (similar to the discussion of bargain purchases in paragraph 59 of the proposed successor to FAS 141); and (5) mentioning "implied contributions" before mentioning "goodwill" in any guidance that discusses both terms, to emphasize that most transactions are expected to involve inherent contributions.

#### *Alternatives to the acquisition method*

In general, we agree that the acquisition method is the appropriate method of accounting for transactions in which the economic substance is an acquisition of the net assets of an entity by a controlling or surviving organization. However, as described in our response to Question 1 in the M&A ED, we are not convinced that application of the acquisition method to a transaction in which there is

not a clearly controlling or surviving party is conceptually superior to the recognition of full fair value (fresh-start accounting) for all of the combining entities.

We also believe that within the overall NPO industry, a subset of nonpublic organizations primarily supported by contributions exists for whom the costs of applying acquisition method accounting may be particularly burdensome. We question whether information produced by applying acquisition method accounting would be useful to donors to those NPOs, and whether the benefits of providing the additional information would exceed the costs. We encourage the FASB to identify that subset of NPOs and to consider whether an option to continue use of carryover basis in accounting for mergers and acquisitions may be justifiable for them based on cost-benefit concerns. This is discussed further in our response to Question 1.

#### *Goodwill in net deficit acquisitions*

In transactions that do not involve an exchange of monetary consideration, goodwill would be recognized under the M&A ED whenever the fair value of liabilities assumed exceeds the fair value of assets acquired. As described in our response to Question 10, we do not agree with this. When the intent of the acquisition is charitable (e.g., a financially sound NPO acquires a failing NPO to ensure that the failing NPO's charitable mission continues to be carried out), we believe goodwill should not be recognized. Instead, the acquired net deficit should be reported as a decrease in net assets, similar to a contribution made at the acquisition date. Only in situations where it is clear that tangible or intangible benefits have in fact been acquired do we believe it is appropriate to report an acquired net deficit as goodwill.

#### *Unique considerations related to identifiable intangible assets*

Under the proposal, FAS 141's guidance on identifiable intangible assets would be applied by NPOs. However, there potentially are unique differences between intangible assets in a for-profit environment and in a not-for-profit environment. For example, in an NPO the future economic benefit embodied in an asset may often represent an enhanced ability to provide desired or needed goods or services to beneficiaries, rather than future cash inflows (as is common in the for-profit environment). Other unique differences include:

- While a business enterprise might view a contract as a "favorable lease," a NPO might believe that the same contract contains a contribution element.
- NPOs often enter into long-term contracts with the federal government on a cost-reimbursement basis that do not involve a profit (or perhaps, generate a loss) in connection with carrying out their missions.
- The prices charged for an NPO's goods and services (if any) often are not based on market-determined exchange rates.
- Some NPOs rely significantly on contributions or donations (cash and noncash) to supplement selling prices.
- Revenue recognized in nonexchange transactions (i.e., contributions) is recognized all at once and up front. This differs from the recognition concepts associated with revenue earned in exchange transactions.

Prior to issuing final standards, we recommend that as part of the overall "differences-based" approach to the project the Board consider how a lack of focus on generating cash inflows and these unique aspects of NPO operations might impact the recognition, measurement, and impairment evaluation of identifiable intangible assets recognized in an NPO combination transaction.

*Noncontrolling interests*

The M&A ED assumes that the consolidated financial statements of NPOs do not include noncontrolling interests in NPO subsidiaries, because SoP 94-3 precludes recognition of such interests. However, we note that the Health Care Guide conflicts with SoP 94-3 by permitting recognition of such interests in certain circumstances. To address this diversity in practice, we believe the Board should resolve the conflict between SoP 94-3 and the Health Care Guide relative to recognition of such interests. Further, assuming that NPOs continue to report such interests, we believe the Board should extend the guidance in Appendix D to include those interests. Our specific comments related to these issues are set forth in our response to Question 16.

*Opt-out clauses*

Some NPO transactions involve "opt-out" (or "divorce") clauses under which the acquirer or acquiree has the unilateral right to elect to walk away from the merged organization during a specified time period subsequent to the merger. If the election is made within the specified time period, the merger is nullified and the combining entities revert to operating as separate entities with discrete management and governance.

