



July 8, 2008

Russell G. Golden, CPA
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LETTER OF COMMENT NO. 8

Re: May 9, 2008 FASB Request Related to the October 2006 FASB Exposure Draft (ED), *Not-for-Profit Organizations: Mergers and Acquisitions* (File Reference No. 1500-100R)

Dear Mr. Golden:

One of the objectives that the Council of the American Institute of Certified Public Accountants (AICPA) established for the PCPS Executive Committee is to act as an advocate for all local and regional firms and represent those firms' interests on professional issues, primarily through the Technical Issues Committee (TIC). This communication is in accordance with that objective. These comments, however, do not necessarily reflect the positions of the AICPA.

TIC has reviewed the Request for Comment and is providing the following comments for your consideration.

GENERAL COMMENTS

TIC does not support the proposal in the Request for Comment. The proposed definition of a merger is not conceptually consistent with the principles established in FASB Statement No. 141R, and, as written, will not be operational in practice. The definition describes combinations that would be seen rarely, if ever, in practice.

Furthermore, the proposal would exclude the mergers that have been TIC's primary concern throughout the length of the project. TIC continues to believe that a combination of two or more not-for-profit entities with the following attributes should be included in the definition of a merger and accounted for under the carryover method:

- The merger involves contribution-based charities;
- No monetary consideration is paid or received or no consideration is exchanged beyond the assumption of liabilities; and





- The purpose of the combination is to prevent loss of the acquiree's services to the community and to continue its mission, which would otherwise not be possible based on the acquiree's distressed financial state.

Combinations involving contribution-based charities where the overriding reason for the acquisition is the acquirer's self-determined moral obligation to continue the good work of another charity that would otherwise not survive represent unambiguous criteria that clearly distinguish such combinations from those involving acquisition by gift. The Board of the distressed entity is ceding control so that the entity's mission can continue to survive.

TIC also believes that recognizing goodwill for the "distressed mergers" described above makes little sense conceptually. Goodwill implies that the combination will result in future economic benefits to the acquirer. On the contrary, the sole motivation for a "distressed merger" is to provide economic benefit to the community (not to achieve economies of scale for the acquirer). The acquirer actually suffers economically from assuming the acquiree's liabilities. For further discussion of these views, please see TIC's February 1, 2007, comment letter on the 2006 Exposure Drafts.

TIC requests that the Board reconsider the above arguments as it re-deliberates the definition of a merger. The additional comments below respond to the Board's specific questions about the stated criteria for distinguishing NPO mergers and acquisitions.

SPECIFIC COMMENTS

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

No. TIC believes the characteristics of a merger described in the Request for Comment do not provide a logical or conceptually sound distinction between mergers and acquisitions. For example, a combination that is entered into for the purpose of cost savings, entering new markets or adding the expertise of the management personnel from one of the combining parties could be structured either by creating a new organization, as defined in the Request for Comment, or as an acquisition. In both scenarios, future economic benefits to be gained from the transferred assets will accrue to the parties to the combination. However, one combination is accounted for on a carryover basis, while the other is accounted for at fair value. TIC does not see any conceptual justification for applying different accounting principles based the composition of the governing board. TIC also believes this distinction would not be transparent to financial statement users.

The request for comment also fails to explain why an acquirer can always be identified in





for-profit combinations but would be impossible for certain not-for-profit combinations. The Request for Comment implies that merger accounting is appropriate when a combination of two or more NPOs has no identifiable acquirer because all parties to the combination cede control of their organizations to create a new organization. However, SFAS 141R, paragraphs 8-9 and A10-A15, requires acquisition accounting for all combinations involving for-profit entities and assumes that an acquirer (i.e., the entity that would have control over the assets acquired) can be identified in all cases. In practice, TIC members with not-for-profit clients have found that the controlling entity was readily identifiable in combinations between/among not-for-profit organizations.

Therefore, TIC is concerned that this proposal will be establishing criteria that will be applicable to few, if any, not-for-profit combinations. This outcome would seem contrary to the original premise of the Request for Comment, paragraph 5, which stated that clearly identifiable mergers of not-for-profit organizations occur more frequently than in the for-profit world. TIC could support merger accounting but not based on the criterion stated in the proposal.

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?*

No. TIC believes the Request for Comment does not provide enough guidance regarding the composition of a “newly formed governing body.” A new board that did not include any members from the boards of the combining entities would clearly meet the definition. However, the creation of a new board that included either equal representation or an unequal number of members from the combining entities could cause inconsistencies and lead to structuring. The term does not take into account structured arrangements that could include majority or 50/50 board representation in form without control in substance. As discussed above, TIC does not support a merger definition that is based on the notion of control.

Although the Board’s reluctance to develop a list of specific criteria is understandable, TIC believes the characteristics of mergers are relatively narrow and represent the predominance of specific factors that, taken together, cause the recognition of goodwill to be largely irrelevant to financial statement users. In many cases, such combinations involve entities acting in the public interest, rather than their own interests. In a merger, neither organization is benefiting at the expense of the other. TIC believes the criteria for a merger should be based, at least in part, on the four criteria identified in the General Comments section above.





If the Board decides to move forward with criteria that would permit merger accounting, TIC also recommends that the final standard include guidance to address the accounting for the deficit net asset position when the carryover basis is applied.

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, subject to any criteria that would be established for a joint venture. Today, joint ventures tend to be created for a specified purpose and may have a limited life. The members of the board of the joint venture separately control other organizations, which have missions apart from the joint venture. In a merger, the board may be comprised of an equal number of members from the predecessor boards, but one or more of the boards from the combining entities generally goes out of existence following the combination.

Question 4: *Does the definition of a merger require any additional criteria or guidance to address the concern noted in paragraph 10 (I think this was supposed to be paragraph 11.)? 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?*

It could be difficult to determine true intent, if entities want to disguise their intentions by structuring around the provisions of the standard. The true intent of the parties may or may not be clear from the applicable agreements.

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.

No, opt-out clauses should not be an isolated, determining factor. An opt-out clause is generally a good business practice for a number of reasons. Restricting its use to ensure a specific accounting method would not be prudent. Just because it is there does not mean that a merger has not occurred.

TIC appreciates the opportunity to present these comments on behalf of PCPS member firms. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

Stephen Bodine, Chair
PCPS Technical Issues Committee

cc: PCPS Executive and Technical Issues Committee

