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File reference No. 1500-100, *Not-for-Profit Organizations: Mergers and Acquisitions*

We appreciate the opportunity to comment on the proposed FASB Statement, *Not-for-Profit Organizations: Mergers and Acquisitions*.

We support the issuance of final statements for not-for-profit organization mergers and acquisitions and on accounting for noncontrolling ownership interests in a subsidiary. We believe that guidance designed for not-for-profit organizations will improve financial reporting by reducing the diversity in accounting practice that has resulted from the need to analogize to the guidance in APB Opinion 16, *Business Combinations*, which was originally developed for business entities and has since been superseded by Statement 141, *Business Combinations*.

We also support the proposed definition of a *merger or acquisition* by a not-for-profit organization and its reliance on other existing accounting literature to define *consolidation events*. We encourage the Board to address consolidation issues in a separate project. We also support the proposed accounting and reporting for noncontrolling ownership interests in consolidated subsidiaries. However, we have significant concerns about the following provisions of the proposed Statement:

- **Objectives.** We support the proposed acquisition method for mergers and acquisitions by not-for-profit organizations, except mergers effected without exchange of consideration that are clearly designed so that no party in the merger has direct or indirect control of the resulting combined organization. For such mergers, we recommend fresh start accounting (see Question 1).
• **Definitions of a business and a nonprofit activity.** We believe that the proposed definitions of a business and a nonprofit activity are too broad to appropriately distinguish between an asset or asset group and a business or nonprofit activity (see Question 2).

• **Control.** We believe that the term *control* has not been used consistently throughout the proposed Statement. Because of the significance of the concept of control in consolidation and merger and acquisition accounting, we believe that special attention should be given to the context in which the term is used (see Question 2).

• **Donor relationship intangible assets.** We recommend that the guidance on donor relationships be clarified and expanded to address noncontractual relationships and relationships arising from contributions of services (see Question 7).

• **Goodwill.** We support the proposal to measure and recognize only the amount of goodwill purchased. However, we recommend that goodwill that would be assigned to reporting units primarily supported by contributions and returns on investments be written off immediately. This recommendation is more fully discussed in our comment letter dated January 29, 2007, on the proposed Statement, *Not-for-Profit Organizations: Goodwill and Other Intangible Assets Acquired in a Merger or Acquisition.*

The recommendations and areas of concern outlined above are described more fully in the following detailed responses to the Board’s questions on the Exposure Draft. Our responses also include suggestions that we think would clarify the proposed guidance.

**Objectives**

**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 believe that the proposed measurement, recognition, and disclosure objectives are appropriate for the application of the acquisition method to mergers and acquisitions by a not-for-profit organization. However, we believe that fresh start accounting rather than the acquisition method would better represent a merger of not-for-profit organizations in a transaction with both of the following characteristics:

- No consideration is exchanged
- The transaction is designed so that it is clear that no merging organization has direct or indirect ability to control either the initial or the continuing governance and/or management of the resulting combined organization

**Drafting suggestion**

*Paragraph 1(c)*. We suggest revising the description of the goodwill measurement objective as follows to be consistent with the measurement objective of an inherent contribution and to encompass goodwill recognized in the acquisition of a net deficit:
Recognize either goodwill of the acquired business or nonprofit activity or the contribution inherent in the merger or acquisition as follows:

(i) Measure goodwill as the amount by which (i) the acquisition-date values of the consideration transferred (if any) and liabilities assumed in the acquisition exceed (ii) the acquisition-date values of the net of the amounts assigned to identifiable assets acquired and liabilities assumed.

(ii) Measure the contribution inherent in the transaction as the amount by which the acquisition-date values assigned to the identifiable assets acquired exceeds the consideration transferred (if any) and the liabilities assumed.

Scope and definitions

Question 2—Is the definition of a merger or acquisition by a not-for-profit organization appropriate? If not, why and how would you modify or clarify the definition?

We believe the proposed definition of a merger or acquisition by a not-for-profit organization is appropriate. However, we suggest including an acknowledgment that a not-for-profit organization that becomes the parent of a for-profit investment company should consider whether to retain investment company accounting in accordance with the AICPA Audit and Accounting Guide, Investment Companies, as amended by the pending AICPA Statement of Position (SOP) clarifying both the scope of that Guide, as well as the accounting by parent companies and equity method investors for investments in investment companies.

