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July 8, 2008

LETTER OF COMMENT NO. 7

To: FASB
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116
Attn: Technical Director—1500-100R

RE: File Reference 1500-100R

To Whom It May Concern,

We would like to thank FASB for heeding our earlier responses on this subject and for once again affording us the opportunity to give comment on contemplated new standards around the combination of multiple not-for-profit organizations. Our hope in this response is to be able to help FASB gain a fuller understanding of the nuances of not-for-profit combinations. We contend that these nuances dictate a different accounting standard for not-for-profit combinations and that any standards promulgated for not-for-profit combinations should complement the work being done in the sector to consolidate. We believe that this can be done without diminishing the consistency and transparency in accounting for such activities.

Before going into the specific questions raised, we would like to make several observations relative to specific points made by FASB staff in the document released for comment. They are as follows:

Paragraph 7: We applaud the board for recognizing that the ceding of control to a new governing body is a key aspect of differentiation between an acquisition and a merger. However, as you will see in our answers to your specific questions, alone it is not a perfect solution.

Paragraph 10a: We share the Board's reservations about using the ceding of control as the sole criterion for differentiating a merger from other types of combinations and/or joint ventures (outside the scope of the proposal). However, taken in concert with the additional criterion we outline later in this letter, we believe it will prove to be an adequate determining factor. We will expand on this point further below.

Paragraph 10b: We agree with the Board that combinations that include an "opt out" clause should not be considered a merger. We view a true merger as a marriage (in the traditional sense, a life-long commitment) and not a courtship that can be called off at any time. We will expand on this point further below.

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Paragraph 10 (in general): We agree with the Board that the definition of a merger should not get too detailed, but concede that a few specific clauses or factors should be included to assure that the intent of the standard is clear and therefore less subject to individual interpretation.

Paragraph 11: We strongly reaffirm our position that the carry-over basis of accounting should be allowed in the case of a not-for-profit merger. While we acknowledge the Board's concern that doing so may indeed "tempt" some to try to classify a contribution of assets as a merger, we believe that such attempts will be rare because there is very little to be gained by the recipient of the assets in doing so. They will reduce some of the short term transaction costs by not having to market value the assets, but the requirement to cede control to a new entity in order to combine its assets with those of another entity that is "going out of business" will likely be more of a long term deterrent than the short term benefit it may offer.

Paragraph 14a: While we still believe that a case could be made for including a Common Mission, defined as similar (e.g. the organizations have a similar purpose) or complementary (e.g. the organizations serve the same population group) we concede to the Board that this may prove to be an unambiguous basis for distinguishing a merger.

Paragraph 14b: If the sole criteria for differentiating between merger and acquisition were the absence of consideration, then we would have to agree with the Board that this criterion would not be sufficient as a determinative factor. However, in the context we originally suggested, this would be one of several factors that, when taken together, we believe does add determinative value to equation.

Paragraph 15: While we can appreciate that desire to avoid lists of indicators and detailed rules, the fact remains that lacking any such guidance in the standard, the practitioners will seek to create their own "guides" for determining what constitutes sufficient evidence that a merger has occurred. Leaving too much to interpretation will naturally result in inconsistency so it seems most appropriate to outline at least a minimum set of "rules" that can be used, such that lacking at least that evidence, the presumption will be that an acquisition has occurred.

Paragraph 16 & ff: Following are our answers to the five specific questions raised by the Board in the Notice. Our responses reflect our overall position on the difference between an acquisition and a merger. We have tried to provide constructive feedback where ever possible and to indicate our agreement where applicable. Our comments are intended to represent what we perceive to be in the best interest of the not-for-profit sector as a whole.

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Question 1: *Is the definition of a merger appropriate for distinguishing mergers from acquisitions by not-for-profit organizations? If not, why?*

- Yes, it is appropriate but it is not adequate as the sole criterion. The challenge we see in using this definition as the sole criteria is that alone it could describe both a merger, a contribution, and possibly a joint venture.