We believe that opt-out clauses should be considered to determine if additional guidance is warranted. Opt-out clauses potentially raise significant accounting issues when viewed in light of the EDs requirements. For example, if an acquiree subsequently divorces itself from the parent under an opt-out clause, the acquiree resumes its business as if the merger had never occurred. However, under the ED, all of the assets and liabilities that it takes back will have been stepped up to fair value. This raises issues such as:

- Whether an opt-out clause results in temporary control, which may call into question whether the transaction meets the definition of a merger or acquisition prior to expiration of the clause.
- Whether fair value is the appropriate measurement basis for initial recognition of the transaction prior to expiration of the opt-out clause (and, if so, whether the presence of the opt-out clause impacts the fair values that would otherwise be assigned to the acquiree's assets and liabilities), or whether the step-up in values should be delayed until the opt-out clause expires.
- What the proper accounting should be if the opt-out clause is executed.
- Whether terms in an opt-out clause that provide for amounts that are contingently payable or receivable upon exercising or not exercising the clause should result in recognition of assets and/or liabilities.

*Assignment of goodwill to reporting units*

The Goodwill ED proposes that segment reporting concepts under FAS 131 be used to determine an NPO's reporting units for evaluating goodwill for impairment. Those concepts can be difficult to apply in practice. Since NPOs are explicitly excluded from the scope of FAS 131, many preparers of NPO financial statements may be unfamiliar with its requirements. Further, we believe that few NPOs (with the possible exception of larger hospital systems) regularly review their financial information by segments. Therefore, we expect that the concepts associated with assigning goodwill to reporting units will be operationally difficult and confusing for many NPOs. In discussing the reasons for exempting NPOs from its provisions, paragraph 118 of FAS 131 notes that there are likely to be unique characteristics of some NPOs that the Board has not studied. We agree. Accordingly, we suggest that the Board address any unique considerations that may exist with respect to application of FAS 131's concepts in the NPO environment prior to issuing a final standard.



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Once again, we appreciate the opportunity to express our views on these EDs, and we look forward to presenting our views in greater detail at the upcoming roundtable discussions. If you have any questions regarding our comments, please contact Ray Beier (973-236-7440), Mike Gallagher (973-236-4328), or Martha Garner (973-236-7294).

Sincerely,

PricewaterhouseCoopers

Appendix A

PricewaterhouseCoopers' Responses to Questions Raised  
in "Notice for Recipients"

**Not-For-Profit Organizations: Mergers and Acquisitions ED**

**Question 1**—*Are the objectives in this proposed Statement appropriate for all mergers and acquisitions by a not-for-profit organization? 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?*

We generally agree that the acquisition method is the appropriate method of accounting for transactions in which the economic substance is an acquisition of the net assets of an entity by a controlling or surviving organization. However, we are not convinced that application of the acquisition method to transactions in which there is not a clearly controlling or surviving party can be viewed as conceptually superior to the recognition of full fair value (fresh-start accounting) for all of the combining entities. Further, we question whether the cost of applying the acquisition method may outweigh the benefits for mergers involving certain nonpublic NPOs that are primarily supported by contributions. Our views are discussed further below.

*Transactions involving no clear acquirer*

NPOs often undertake mergers for noneconomic reasons (e.g., with the ultimate goal of increasing service potential and achieving mission-critical objectives). In mission-driven mergers, it is not uncommon for two or more NPOs to merge by transferring their net assets to a newly formed entity over which they share equal control. In some instances, the transaction is carefully crafted to ensure that neither entity is (or appears to be) the acquirer or acquiree. For example, NPO A and NPO B merge by creating a new not-for-profit corporation (NEWCO). Assume that the Board of NEWCO includes equal representation from NPO A and NPO B and further assume that the CEOs of the former constituent entities agree to share responsibility (e.g., through a co-CEO structure or a structure wherein NPO A's CEO serves as NEWCO's CEO for a one-year term and is then replaced by NPO B's CEO for a one-year term), with the remaining key management positions split equally among the members of NPO A and B's former management teams. Based on the equal sharing of governance and day-to-day management, we believe that it would be difficult to conclude that either A or B has "obtained control of the other...." in the formation of NEWCO.

In such combinations, attempting to identify an acquirer to recognize the fair value of a presumed acquiree would seem to be an arbitrary exercise that would generate accounting information that does not faithfully portray the underlying transaction. Additionally, we are not convinced that the acquisition method, under which the fair value of only one entity would be recognized, would be conceptually superior to the recognition of full fair value (fresh start) of all combining entities. We believe that such determinations become further complicated when three or more entities are combined and no single party obtains a controlling voting interest in the NEWCO board.