Definition and use of the term control

According to the minutes of the December 18, 2002, Board meeting, the Board agreed with the staff recommendation to exclude a definition of control from the standards section of the proposed Statement, but to provide existing GAAP definitions of control in the basis for conclusions, as was done in Statement 136, Transfers of Assets to a Not-for-Profit Organization or Charitable Trust That Raises or Holds Contributions for Others. Consistent with that Board decision, paragraph B50 in the basis for conclusions of the exposure draft states, “The term control is not defined in this proposed Statement.”

However, paragraph 4(i) in the standard section defines control for the proposed Statement as follows:

Control is “the direct or indirect ability to determine the direction of management and policies through ownership, contract, or otherwise.” (paragraph 20 of AICPA Statement of Position (SOP) 94-3, Reporting of Related Entities by Not-for-Profit Organizations, and paragraph 11.08 of AICPA Audit and Accounting Guide, Health Care Organizations).

Control, as defined, is not a sufficient condition to require consolidation under either SOP 94-3 or the Health Care Guide, nor is it synonymous with controlling financial interest, an undefined term that is the basis for consolidating a for-profit business or a not-for-profit organization that owns a majority voting interest in the business or organization. We believe that the term control has been used inconsistently or inappropriately throughout the exposure draft, as discussed in the following comments on clarification of scope guidance, acquisition date, step acquisitions, and noncontrolling interests. In addition to our recommendations under each of those topics, we suggest removing the definition of control from paragraph 4(i) from the standard section, in accordance with the 2002
Board decision. If the Board decides to retain the definition in paragraph 4(i), we suggest adding the
definition of an economic interest in SOP 94-3 to paragraph 4 of the proposed Statement and being
careful to use control in an appropriate context.

In accordance with SOP 94-3 and the Health Care Guide, a not-for-profit organization would
consolidate another entity in which it holds a controlling financial interest through the direct or
indirect ownership of a majority voting interest in that entity. Accounting literature—SOP 94-3, the
Health Care Guide, ARB 51, Consolidated Financial Statements, (and its proposed replacement)—
does not define the term controlling financial interest. However, a not-for-profit organization’s
obtaining control of another entity without having a controlling financial interest through the direct
or indirect ownership of a majority voting interest in that entity will not always result in
consolidation. For example, the controlling organization would not consolidate the controlled entity
in the following circumstances:

- The not-for-profit organization obtains control of another not-for-profit organization, but does
  not have an economic interest in the controlled organization
- The not-for-profit organization obtains control of and an economic interest in another not-for-
  profit organization, but
  - Control is likely to be temporary, or
  - The controlling organization elects not to consolidate the controlled organization, as
    permitted for some forms of control under paragraph 12 of SOP 94-3 and paragraph
    11.12 of the Health Care Guide

Therefore, a not-for-profit organization’s initial consolidation of a controlled organization might be
the result of subsequently

- Obtaining an economic interest in an organization that it already controls
- Obtaining a different form of control so that consolidation that was previously optional
  becomes mandatory
- Changing the controlling organization’s consolidation election under either paragraph 12 of SOP
  94-3 or paragraph 11.12 of the Health Care Guide

Clarification of scope guidance

Paragraph 5(d) of the proposed Statement is part of a list identified as examples of mergers or
acquisitions. By focusing only on forms of control without providing appropriate context, paragraph
5(d) creates an impression that obtaining control, by any of the means listed, is a condition sufficient,
by itself, to require consolidation that would be accounted for as a merger or acquisition.

Paragraph 6 provides examples of transactions that would not be considered mergers or acquisitions,
stating in paragraph 6(a), “An event that gave rise to a change in control for which an organization
does not consolidate a controlled entity is not a merger or acquisition.” Thus, paragraph 6(a) is
consistent with SOP 94-3 and the Health Care Guide, but may appear to conflict with, rather than
clarify, the examples of a merger or acquisition as described in paragraph 5(d).

