

July 8, 2008



LETTER OF COMMENT NO. 9

Mr. Russell G. Golden
Director of Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: File Reference No. 1500-100R

Dear Mr. Golden:

The Planning Subcommittee (PSC) of the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants (AcSEC) and certain other AcSEC members are pleased to offer comments on the FASB's May 9, 2008 request for additional comments on a potential revision to the October 2006 Exposure Draft of a proposed Statement of Financial Accounting Standards, *Not-for-Profit Organizations: Mergers and Acquisitions*.

We commend the Board for seeking additional input on this issue. We continue to support the differences-based approach (differences from Statement No. 141 (R), *Business Combinations*) in developing standards for NPOs in this area.

We commend the Board for taking what we believe is a principles-based approach in addressing the issue of transactions in which there is no clear acquirer, and share the concerns expressed in the request for comment regarding provision of detailed guidance or lists of criteria to consider in distinguishing a merger from an acquisition. In the spirit of a principles-based approach, however, we believe some examples applying the guidance to common forms of transactions would be helpful in appropriately illustrating the principle. Further, as described in our response to Question 2, we believe inclusion of specific examples could clarify the Board's intent regarding the scope of the proposed standard as it pertains to venture-type transactions.

We have provided more specific comments in the attachments to this letter.

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We appreciate the opportunity to provide additional comments on the proposed Statement. In addition, we are available to discuss our comments with Board members or staff at their convenience.

Sincerely,

Ben Neuhausen
Chairman
Accounting Standards Executive Committee

Martha Garner
Chair
NPO Mergers and
Acquisitions Comment
Letter Task Force

Attachment A -- responses to specific questions raised in the Request for Comments

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

Response: Yes, assuming that the scope exclusion for venture-type transactions is clarified as discussed in our response to Question 2.

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?

Response: We believe application of the definition will be straightforward with respect to transactions in which entire organizations are combining. However, with respect to transactions in which "sponsoring organizations" each contribute a portion of their net assets (e.g., an entire subsidiary or an integrated set of net assets) to create a new organization, we share the concern of some Board members that the proposed definition is not sufficiently clear to achieve the Board's intent. Such transactions, which frequently occur in the NPO sector, may include (1) formation of a "traditional" joint venture as defined in paragraph 3 of APB 18, *The Equity Method of Accounting for Investments in Common Stock*; (2) formation of a venture in which control is shared, but the sponsors do not share risks and rewards and retain no ongoing economic interest; and (3) similar transactions involving contributions of subsidiaries or integrated sets of net assets in which sponsors cede control by having equal representation on the initial board but thereafter the board is self-perpetuating.¹ Attachment B to this letter includes illustrations of these transactions.

¹ A and B each contribute a subsidiary to NEWCO. A and B each have the right to appoint an equal number of members of NEWCO'S initial board. Subsequently, NEWCO'S board will be self-perpetuating.

We believe the Board could resolve this concern by supplementing the definition of a merger with an example in which (a) entities A and B transfer their net assets to newly formed entity C, (b) entities A and B are dissolved (or otherwise cease to exist as separate substantive entities), and (c) neither A nor B (nor their previous Boards or management) control C. By contrast, in the formation of a venture, (a) entities A and B transfer assets to newly formed entity C, and (b) entities A and B continue to exist as substantive entities.

As discussed in AcSEC's March 1, 2007 comment letter on the Exposure Draft, we believe the FASB should clarify the standard's intent regarding the accounting to be applied by the venture in joint venture formation transactions (that is, the types of transactions identified in item (1) above). Paragraph 10 of the Request for Comments explicitly states that the formation of a JV is not a merger; however, the scope-out in the proposed standard as written appears to only address the *sponsor's* accounting and is silent with respect to accounting used by the *venture* for the formation transaction.

Further, we believe the scope-out should be broadened to include the types of transactions identified in (2) above; that is, transactions that differ from the transactions identified in (1) above because they involve no sharing of risks or rewards or other ongoing economic interest by the sponsors. We believe diversity in practice may exist regarding views on whether the transactions identified in (2) above meet the definition of a *joint venture* in paragraph 3 of APB 18, and therefore clarification in this area is needed.

With respect to the types of transactions identified in (3) above (which involve a similar initial formation transaction but the sponsors subsequently do not retain shared control), we believe diversity in practice may exist regarding views on whether the transactions meet the definition of a *joint venture* in paragraph 3 of APB 18. As a result, the Board's intent is unclear. We believe that in practice, such formation transactions generally are reported using carryover basis accounting (similar to the accounting for initial formation of joint ventures). If these types of formation transactions are included in the scope of the proposed standard, they would be subject to the presumption that one organization (or one integrated set of net assets) has acquired the other unless it can be demonstrated that no clear acquirer exists. We believe this would be inconsistent with the nature and intent of the transaction and, as a practical expedient, FASB should

expand the scope exclusion for formation of joint ventures to encompass the formation of these types of ventures.

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?

Response: See our response to Question 2.

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?

Response: We suggest that FASB provide appropriate linkage of the discussion of the principle to the exposure draft's discussion of indicators *for an acquirer*. We further suggest that FASB consider providing relevant examples to illustrate the principle, including one or more examples that would illustrate its intent regarding the venture-type transactions described in our response to Question 2. In addition, we believe that supplementing the definition of a *merger* with the example that we suggest in our response to Question 2 also would help address the concern noted in paragraph 10.

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 exist 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.