We recommend the Board consider an approach under which there is a rebuttable presumption that a combination transaction is an acquisition of one organization by another unless the relevant facts and circumstances indicate that no single entity has obtained control of the other entit(ies). Under that approach, the determination of whether a transaction does not involve a clear acquirer would require judgment utilizing the relevant facts and circumstances. To assist preparers and others in making that

judgment, we suggest that factors or indicators be provided in the final standard for evaluating whether a merger is, in substance, a transaction in which there is no clear acquirer. These might include:

- Membership of merged entity's governing board is drawn equally from each of the combining entities.
- The transaction is effected through formation of a new entity with new articles of incorporation/bylaws and a new governance structure.
- Debt of the predecessor entities is replaced with debt of the new entity.
- No single predecessor entity clearly dominates management of the merged entity (e.g., CEOs of the constituent entities agree to share responsibility in a co-CEO structure or to serve rotating terms, with remaining key management positions split equally among the constituent entities' former management).

We believe that no one indicator should be considered presumptive or determinative, but rather that the relative strength of each indicator should be considered when evaluating each transaction's specific facts and circumstances. However, there should be an expectation that the hurdle would be high to be able to conclude that neither combining organization has obtained control.

#### *Cost-benefit considerations for certain nonpublic<sup>1</sup> NPOs*

Within the conceptual framework, the FASB identified financial reporting objectives for both NPOs and business enterprises. NPOs that finance most of their operating and capital needs with private philanthropy (i.e., that have predominantly nonbusiness characteristics) may have different financial reporting objectives than NPOs that finance most of their capital needs with the proceeds of debt issues and most of their operating needs from charges for goods or services. For NPOs with predominantly nonbusiness characteristics, CON 4 discusses the objectives of financial reporting, the users of those financial reports, the information needs of those users, and the cost-benefit considerations associated with providing the information.

Financial reporting objectives for organizations with predominantly nonbusiness characteristics stem from "the common interests of those who provide resources to those organizations" in "the services those organizations provide and their continuing ability to provide those services." This differs significantly from the financial reporting objectives for business enterprises, which stem from "the interests of resource providers in the prospects of receiving cash as a return of and return on their investment." The primary resource providers for nonpublic entities with predominantly nonbusiness characteristics are donors who expect no economic return on the resources they provide. Their primary concerns are deciding whether to contribute to a particular NPO and assessing how their donations will be used by the organizations to which they contribute.

Because the primary users of nonpublic nonbusiness NPOs' financial statements are donors whose interests are focused on resource inflows and outflows, the relevance of information produced by acquisition method accounting (e.g., reporting of intangible assets related to donor lists, donor relationships and the like) is questionable, particularly in light of the fact that NPO combination transactions typically do not involve investment of donated resources (i.e., payment of cash consideration). Thus, the presumption that information provided in financial statements is decision-useful may not be true for those organizations when the information is developed from the application of acquisition accounting.

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<sup>1</sup> "Public" NPOs are defined in FSP FAS 126-1.

We also are concerned that the costs associated with imposing acquisition method accounting requirements on smaller nonpublic nonbusiness NPOs will be disproportionately burdensome. Many of these organizations are resource constrained and do not have an abundance of financial reporting staff. Application of the proposed standard to such an organization that might desire to merge purely for mission purposes would impose additional costs in the form of increased accounting assistance, increased audit fees, and costs of obtaining valuations. CON 2's general presumption that "the costs of providing financial information are mostly passed on to the users of information and to the consumers of the organization's goods and services" may not hold true for these organizations as, in general, costs could not be passed on to users of the NPOs goods and services and such organizations typically are not in a position to directly pass on such costs to their donors. Accordingly, if the additional information is not useful in decision making for donors (as discussed above), and the significant cost of developing that information cannot be recovered by the organization from sources other than donors, we believe the cost-benefit test would not be met.

Therefore, we believe that a subset of nonpublic nonbusiness NPOs exists within the overall NPO industry for whom the costs of implementing this proposed standard may be particularly burdensome. We encourage the FASB to identify that subset and to consider whether allowing them an option to continue use of carryover basis accounting for mergers and acquisitions may be justifiable for cost-benefit reasons.

**Question 2**—*Is the definition of a merger or acquisition by a not-for-profit organization [as any event that requires a not-for-profit organization to consolidate a previously unconsolidated entity] appropriate? If not, why and how would you modify or clarify the definition?*

In general, we support the Board's approach to defining a merger or acquisition involving NPOs by referencing a consolidating event, as we believe that this guidance will be practical and useful. However, other areas of the proposed standard suggest that the definition should include the formation of certain NEWCOs. Our views on this and other matters relevant to the definition are presented below.