Therefore, we suggest that paragraph 5(d) simply refer to consolidation under existing consolidation
standards to avoid any confusion that may result from providing an incomplete description of
circumstances resulting in consolidation. We believe this approach would provide sufficient and appropriate guidance as an example of a merger or acquisition and would eliminate any apparent conflict with paragraph 6(a). Accordingly, we suggest revising paragraph 5 as illustrated below:

5. ... An organization may structure a merger or acquisition in a variety of ways for legal, taxation, or other reasons. Examples of a merger or acquisition include:

d. An organization obtains control of and initially consolidates recognizes a subsidiary (a business entity or a not-for-profit organization) in its financial statements in accordance with SOP 94-3, or the health care Guide, or other relevant consolidation accounting literature, by obtaining the right to:

(1) Appoint or designate all or a majority of the acquiree’s governing board either through an acquisition of a majority of shares or through other means. For example, the acquirer may obtain the power to designate the acquiree’s board of directors.

(2) Exercise decision-making powers of control over the acquiree through the terms of a contractual agreement. For example, the acquirer may obtain control of an acquiree by contract or an affiliation agreement and not transfer any consideration for control of the acquiree or for the net assets of the acquiree.

(3) Be named the sole member of a not-for-profit organization that is legally organized as a membership corporation. For example, the acquirer may be named as sole corporate member of another not-for-profit organization through an amendment of that organization’s articles of incorporation.

Acquisition date

We believe that paragraph 4(c) in the proposed Statement appropriately defines the acquisition date as the “date the acquirer initially recognizes the net assets of the acquiree in its financial statements.” However, paragraph 13 appears to redefine the acquisition date as “the date an acquirer obtains control of an acquiree.” The latter definition of the acquisition date was appropriate for the proposed revision of Statement 141, Business Combinations, because it was consistent with the definition of a business combination as “a transaction or other event in which an acquirer obtains control of one or more businesses.” For purposes of the proposed revision of Statement 141, control is defined by reference to conditions that indicate the existence of a controlling financial interest.

However, the proposed definition of a merger or acquisition by a not-for-profit organization avoids reference to control because, in accordance with SOP 94-3 and the Health Care Guide, control may not be a sufficient condition to require consolidation. We do not think it would be appropriate to measure and recognize a controlled entity as of the date control is obtained if, for example, the controlling organization initially consolidated that entity two years after obtaining control on acquiring an economic interest in the controlled entity. Therefore, we recommend the following revisions to the proposed Statement:

- Paragraphs 13 and B61 should be revised to be consistent with the acquisition-date definition in paragraph 4(c)

- Paragraph 14 should be revised to be consistent with the suggested revision of paragraph 13, as follows:
The closing date or the date the merger or acquisition is finalized in law often is the same as the acquisition date on which an acquirer obtains control of an acquiree.

- The fundamental principles in paragraph B41 (a) and (b) should require measurement and recognition as of the acquisition date rather than as of the date control is obtained.

- The Board should consider providing guidance on how to account for the initial consolidation of an organization resulting from a voluntary change of the controlling organization’s consolidation election under paragraph 12 of SOP 94-3 or paragraph 11.12 of the Health Care Guide. The initial consolidation would be within the scope of the mergers and acquisitions standard. Assuming that the global amendment in paragraph E2 of the proposed Statement applies to paragraph 2(f) of Statement 154, Accounting Changes and Error Corrections, a merger or acquisition by a not-for-profit organization would be excluded from the definition of a change in reporting entity. However, it may not be clear whether Statement 154 would apply when the only event that caused a merger was a voluntary change in accounting principle because neither the definition of nor accounting guidance for a change in accounting principle in Statement 154 explicitly exclude business combinations.

**Step acquisitions**

Paragraph A75 in the proposed Statement uses obtained control to describe when a not-for-profit organization would initially consolidate a business or another not-for-profit organization in which it previously held a noncontrolling ownership interest. We believe that, in this context, control is being used with the meaning of a controlling financial interest through the ownership of a majority voting interest, which is the relevant consolidation criterion in SOP 94-3 and the Health Care Guide. This usage would provide symmetry with the proposed accounting for deconsolidation in Appendix D in the exposure draft, which is intended to be finalized as part of the replacement of ARB 51. The exposure draft of the ARB 51 replacement describes conditions of a controlling financial interest, but, like ARB 51, SOP 94-3, and the Health Care Guide, it does not define the term. In SOP 94-3 and the Health Care Guide, a controlling financial interest embodies control, but the terms are not used synonymously—a controlling financial interest through ownership of a majority voting interest is sufficient to require consolidation, but control, as defined in that literature, is not. Therefore, we believe the use of the term control in paragraph A75 is inconsistent with the definition in paragraph 4(f). In paragraph A75, we recommend referring to meeting the conditions to initially consolidate an entity rather than to control.