Response: On a broad level, we believe the issue of opt-out clauses is an important issue that the Board should consider apart from consideration in the context of mergers. Specifically, we believe FASB should discuss whether the existence of an opt-out clause affects whether or not a "consolidating event" has occurred. We believe this is particularly important in light of the Board's recent change to the definition of a "sole corporate member" in FSP SOP 94-3-1 and AAG HCO-1, *Omnibus Changes to Consolidation and Equity Method Guidance for Not-for-Profit Organizations*.² Prior to issuance of that FSP, for health care entities, consolidation would have been required in a merger achieved by designating one organization as the sole corporate member of another, irrespective of the existence of an opt-out clause. If considered in the light of opt-out clauses, the revised definition of "sole corporate member" could be interpreted as precluding consolidation. The Board should clarify its intent with respect to whether the presence of an opt-out clause in a combination transaction would represent a limitation on a sole corporate member's control that is sufficient to preclude consolidation. If that is the Board's intent, absent discussion of that fact in the proposed combination standard, we believe practice would be unlikely to consistently reach that conclusion.

If the board concludes that a consolidating event can occur in some or all circumstances in which an opt-out clause exists, we believe:

- The existence of an opt-out clause (or other facts and circumstances in which activities, assets, net assets, or other transferred economic benefits may revert back to one of the combining entities) is fundamentally inconsistent with the notion of a merger. From a practical perspective, therefore, in the context of mergers and acquisitions, we believe it would be highly unusual for an opt-out clause to exist in a transaction in which there is no clear acquirer,

² Paragraph 8 of the FSP provides that "[s]ole corporate membership of one not-for-profit organization in another shall be considered a controlling financial interest unless control does not rest with the sole corporate member (for instance, if the other [membership] organization is in bankruptcy or if other legal or contractual limitations are so severe that control does not rest with the sole corporate member).

because opt-out clauses typically exist in a deal to provide some protection to an acquired entity.

- The Board should consider adding opt-out clauses to the list of factors to consider in identifying an acquiree.

ATTACHMENT B - Illustrations of venture transactions described in response to question 2

(1) NEWCO WITH SHARED CONTROL (Excerpted from AcSEC's March 1, 2007 comment letter):

"Joint ventures and joint operating arrangements are common in the NPO healthcare industry. For example, System A and System B sponsor the formation of a not-for-profit NEWCO in a particular geographic market. Each system contributes its subsidiary hospital in that market to NFP-NEWCO. NFP-NEWCO is governed by a board comprised of 50% A and 50% B. Executive leadership positions are rotated between A and B.

"Based on the guidance in paragraph 6b [of the ED], it appears that because System A and System B jointly control NFP-NEWCO, neither system would be required to apply the ED to the transaction in preparing their respective financial statements. However, it is unclear whether the ED should be applied by NFP-NEWCO in reporting the formation transaction.

"Because control over the two hospital subsidiaries has been transferred to NFP-NEWCO, it might appear that this formation transaction could be within the scope of the ED pursuant to paragraph 12, in which case NFP-NEWCO would be forced to designate one of the hospital subsidiaries as acquirer and revalue the other half of the NPO. However, in this circumstance, NFP-NEWCO's governance and management are shared equally by the two sponsors, and as such NFP-NEWCO appears to be a corporate joint venture. Paragraph 6b addresses only NPOs that participate in the formation of a joint venture, but not the joint venture itself; FASB No. 141 paragraph 9's joint venture exception appears to be broader in scope ("For purposes of this Statement, the formation of a joint venture is not a business combination.") AcSEC therefore requests FASB to clarify the standard to address whether such joint venture formation transactions would be within the scope of the ED."

(2) NEWCO WITH SHARED GOVERNANCE; NO SHARING OF RISKS AND REWARDS OR OTHER ONGOING ECONOMIC INTEREST: NPO A and NPO B each contribute a subsidiary (or *business or nonprofit activity* as defined in the ED) to NFP-NEWCO. NPO A and NPO B share governance; however, neither is entitled to a share of NFP-NEWCO's operations.

(3) NEWCO WITH NO SHARED GOVERNANCE; NO SHARING OF RISKS AND REWARDS OR OTHER ONGOING ECONOMIC INTEREST:

NPO A and NPO B each contribute a subsidiary (or *business* or *nonprofit activity* as defined in the ED) to NFP-NEWCO. NPO A and NPO B retain no rights with respect to governance; neither is entitled to a share of NFP-NEWCO's operations or has a residual or other interest in NFP-NEWCO's net assets.

It is unclear whether this transaction represents a not-for-profit combination transaction as contemplated by the proposed Statement.³ If it is considered a combination transaction (and therefore is within the scope of the proposed Statement), it's unclear whether it's a merger (rather than an acquisition) because it involves the ceding of control of a portion of the organization, rather than the entire organization. (Based on the description of the principle contained in paragraph 7 of the Request for Additional Comments, it appears that the transaction might not qualify as a merger because control of a subsidiary, rather than an organization, was ceded.⁴)

We believe that as a practical expedient, the transaction should be outside the scope of the proposed Statement.

³ **Note for reviewers:** Paragraph 5 of the FASB's October 9, 2006 Exposure Draft, *Not-for-Profit Organizations: Mergers and Acquisitions*, provides that "a merger or acquisition is any transaction or other event that results in a not-for-profit organization initially recognizing a business or nonprofit activity in its financial statements." FAS 141 defines a *business combination* as "a transaction or other event in which an acquirer obtains control of one or more businesses. Transactions sometimes referred to as 'true mergers' or 'mergers of equals' also are business combinations as that term is used in this Statement."

⁴ **Note for reviewers:** Paragraph 4 d of the FASB's October 9, 2006 Exposure Draft, *Not-for-Profit Organizations: Mergers and Acquisitions*, defines a *business* as follows:

A business is an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing economic benefits in the form of a return to investors. Those returns are reflected in the market price of the equity interests or through dividends or through other forms, such as lower costs that are provided directly and proportionately to owners, members, or participants. A business often is, but need not be, a separate legal entity.

We believe the transaction should be outside the scope of the proposed Statement.