#### *Voluntary consolidation*

As noted in paragraph B48(c) of the ED, control of another NPO results in optional consolidation in only one of the circumstances described in that paragraph. Accordingly, we believe that paragraph 2 of the ED should be revised to read as follows: "For purposes of this Statement, a merger or acquisition is any event that results in the initial recognition of another business or nonprofit activity (acquiree) in the financial statements of a not-for-profit organization. Thus, any event for which an organization is required or permitted to consolidate a previously unconsolidated entity by initially recognizing its net assets is a merger or acquisition."

#### *Transactions involving NEWCOs*

Paragraph 12 of the ED indicates that, if a new NPO is formed to effect a merger or acquisition between two or more NPOs, one of the entities that existed before the merger or acquisition should be identified as the acquirer based on available evidence. However, that type of transaction does not appear in the ED's scope section. Therefore, paragraph 2 of the ED should be clarified to indicate that the scope also includes combinations in which two or more NPOs transfer net assets to a newly formed entity.

We also recommend that such a transaction be included as an example in paragraph 5. We also recommend that the Board include guidance in the final standard that will assist preparers in clearly distinguishing transactions that are within the scope of the ED from joint ventures (which are excluded from the scope, as described in paragraph 6b), because arrangements resembling joint ventures

established through NEWCOs are common, particularly among business-type NPOs. For example: Health System A and Health System B each transfer a wholly-owned subsidiary to a newly-formed joint venture. The joint venture is established by creating a new NPO parent [NEWCO] to govern the contributed subsidiaries. Health System A and Health System B have equal voting interests in the board of NEWCO. This transaction would appear to meet the definition of a joint venture in paragraph 6b (and thus excluded from the scope of the ED). However, it also appears to fit the fact pattern described in paragraph 12, which would indicate that it is within the scope of the ED and which requires designation of an acquirer. We believe this issue should be clarified in the final standard.

#### *Symmetry with FAS 141*

Organizations must be able to clearly determine whether a particular merger or acquisition transaction is within the scope of the ED or within the scope of FAS 141. Paragraph 12 of FAS 141 states: "This Statement does not apply to combinations between not-for-profit organizations, nor does it apply to the acquisition of a for-profit business entity by a not-for-profit organization." We suggest that the ED mirror that language by inserting the statement, "This Statement applies to combinations between not-for-profit organizations and to the acquisition of a for-profit business entity by a not-for-profit organization," as the first paragraph under the "Scope" subheading. Further, it would be helpful for the Board to indicate explicitly whether acquisitions made by for-profit subsidiaries of not-for-profit organizations should be accounted for in accordance with FAS 141 (i.e., because the acquirer is a for-profit entity) or the ED (based on the guidance applicable to the subsidiary's ultimate parent).

We also note that the scope of FAS 141 includes transactions involving an exchange of a business for a business. Although a transaction involving an exchange of an NPO for an NPO is likely to be rare, we believe that it is possible. Therefore, we recommend that the definition explicitly state that the exchange of a NPO for a NPO is considered a combination that results in a merger or acquisition.

#### *Impact of opt-out clauses*

Some transactions that meet the ED's definition of a merger or acquisition include an opt-out clause, which allows the acquirer or acquiree to unilaterally walk away from the merger within a certain time period after the closing date. We believe that opt-out clauses raise issues pertaining to the definition of an NPO merger or acquisition and that the Board should consider the implications of such clauses before issuing a final standard.

#### **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?***

As stated in our response to Question 2, we believe that the Board's approach to defining a merger or acquisition by referencing a consolidating event based on existing industry-specific consolidation guidance is appropriate for transactions in which one NPO becomes a subsidiary of another. However, for this approach to be implemented in a consistent manner, we believe that two revisions to the industry-specific consolidation guidance should be made.

First, we note that the implications of "sole corporate member" status for consolidations are explicitly addressed in the Health Care Guide, but are not addressed in SOP 94-3. The Health Care Guide states:

Sole corporate membership in a not-for-profit organization should be considered to be equivalent to ownership of the majority voting interest in a for-profit entity, unless the sole corporate member's economic interest in the controlled entity is limited by state law or contractual agreement. Thus, no assessment of the existence of an economic interest would be required in circumstances in which sole corporate membership exists, unless the sole

corporate member's economic interest in the controlled entity is limited by state law or contractual agreement.

We recommend that SoP 94-3 be revised to provide similar guidance for non-healthcare NPOs with a sole corporate member. Further, we believe that the guidance outlined in the Health Care Guide should be displayed more prominently (currently, it appears in a footnote).