**Appendix D on noncontrolling interests**

We note that control appears to have been used in Appendix D to mean controlling financial interest, a usage that is consistent with the proposed replacement of ARB 51 rather than with the definition used in the mergers and acquisition proposal. This may be appropriate because Appendix D is expected to be finalized as part of the ARB 51 replacement. However, that usage is inconsistent with the definition of control in paragraph 4(f).

**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?**

We believe it is appropriate to rely on existing consolidation guidance in other accounting literature (SOP 94-3 and the Health Care Guide) to define the event for which the proposed Statement would provide measurement and recognition guidance. That approach is consistent with the proposed revision of Statement 141, which would identify a business combination based on control, but
control would be defined by reference to existing consolidation criteria carried over from ARB 51 and its related Interpretation 46 (revised December 2003), Consolidation of Variable Interest Entities. Statement 141 and its proposed revision provide measurement and recognition for consolidation events defined by existing consolidation literature without establishing new consolidation policy.

We note that the FASB was unable to finalize consolidation policy exposed in 1999, currently has a long-term research project on consolidation policy, and is monitoring the International Accounting Standards Board’s active consolidations project. We encourage the FASB to comprehensively address consolidation policy issues involving not-for-profit organizations, as well as to consider not-for-profit organizations when developing consolidation guidance applicable to for-profit entities. However, we do not support deferring the finalization of the mergers and acquisitions standard to address consolidation policy issues that may exist. Therefore, we believe the standard on mergers and acquisitions should be based on existing consolidation guidance in SOP 94-3 and the Health Care Guide.

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?

Definition of a nonprofit activity

Paragraph 4(p) of the proposed Statement defines nonprofit activity as follows:

A nonprofit activity is an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing benefits, other than goods or services at a profit or profit equivalent, as a fulfillment of an organization’s purpose or mission (for example, goods or services to beneficiaries, customers, or members). As with a not-for-profit organization, a nonprofit activity possesses characteristics that distinguish it from a business or a for-profit business entity. A nonprofit activity often is, but need not be, a separate legal entity. [Emphasis added.]

The definition of a nonprofit activity refers to a profit equivalent, which is consistent with the use of the phrase profit or profit equivalent in Concepts Statement 4, Objectives of Financial Reporting by Nonbusiness Organizations, and Concepts Statement 6, Elements of Financial Statements, to describe the characteristic of a not-for-profit or nonbusiness organization. However, the proposed Statement and the Concepts Statements do not define profit equivalent, and the term does not appear in the definition of a not-for-profit organization in Statements 116, Accounting for Contributions Received and Contributions Made, and 117, Financial Statements of Not-for-Profit Organizations. We think the inclusion of profit equivalent in the definition of a nonprofit activity could raise questions about whether an organization could be a not-for-profit organization for purposes of applying Statements 116 and 117, but not be a nonprofit activity under the proposed mergers and acquisitions standard. We suggest removing the term profit equivalent from the definition of a nonprofit activity.
Definition of a business

The wording of the definition of a business in the not-for-profit organizations exposure draft differs from that in the proposed revision of Statement 141. Although we do not think the differences are substantive, we suggest that in the final standards, the wording should be identical.

