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LETTER OF COMMENT NO. 1

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Financial Accounting Standards Board 401 Merritt 7 PO Box 5116 Norwalk, Connecticut 06856-5116

Sent via e-mail to director@fasb.org

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Subject: Comments from Moss Adams LLP on FASB Exposure Draft, Not for Profit Organizations: Mergers and Acquisitions

Dear Technical Director:

We appreciate the opportunity to provide input on the Exposure Draft, Not for Profit Organizations: Mergers and Acquisitions (the "Exposure Draft"). In general, we agree with the provisions of the proposed statement. Our comments below provide our input on those portions of the statement that we believe would benefit from clarification or amendment. Our comments are organized by the questions posed in the Exposure Draft. Where we have provided no comment, we are in agreement with the Exposure Draft.

Comments

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?

The definitions of control and financial interest in AICPA Statement of Position (SOP) No. 94-3 and the AICPA Health Care Organizations Audit Guide are unclear and, we believe, have historically resulted in a significant diversity of practice in consolidation by not-for-profit organizations. The existing guidance is satisfactory in situations where control and financial interest are relatively obvious but does not provide the clarity needed to evaluate situations where control and financial interests are less obvious.

We recommend that the definitions of control and financial interest be clarified as an amendment of the existing provisions or by providing additional clarifying information and examples in the proposed standard for not-for-profit mergers and acquisitions. We also believe that a single source of authoritative GAAP guidance for these definitions and the application of consolidation standards would help eliminate confusion and would enhance compliance and consistency in the application of the standards.

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?

The definition of a business in the Exposure Draft does not address the acquisition of a business or nonprofit activity in which the vast majority of the fair value is attributable to a single asset. This is likely to occur for not-for-profit organizations. In addition, not-for-profit organizations frequently acquire such single assets or single asset businesses through contribution and may benefit from clarification of when such a transaction is a merger or acquisition and when it is a purchase of an asset or a contribution.

We recommend that, similar to the guidance provided in Appendix C of FASB Interpretation (FIN) No. 46(R), Consolidation of Variable Interest Entities - An Interpretation of ARB No. 51, the definition of a business in the Exposure Draft include the following concept:

"If all but a de minimis (say, 3 percent) amount of the fair value of the set of activities and assets is represented by a single tangible or identifiable intangible asset, the concentration of value in the single asset is an indicator that an asset rather than a business is being evaluated."

Furthermore, we recommend that illustrative examples or consideration factors be included in the standard to assist in the evaluation of whether the transaction constitutes a merger/acquisition, a purchase of an asset, or a contribution.

Question 5—Do you believe control and those factors are appropriate for determining the acquirer in a merger or acquisition by a not-for-profit organization? If not, why and what additional factors or guidance should be considered?

We agree that an acquirer should be identified in every qualifying transaction and that the factors specified are appropriate. In situations where the factors are largely equal, an additional factor worthy of taking into consideration is which entity the public might believe to be the acquirer. While a high degree of judgment is required to anticipate the public's view, such a consideration would take into account the public interest aspect of not-for-profit organizations.

Question 7—Do you agree that identifiable donor-related intangible assets can be measured with sufficient reliability to be recognized separately from goodwill? If not, which identifiable donor-related intangible assets would not be measurable with sufficient reliability and why?

We believe that donor lists present unique valuation challenges, especially for small not-for-profit organizations, that will limit the reliability of such estimates to the point it is inadvisable to recognize donor-related intangible assets separately from goodwill. Some of the unique valuation challenges for donor lists are:

- Many donors or groups of donors do not have a contribution pattern. For those who do,
 the pattern is driven by personal and philanthropic reasons which are inherently
 unpredictable. Historical patterns of donations are inherently unreliable indicators of future
 patterns of donation, and the impact of personal and philanthropic motivations cannot be
 determined with meaningful precision.
- Many not-for-profit organizations, especially smaller organizations, are supported by relatively small populations of donors, which increases the volatility of contribution patterns.
- Some organizations obtain a substantial portion of their donor support in the form of a
 few large bequests received upon the death of the donor. Since bequests will not be
 repeated by those donors, the historical patterns are not indicative of future expectations.
 In addition, organizations generally do not have knowledge of being named in potential
 donors' wills and, accordingly, could not make reliable estimates of the amount or timing
 of future bequests.
- A donor's continuing propensity to contribute is related, in part, to the donor's commitment to the not-for-profit organization's management and that management's method of fulfilling the organization's mission. The event of a merger or acquisition itself creates potential variability and uncertainty in future donation patterns as the acquiree's supporters may have a negative perception of the effect of the merger on the organization's ability to continue its mission. There is no reliable way to anticipate the effect of a merger on the public's perception and continuing support.
- The reputation of the acquirer would have an effect on post-merger contribution patterns (positive or negative). The influence of the acquirer on the contribution patterns is a factor that would be impossible to measure but would be a factor affecting the value of a donor list.