Additionally, we recommend that the definition of *majority voting interest* that appears in the Glossary of SoP 94-3 and in footnote 8 to paragraph 11.11 of the Health Care Guide be revised to clarify that the key point is Entity A's unilateral right to appoint (and remove) a majority of the Board members of Entity B, irrespective of any formal affiliation those appointees may have with Entity A.

**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?*

Yes. We believe the definitions are appropriate to distinguish between a merger and acquisition and a purchase of assets.

**Question 5**—*Do you believe control [as described in existing literature, including SOP 94-3 and the Health Care Guide] and [the factors provided in paragraph 11 of the ED] are appropriate for determining the acquirer in a merger or acquisition by a not-for-profit NPO? If not, why and what additional factors or guidance should be considered?*

As stated in our response to Question 1, we believe that in some circumstances an acquirer cannot be clearly identified. We recommend that this be acknowledged in the final standard. Accordingly, we oppose using the criteria in paragraph 11 to arbitrarily designate an acquirer because we believe there can be combinations in the NPO environment in which there is no clear acquirer.

In situations where the criteria in paragraph 11 could result in the identification of an acquirer, we recommend including as a factor consideration of whether one of the entities is financially unsound, which might indicate a likely acquiree. Additionally, we believe that relative size (paragraph 11(c)) is not as clearly an indicator of an acquirer in the NPO sector as in the for-profit sector. While sometimes the relative sizes of the organizations (in terms of resources) might indicate that one is the acquirer, in other cases, the smaller organization may possess compensating strengths (in healthcare, for example, such strengths might be a superior reputation for quality, superior name recognition, or superior managed care contracting relationships) which overcome the presumption that the larger entity is the acquirer. We suggest that this be noted in the final standard.

As discussed in our response to Question 3, we believe that the reliance on existing consolidation guidance is appropriate in circumstances in which one NPO obtains control over another NPO and that control is of a type that requires or permits consolidation. It would be helpful if paragraph 10 of the ED were more explicit regarding circumstances in which the guidance in SoP 94-3 and the Health Care Guide may not be clearly applicable (e.g., when a combination is effected through formation of a NEWCO).

We also note that the proposed standard would apply to transactions in which an NPO acquires a for-profit business enterprise. While SoP 94-3 and the Health Care Guide address consolidation based on ownership of a controlling financial interest in stock of a for-profit enterprise, they do not address consolidation issues related to other types of structures (e.g., LLCs, partnerships, LLPs). In order to

promote consistency, we suggest that the ED include an appendix listing consolidation guidance (apart from SoP 94-3 and the Health Care Guide) that typically should be considered by NPOs in evaluating whether related for-profit organizations should be consolidated.

**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?*

We believe that this requirement is appropriate, and provides more complete and relevant financial information for most transactions. As discussed in our response to Question 1, however, we encourage the Board to consider whether the costs of requiring fair value would outweigh the benefits of mergers involving certain nonpublic NPOs that are primarily supported by contributions. Further, we recommend the Board consider the unique issues associated with measurement of identifiable intangible assets in the NPO environment before issuing a final standard.

**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?*

While we believe that certain donor-related intangible assets, such as donor lists, can be measured with sufficient reliability to be recognized separately from goodwill, we believe there is a risk that the guidance on recognizing donor relationships could be misunderstood and misapplied.

In particular, we are concerned about the analogy drawn in paragraph A26 between donor promises to contribute and contractual customer relationships. For contractual customer relationships, an acquirer may ascribe value to the contracts because they will contribute to revenues in future periods. However, promises to contribute that exist as of the acquisition date will not contribute to revenues in future periods, because that revenue was recognized up front when the promise was received. NPOs may misinterpret the guidance as requiring them to recognize an intangible asset related to a promise to contribute in addition to recognizing the gift itself. We also believe that confusion could arise as to the interaction between noncontractual donor relationships and intentions to give under FAS 116 unless the underlying principles are more clearly delineated and illustrated.

We also recommend that the final standard contain a more robust discussion of valuation considerations related to donor relationships. In discussing the ED with various individuals, we found a common perception related to valuing donor relationships is that it would involve using a discounted cash flow valuation to determine the present value of future contributions over the expected lives of current donors, which could generate an extremely large intangible asset with a very long amortization period. We believe this interpretation may not be consistent with the Board's intent. We also believe that the illustration in A30-A31 needs to be more robust if it is to be helpful to users in applying the underlying guidance.