Question 2: *Would the definition of a merger, together with the definition of control, be workable in practice? That is, can it be applied in practice with a reasonable degree of consistency, particularly in distinguishing a merger from the transactions noted in paragraph 6(a) and 6(b)? If not, why, and how might it be improved?*

- Yes, it will be workable in practice but it is important to note that the addition of the definition of control simply amplifies the definition of merger, it is not another level of criteria the way control is currently defined. To use it as a second level of criteria, there needs to be a better definition of what constitutes a "ceding" of control to a new organization.

- The definition of control offered (*the direct or indirect ability to determine the direction of management policies through ownership, contract, or otherwise*) could be improved upon if it were supplemented to include evidences of an actual change of control such as:

    - A newly constituted board rather than a simple combining of the existing boards into a joint board

    - A new set of Bylaws and Articles of Incorporation that clearly outlines the makeup of the new board and its authority to manage all the assets of the new organization.

    - There should be no evidence, written or verbal, that the parties to the merger are contemplating an "opt out" at a future date.

    - There should be no consideration given to the organizations that will go out of existence subsequent to the merger beyond assumption of the liabilities.

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- Adding the above will help resolve the concerns indicated in paragraphs 6(a) and 6(b):
    - This definition would differentiate between a merger and an acquisition in which one entity acquires another entity by gift because in such a combination the donating organization would cede control of its assets but there would be no ceding of control by the surviving organization. *Clearly, without ceding of control by both parties, a merger has not* occurred.
        - Specific to the Board's concern that some parties may be "tempted" to structure a gift as a merger in order to avoid valuing the assets to market, we believe that the temptation will be significantly diminished if the surviving organization is required to reconstitute its board and redraft its Bylaws in order to accept the gift.
        - However, if the surviving organization's board is willing to agree to cede control of their existing assets to a newly constituted organization in order to garner the gift, then are they not indeed merging, as defined above?
        - It seems that the organization receiving the assets would consider carefully the cost/benefit of structuring the transaction as a merger. In most cases the benefit from not having to value the assets will be far outweighed by the cost of ceding control of their existing assets and thus the likelihood of parties "taking advantage" of the rule will be so minimal that it doesn't merit concern at this point.
    - The definition would differentiate between a merger and a joint venture because there can be no contemplation of future separation going in.
        - A written "opt out" clause would be proof positive that the combination is indeed a joint venture and not a merger.
        - While likely not needing to be specifically identified in the standards, there would be any number of other indicators that *point to an expectation of potential separation in the future and* thus identify the combination as a joint venture rather than a merger. Examples of such indicators include but are not limited to:

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- Active discussion of how the organizations can separate if needed as part of the merger discussions that are documented in the minutes of the merger meetings
- Agreement that the existing legal entities will be "put on the shelf" for a period of time rather than summarily dissolved subsequent to consummation of the merger agreement
- Operating agreements that allow the representatives of existing organizations to continue to exercise sole management of their respective pre-merger assets

***Question 3**: Do the definitions of a merger and control, taken together, make it sufficiently clear that transferring an integrated set of net assets to a newly created joint venture in which the transferor retains shared control is not the equivalent of ceding control? If not, how might the Board clarify the definitions or make it clear that the creation of a joint venture is beyond the scope of the proposal?*

- Yes, if the definition includes the definition of "ceding" of control that we described above. Using that definition, the logic is simple... shared control is not ceded control and without ceded control, no merger has occurred.
- In terms of making it clear that the creation of a joint venture is beyond the scope of this proposal, it seems that the Board need only identify the fact that these rules establish the existence of a difference between a joint venture and a merger, and then state clearly that these rules apply to mergers only because the rules for a joint venture are covered in a different standard.

***Question 4**: Does the definition of a merger require any additional criteria or guidance to address the concern noted in paragraph 10? That is, in general, will the ceding of control be discernable in practice from the surrounding facts and circumstances, despite the possibility that some entities may attempt to structure the new organization's Board composition, senior management, or charter to disguise circumstances in which one of the governing bodies retains control over the newly created organization?*

- Yes, as we have indicated above, there must be a "ceding" of "control" and if both words are properly defined then we believe the concerns noted by the Board in paragraph 10 will be sufficiently mitigated.