Due to the valuation challenges noted above, we do not believe that donor-related intangible assets can be measured with sufficient reliability to be recognized separately from goodwill. Further, we believe the costs and operational difficulties associated with estimating the fair value of a donor list do not outweigh the benefits of providing this information for a not-for-profit organization. Without further development of valuation techniques and sufficient application guidance on estimating the fair value, the proposal may be difficult to implement, may not provide the most useful information to users and may unnecessarily expose preparers and auditors to second-guessing by regulators and litigants.

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?

We generally agree with the provisions for measurement of goodwill based on the amount that is purchased. However, there is an area that requires further guidance. The characteristic of many not-

for-profit organizations being supported by nonreciprocal gifts and support from others could result in assumption of another organization's liabilities for reasons unrelated to its perception of the value of the acquired organization. In this situation, using assumed liabilities to measure the acquisition price might overstate the value of the goodwill. In essence, the amount of goodwill calculated by applying the proposed standard may result in goodwill that is considered impaired immediately when the transaction is completed.

For example, one financially healthy not-for-profit organization (Entity A) accepts the governance and financial responsibility for another not-for-profit organization (Entity B) that is functionally bankrupt. Support for the arts (in general) comes from the city in which these organizations operate or another major donor. Financial failures of other arts organizations in the community in the past have threatened the continuation of the city's or major donor's support of the arts in the community, in general, and to Entity A in particular. Accordingly, Entity A accepts governance and financial responsibility for Entity B as a "bail out" to protect Entity A's own support from the city or major donor. No consideration is exchanged. The bail out represents an "investment" in the continuing support from the city or major donor to arts in the community rather than goodwill attributable to Entity B. Under the proposed standard, Entity A would be required to recognize as goodwill the excess of the liabilities assumed over the value of the identifiable assets acquired, even though there is no goodwill that would reasonably be associated with the acquired operations of Entity B. The recorded goodwill would be considered impaired immediately when acquired.

We recommend that the standard provide clarity for how to account for any excess value that would be considered impaired immediately when the merger or acquisition occurs.

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?

Paragraph 60 provides that differences between consideration transferred and assets received that are not part of the acquisition should be accounted for separate from the acquisition. It lists some possible reasons for such differences. Another possible reason not listed is an excess benefit transaction. That is, payment by the not-for-profit in excess of fair value of an acquiree for no determinable business reason. That could occur if the owner(s) of the acquiree is in a position of influence over the not-for-profit organization and exerts that influence for its own benefit. Accounting for excess benefit transactions is not addressed in accounting literature other than through the SFAS No. 5 contingency implications of the exempt tax issues that might give rise to tax liabilities and potential going concern issues in the event of loss of tax exempt status. We recommend that the possibility of excess benefit transactions be addressed in the proposed standard.

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 believe the disclosures for public entities would be useful to financial statement users and agree with their inclusion in the standard. We do not believe such disclosures should be extended to apply to not-for-profit organizations that are not public entities due to cost/benefit considerations.

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?

The most significant benefit will be consistent reporting of mergers and acquisitions by not-for-profit organizations. The principal cost to not-for-profit management will involve the time, energy and direct costs attributable to performing the valuation of intangibles, especially donor lists. The costs of that valuation process will result from the learning curve required for not-for-profit management to understand the valuation process, validate assumptions by studying historical data, and make the valuation computations if they perform this task in-house. If management chooses to outsource the valuation process, there could be substantial direct costs associated with hiring an expert in addition to acquiring sufficient internal knowledge to oversee the work of the external party. The extent of the cost will depend on the technical sophistication of the effected not-for-profit organizations.

We believe that the cost impact of implementing this proposed standard will be particularly burdensome because the level of merger and acquisition activity is more likely to be concentrated in smaller organizations coming together to achieve economies of scale. These smaller organizations tend to be less technically sophisticated, and therefore are more likely to incur higher incremental costs for accounting for a merger or acquisition.

Accordingly, we recommend two things:

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- 1. In acquisitions where intangibles exist that are entered into by small acquirers (say, with pre-acquisition revenues of less than \$20 million), provide the option to assign to a single intangible asset the entire excess of identifiable tangible liabilities assumed and fair value transferred over the fair value of identifiable tangible assets acquired.
- Provide computational guidance for valuing donor lists to assist the large acquirees and those small acquirees that do not elect the option proposed above.

Thank you for the opportunity to comment on this Exposure Draft. If you have any questions on our response please contact Erica Forhan in our Professional Practice Group at (206) 302-6826 or Erica. Forhan@mossadams.com.

Very truly yours,

Moss Adams LLP