**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?*

Yes. We agree that these exceptions are appropriate because of the cost-benefit and practicability concerns articulated by the Board.

**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. Some healthcare organizations recognize identifiable intangible assets related to costs associated with obtaining Certificate of Need (CON) approvals. The CON program is a regulatory process that requires certain healthcare providers to obtain state approval before offering new or expanded services or making major capital expenditures. Absent CON approval, those healthcare providers would be unable to obtain the accreditation necessary to operate. Often, CON costs associated with major capital expenditures are capitalized and depreciated as part of the related capital asset, while costs associated with approvals for new or expanded services are capitalized as identifiable intangible assets.

Another common intangible recognized in healthcare combinations pertains to physician relationships. Due to the nature of healthcare services, relationships with non-employee physicians can be considered noncontractual customer relationships, as physicians ultimately control patients' admissions to healthcare facilities through their admitting privileges. If an acquired entity has these referral source relationships in place, this has value to the acquiring organization, as those relationships are directly associated with the acquiree's ongoing revenue stream.

Other healthcare-related intangible assets that may be helpful to discuss in terms of recognition/nonrecognition or valuation include: accreditations, designations or certifications (e.g., accreditation from the Joint Commission on Accreditation of Health Care Organizations, designations such as "level 1 trauma center" or "sole community hospital"); patient lists or relationships (in light of privacy regulations); and medical records and similar databases containing confidential information that must be preserved.

Religious organizations may have intangible assets associated with religious sponsorships or designations (e.g., designation as "Catholic" implies an entity subject to the values and controls of the Catholic church).

An NPO acquiree's volunteer base might also represent an intangible asset in some circumstances.

**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?*

Generally, yes. However, for transactions that do not involve an exchange of monetary consideration, the ED requires that goodwill be recognized when the fair value of liabilities assumed exceeds the fair value of assets acquired (i.e., a net deficit is acquired). The Basis for Conclusions explains the Board's rationale for concluding that all acquired net deficits should be reported as goodwill. The notion that an organization's intent for acquiring the net deficit could be charitable was dismissed by the following statement:

".....the fiduciary responsibilities of an acquiring organization and its directors would preclude them from assuming the liabilities of a financially weaker organization unless they believed there was some unidentifiable intangible asset, such as goodwill. Additionally, if an acquirer assumed an acquiree's liabilities that exceeded both its identifiable and unidentifiable assets, the acquirer essentially would be making a charitable contribution to another organization's creditors, which would be highly unlikely."

We do not agree with the Board's conclusion that transactions in which the intent is purely charitable would be precluded for fiduciary reasons. The willingness of a financially sound soup kitchen to

assume the operations and liabilities of a failing soup kitchen in order to keep its mission going would appear to be sound from a public policy perspective. Further, state attorneys general who regulate charitable mergers typically focus on the effect of such mergers on the combined organization as well as on the individual constituents. (The Board may wish to explore this issue further with state attorneys general who oversee mergers of NPOs.)

Instead, we believe that when a net deficit is acquired, the nature of the net deficit acquired should be assessed and the acquirer's motivation for entering the transactions should be considered. In situations where there is verifiable evidence that the deficit represents value that has been acquired (e.g., based on perceived operating synergies, or because the acquiree has unrecognized assets), the net deficit should be reported as goodwill. In all other situations, the acquired net deficit should be reported as a decrease in net assets at the acquisition date (and for a health care organization, reported below the performance indicator). We believe that this treatment is symmetrical to the EDs treatment of inherent contributions when the fair value of assets acquired exceeds the fair value of liabilities assumed.

We also note that the definition of "goodwill" provided in paragraph 4(l) does not facilitate an understanding of the concept of acquired net deficits representing goodwill. We suggest that the following sentence be added after the first sentence of the definition: "Inherent goodwill is present in a not-for-profit merger or acquisition if (a) the fair value of the liabilities assumed plus consideration transferred (if any) exceeds the fair value of the assets acquired and (b) the organization was willing to acquire the net deficit because of inherent benefits embodied in the transaction, such as synergies that will result from the transaction, or because the acquiree has assets that are not required to be recognized under GAAP (such as some collections)."

**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?*

The requirement that the acquirer recognize a contribution inherent in an acquisition that is measured as a residual is appropriate in circumstances where one entity obtains control over another. As discussed in our response to Question 1, however, we are not convinced that application of the acquisition method to transactions in which there is not a clearly controlling or surviving party would be conceptually superior to recognizing full fair value for all the combining entities.