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- The operative points are the combination of ceding control to a new governing board under new bylaws and the lack of an opt out option.
    - The concern in 10(a) is mitigated by the requirement to cede control to a new governing board. It is important to note that before the merger, each party has 100% control of its own assets and no control of the other party's assets but subsequent to the merger, the new board has 100% control of the combined assets.
    - The concern in 10(b) is addressed by our earlier recommendation to specifically indicate in the standard that the existence of an "opt out" clause or evidence of an "opt out" possibility will automatically identify the combination as a joint venture rather than a merger.

***Question 5**: If one or more parties to a potential combination retains an opt-out clause, would that alone be sufficient evidence to determine that that party has not ceded control? Some respondents asked the Board to consider whether retention of so-called opt-out clauses by the parties to a combination would indicate that a merger or acquisition had not occurred. The staff has been told that such contingent provisions sometimes are included in acquisitions of physician practices by not-for-profit organizations. However, presumably, such provisions could occur in mergers or acquisitions of other private practices, including acquisitions by business entities. The staff thinks that the specific terms of each contractual arrangement need to be assessed to determine whether the definition of a merger or acquisition has been met and would not expect a unique interpretation for mergers or acquisitions by not-for-profit organizations.*

- Yes, see our responses above.

- We are not qualified to address the specific challenges of the use of opt-out clauses relative to acquisition of physician practices but we believe creating an exception for certain types of combinations would dilute the value of using the existence of an opt out clause as a determining factor.

- We believe that a fair analogy would be that an opt out clause is like a prenuptial agreement for a marriage. If one enters into a marriage (merger) with an eye toward how they can extricate themselves if it doesn't go well, they are much more likely to end up divorcing (opting out). They might better go steady (work collaboratively or create a joint venture that may later result in a merger) for a while to get to know each other better rather than rushing into something that they are not sure of.

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In hopes of helping the Board better understand how we perceive that the standard, including our recommendations would be applied in practice, we have attached three examples as an addendum to this letter. While no example can contemplate every possible scenario, we believe these examples demonstrate that for the vast majority of non-profit mergers, the proposed rules, together with our suggested additions, will indeed result in a practicable standard for the application of specific accounting rules for the merger of non-profit organizations.

United Way of America will be happy to participate in any additional meetings or conversations on these matters in order to provide additional observations for the Board's consideration as they continue to review and modify the proposed Statement.

In conclusion, we again thank the Board for this opportunity to comment and advocate for what we believe is in the best interest of the not-for-profit sector, namely to create a clearly defined standard for mergers of not-for-profits and continuing to allow use of the carry-over basis method when a merger is being executed.

If the Board would like to discuss our responses further, 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

Kenneth C. Euwema
Vice President of Membership Accountability (United Way of America)
For the United Way of America Financial Issues Committee

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Appendix: Examples of Application

Example #1: Four non-profit organizations enter into an agreement to "merge" their operations.

Following are the characteristics of the various parties:

	Party A	Party B	Party C	Party D
Book Value of Net Assets	$1.4 mil.	$1.2 mil.	$38.5 mil.	$0.8 mil.
Number of Board Members	15	24	42	12

Following are the characteristics of the merged organization:

- Number of Board Members = 35, each with one vote, composed as follows:
  - Each party appoints 3 members for the new board from their existing board to represent the interests of their original organization
  - Each party nominates 2 members from their respective constituency to serve as members at large
  - 15 new members are nominated from the combined constituency to represent the interests of the combined population to be served by the merged organization
- All assets and liabilities are transferred onto the books of Party C at book value with no consideration provided to the other parties.
- During the course of discussions surrounding the creation of the merged entity, consideration is given to maintaining the existing legal entities for a period of time subsequent to merger in case there is a need to dismantle the merged organization. Ultimately this idea is abandoned and a plan for dissolution of the original entities is made part of the merger agreement that leaves them in tact only for as long as is necessary to facilitate an orderly legal dissolution.