We also recommend that the definition of "contribution" in paragraph 4(h) be revised to facilitate an understanding of the concept of inherent contributions. We suggest that the second to last sentence of the definition be revised to read as follows: "An inherent contribution is present in a not-for-profit merger or acquisition if the fair value of the acquiree's assets exceeds the fair value of the liabilities assumed plus consideration transferred (if any)."

**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?*

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

Yes, we believe this guidance generally is appropriate and helpful.

**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?

Yes, we agree with the proposed disclosure objectives and believe that the minimum disclosure requirements are appropriate.

We suggest that the minimum disclosures regarding pre-acquisition relationships between the acquirer and the acquiree also include information related to amounts reported in the historical statements of activities associated with these arrangements.

In addition, we believe NPOs should disclose any portion of the consideration transferred (i.e., payments or other arrangement) and any assets acquired or liabilities assumed/incurred that are not part of the merger or acquisition (as discussed in paragraphs 58 and 59 of the ED).

**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 generally agree that the disclosures for public entities would be useful to the users of an NPO's financial statements, but offer the following suggestions.

Paragraph 67 (a) - (c) requires that the disclosure of certain amounts (primarily performance measures) related to the acquiree be included in the statement of activities subsequent to the acquisition date. We believe this requirement will be impracticable in situations where the acquiree's operations and its reporting systems have been integrated with those of the acquirer. The Board may wish to note this in the final standard as an example of impracticability.

We are also concerned that, in practice, there would be inconsistent determination of the adjustments made for purposes of preparing the pro-forma information required by paragraph 68. We suggest replacing this requirement with a requirement to disclose those actual amounts for the acquiree for the period *prior* to the acquisition. If the Board decides to retain the disclosure requirement as proposed, we suggest that guidance be provided to promote consistency in the development of the pro-forma information.

**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?

The reporting of noncontrolling interests occurs frequently in financial statements of business-type NPOs (particularly in the healthcare sector), but far less frequently in the financial statements of "traditional" NPOs. Further, the reporting of noncontrolling interests by NPOs is not limited to situations involving for-profit subsidiaries. For example, some healthcare NPOs recognize noncontrolling interests in NPO subsidiaries in situations where they have a less-than-complete voting interest in the

board of the subsidiary, as permitted under the Health Care Guide (paragraphs 11.16). SoP 94-3 precludes other types of NPOs from reporting such interests, as noted in paragraph D5a of the ED.

We believe the guidance followed by all NPOs with respect to recognition of noncontrolling interests in other NPOs should be consistent regardless of whether they are covered by the SoP or the Health Care Guide. The Board should consider resolving the inconsistency between the two publications, including addressing the general issue of the appropriateness of reporting noncontrolling interests in nonprofit subsidiaries.

Further, assuming that NPOs continue to report partial voting interests as noncontrolling interests, it would be appropriate for the guidance in Appendix D to include those interests. Excluding partial voting interests in NPOs from the scope of the guidance in Appendix D would create a void in guidance for healthcare NPOs that are currently reporting noncontrolling interests.

**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 disagreed with the proposed presentation requirements in our 2005 comment letter to the FASB on the noncontrolling interests exposure draft. The Board has since redeliberated this issue and affirmed its conclusion that noncontrolling interests are part of the consolidated entity's equity. In recognition of the differences-based approach being used for this project, we do not see any rationale for providing presentation standards for NPOs that are inconsistent with the conclusions reached by the Board in its noncontrolling interests project. We agree with the requirements related to accounting for loss of control of subsidiaries as outlined in this ED.

**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?*

Business-type NPOs (in particular, healthcare NPOs) commonly undertake transactions within the scope of the proposed standard. For those entities, the costs of applying the proposed standard are likely to be significant. The primary costs incurred would be (a) identifying assets and liabilities to be recognized and (b) determining the fair values of those assets and liabilities. It appears that mergers by "traditional" NPOs occur with far less frequency.

As discussed in our response to Questions 1 and 10, we believe the Board could further reduce the costs of applying the proposed standard by a) providing an exception on cost-benefit grounds for certain nonpublic NPOs that are primarily supported by contributions and b) limiting situations where the residual acquired in a net-deficit transaction is reported as goodwill to those where it is clear that benefit has been obtained.

One benefit of the proposed standard is that the accounting for acquisitions made by not-for-profit and for-profit organizations within the same reporting entity would be harmonized.

## NFP Organizations: Goodwill and Other Intangible Assets ED

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

Yes. We believe the accounting requirements for intangible assets are appropriate, understandable, and sufficient for identifiable intangible assets acquired in a merger or acquisition.

**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 believe that the departure from the goodwill impairment evaluation in FAS 142 for reporting units that are primarily supported by contributions and returns on investments is appropriate. As indicated in our transmittal letter, however, we believe that the recognition of goodwill in situations involving an acquired net deficit should be limited to situations where it is clear that tangible or intangible benefits have been acquired.

**Question 3**—*Are the criteria for determining which impairment evaluation to apply appropriate, understandable, and sufficient? If not, why and how should the guidance be modified or clarified?*

We suggest the guidance for determining whether a reporting unit is "primarily" supported by contributions and investment income be more clearly articulated to promote consistency in application by NPOs. In addition, due to the importance of federal government grants as a source of revenue for many NPOs and the difficulties often encountered in determining whether such grants represent revenues earned in exchange transactions (i.e., fees for services) or nonexchange revenues (i.e., contributions) the Board might consider addressing this issue relative to the evaluation of primary support.

**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? 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?*

Yes, we believe the qualitative evaluation is generally operational and provides necessary guidance for determining the correct period during which to record a goodwill impairment charge.

**Question 5**—*Is the guidance for identifying the triggering events appropriate, understandable, and sufficient? If not, why and how should the guidance be modified and are there additional examples that should be included?*

Yes, we generally believe that the guidance for identifying triggering events is appropriate, understandable, and sufficient.

**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)? If not, why and what alternative do you suggest?*

Yes, we agree that the impairment loss recognized should be equal to the carrying amount of goodwill related to the acquisition within the reporting unit.

**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? If not, why and how should the guidance be modified or clarified?*

An organization should not necessarily switch to a fair value evaluation when support shifts from contributions to fees. If goodwill was initially recognized in a contribution-supported reporting unit for a specific reason (such as unrecorded collection assets), then as long as the indicators established for impairment have not occurred, that goodwill should continue to be evaluated under the trigger-based model even if the reporting unit's primary support shifts to fees. For example, assume NPO A acquires NPO B (an organization primarily supported by contributions) in a net deficit acquisition and the net deficit is assumed to be attributable to unrecorded assets on NPO B's books (e.g., a specific work of art). NPO A identifies loss or destruction of the collection item as a triggering event for impairment. Even if the primary support of the reporting unit containing the goodwill subsequently shifts to fees, we believe the evaluation of goodwill should continue to be qualitative, because the trigger identified is the simplest and most logical indicator of impairment in this circumstance.

**Question 8**—*What costs do you expect to incur if the requirements of the proposed Statement were issued as a final Statement? What benefits do you expect? How could the Board further reduce the related costs of applying the requirements of the proposed Statement without significantly reducing the benefits?*

Currently, NPOs account differently for goodwill generated in acquisitions entered into by their for-profit subsidiaries than they do for goodwill generated in acquisitions entered into by a not-for-profit parent or a not-for-profit subsidiary. Consequently, NPOs with for-profit subsidiaries may be reporting "hybrid" goodwill at the consolidated level, some of which is amortized and some of which is not. By eliminating amortization of goodwill, the ED would harmonize the accounting for all goodwill reported by an NPO reporting entity; financial statements users would benefit significantly from this simplification. Additionally, since the majority of the mergers and acquisitions are effected by business-type NPOs, this would create symmetry in accounting treatment for goodwill between business-type NPOs and their for-profit counterparts.

We also believe that the qualitative method of impairment testing will be less costly for contribution-supported NPOs to apply. We note that much of the complexity associated with the qualitative method centers on the need for continued evaluation of the reporting unit's primary support in circumstances where a unit is supported by both contributions and fees for services (e.g., subsidized activities). If the guidance on evaluation of primary support could be further simplified, cost-effectiveness would be enhanced.

As discussed in our response to Question 18 of the M&A ED, we believe that the Board could further reduce the related costs of applying that proposed standard by limiting situations in which the residual acquired in a net-deficit transaction is reported as goodwill to those in which it is clear that benefit has been obtained. This would also reduce the number of situations in which goodwill must be evaluated for subsequent impairment in the manner described in the Goodwill ED.

Finally, we believe that the requirement to apply FAS 131 operating segment concepts to assign goodwill to reporting units will be operationally difficult for many NPOs and potentially costly, as they may be required to incur costs associated with additional accounting assistance. Therefore, as discussed in our transmittal letter, we believe it would be appropriate for the FASB to explore whether FAS 131 concepts are operational from an NPO perspective prior to issuing a final standard.