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Application of the proposed definition of the merger results in the judgment that this does qualify as a merger because:

1. The governing bodies of the original organizations have conceded control to a new organization:

    a. No one party has 100% control of the new governing body

    b. The composition of the new board is different than the composition of any one of the merging organizations

    c. Bylaws were changed to create a governing body that represents the interest of each party prior to merger and the interests of the combined constituency

2. No consideration is given by the surviving entity in exchange for the net assets of the other entities

3. While there is evidence of a discussion of an opt out clause, in the end there is no opt out option granted to any party.

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Example #2: Three non-profit organizations enter into an agreement to "merge" their operations.

Following are the characteristics of the various parties:

	Party A	Party B	Party C
Book Value of Net Assets	$1.0 mil.	$1.5 mil.	$30.0 mil.
Number of Board Members	10	15	40

Following are the characteristics of the merged organization:

- Number of Board Members = 45, each with one vote, composed as follows:
    - Party A appoints 2 members for the new board from their existing board to represent the interests of their original organization
    - Party B appoints 3 members for the new board from their existing board to represent the interests of their original organization
    - Party C maintains all of its original 40 board members and amends its bylaws to allow for 5 additional board seats to be filled by the original constituency of the other two parties
- All assets and liabilities were transferred onto the books of Party C at book value in exchange for a bank account with a balance of $100 being established in the name of the other parties.
- During the course of discussions surrounding the creation of a merged entity, it is decided to maintain the existing legal entities for a period of time subsequent to merger in case one or more parties is dissatisfied with the results achieved by the merged entity.

Application of the proposed definition of the merger results in the judgment that this <u>does not</u> qualify as a merger because:

1. The governing bodies of only two of the original three organizations have conceded control to a new organization:
    a. The composition of the new board is not different than the composition of Party C's original board (e.g. all Party C did was add a few additional seats) and it therefore retains effective control of the new governing body

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b. Bylaws were changed only to create additional seats on the existing governing board of Party C that represent the interest of Parties A & B prior to merger rather than creating a body that effectively represents the interests of the combined constituencies

2. The bank accounts opened in the name of two of the three original parties is consideration given by the surviving entity in exchange for the net assets of the other entities and is further evidence that not all parties have ceded control and that they have left structure behind that would facilitate an opt out in the future (see next point).

3. While an opt out clause was not officially included in the agreement, the decision not to dissolve the original entities for a period of time subsequent to merger and leave a structure behind that would facilitate an opt out in the future (see point 2 above) is evidence that there is an expectation of possible opt out. This gives additional strength to the determination that this is not a merger.

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Example #3: Two non-profit organizations enter into an agreement to "merge" their operations.

Following are the characteristics of the various parties:

	Party A	Party B
Book Value of Net Assets	$4.0 mil.	$6.0 mil.
Number of Board Members	20	20

Following are the characteristics of the merged organization:

- Number of Board Members = 30, each with one vote, composed as follows:
  - Party A appoints 12 members for the new board from their existing board to represent the interests of their original organization
  - Party B appoints 18 members for the new board from their existing board to represent the interests of their original organization
  - The bylaws of the new organization include a clause that requires a 2/3 majority vote on all decisions relative to the acquisition or disposal of assets.
- All assets and liabilities of Parties A & B are transferred onto the books of a new organization (Party C) at book value with no consideration provided to the original parties.
- As a part of the merger agreement, plan for dissolution of the original entities simultaneous to the creation of the new organization (Party C) is made and approved by the boards of both parties.

Application of the proposed definition of the merger results in the judgment that this does qualify as a merger because:

1. The governing bodies of the original organizations have conceded control to a new organization:
   a. A new legal entity (Party C) was created with its own board, bylaws, and articles of incorporation.

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b. While one party has more seats than the other on the new board, no one party has indirect control of the assets as evidenced by the 2/3 vote requirement in the bylaws.

c. The composition of the new board is different than the composition of any one of the merging organizations

2. No consideration is given by the new entity (Party C) in exchange for the net assets of the other entities

3. The plan for simultaneous dissolution of the original entities gives clear evidence that the parties have not expectation of an option to opt out of the merger agreement once entered into.