Distinguishing between an asset group and a business or nonprofit activity

We believe that the proposed definitions of a business and a nonprofit activity, along with the related guidance, are insufficient to appropriately distinguish a business or nonprofit activity from an asset group. As we explained in our comment letter on the proposed revision of Statement 141, we agree with the Board’s decision not to expand the scope of the proposed Statement to include asset acquisitions until the necessary research and deliberations are completed. Accordingly, we believe the definitions of a business and a nonprofit activity must be robust enough to appropriately distinguish a business or a nonprofit activity from an asset group. The following comments from our responses to the definition of a business in the proposed revision of Statement 141 also apply to the proposed definition of a nonprofit activity. The paragraph numbers mentioned below refer to the FASB and International Accounting Standards Board (IASB) exposure drafts on business combinations. The guidance in paragraphs A2-A7 on the definition of a business in the business combinations exposure drafts is nearly identical to the corresponding guidance on the definitions of a business and a nonprofit activity in paragraphs A2-A7 of the not-for-profit organization mergers and acquisitions exposure draft Excerpts of our Comment Letter from October 25, 2005, follow:

We understand that the [FASB and IASB] Boards based the proposed definition of a business on the existing definition in EITF Issue 98-3, “Determining Whether a Nonmonetary TransactionInvolves Receipt of Productive Assets of a Business.” The proposed definition would modify and clarify the existing EITF guidance that the Boards incorporated modifications to the original EITF guidance in the proposed definition.

We believe the following proposed changes to the existing definition of a business would improve that definition:

• elimination of the “self-sustaining” requirement (FASB only, IFRS 3 does not include that requirement)
• clarification that inputs and processes but not outputs are essential elements
• clarification that administrative systems typically are not processes that are used to create outputs
• inclusion of the guidance in paragraph A5 on development stage companies.

We are concerned that the proposed definition could be applied so broadly as to inappropriately identify an asset or asset group as a business. Paragraph 3d defines a business as “… an integrated set of activities and assets that is capable of being conducted and managed for the purpose…” We are particularly concerned about the phrase is capable of being in the definition. Paragraph B37a (FASB) [of proposed Statement 141R] indicates the phrase is capable of being is part of the replacement for the self-sustaining condition in the
existing definition. Paragraph BC 37 (IASB) explains the IASB's reason for adding this phrase as follows:

... the acquired set is assessed as it exists at the acquisition date rather than how it was used by the seller or how it will be used by the buyer. *This change is intended to clarify that a business need not include all of the inputs or processes that the seller used in operating that business if a willing acquirer is capable of operating the business, for example, by integrating the business with its own inputs and processes.* [Emphasis added.]

The intended clarification described in paragraph BC 37 (IASB) is included in application guidance in the second sentence of paragraph A3, as follows:

However, a business need not include all of the inputs or processes that the seller used in operating the business if a willing party is capable of acquiring the business and continuing to produce outputs, for example, by integrating the business with its own inputs and processes.

We do not believe that this guidance achieves its goal of distinguishing a business from an asset or asset group. The proposed guidance does not address how to determine the extent to which the inputs and processes of the seller's business could be excluded from the transaction without changing the nature of what was purchased from a business to an asset group. A market participant's ability to continue to produce outputs by acquiring something less than all of the seller's inputs and processes is not dependent on whether the acquired part is determined to be a business. Therefore, that ability is not sufficient to identify the acquired part as a business. We are concerned that paragraph A3 could be interpreted as effectively eliminating any distinction between a business and an asset or asset group and could result in the inappropriate identification of an asset or asset group as a business.

Furthermore, under paragraph A3, different parties could reach different conclusions about the nature of the same set of inputs and processes. We think that the reference to "a willing party" in paragraph A3 could be understood to mean a single market participant or, more generically, any market participant, or all market participants. Therefore, it appears that conclusions about the nature of a set could be based on a consideration of how the acquired set could be used by a specific acquirer (a willing party), notwithstanding the IASB's expectation that the nature of an acquired set be assessed without consideration of how it will be used by the buyer. For example, a market participant with sufficient existing inputs and processes might be capable of continuing to produce outputs by acquiring a small part of the seller's business. That potential buyer could identify the acquired part as a business under the proposed guidance because of its ability to integrate that part to produce outputs. At the same time, other market participants (other willing parties) that would not be capable of producing outputs by acquiring such a small part of the seller's operations might determine that part to be a group of assets, rather than a business.

To reduce the likelihood of diverse and inappropriate interpretations of what constitutes a business, we recommend that the Boards

- eliminate the phrase *is capable of being* from the definition of a business
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- clarify the guidance in paragraph A3 to provide a robust distinction between a business and an asset group that can be applied to determine consistently whether an integrated set of activities is a business. We believe that the application of the proposed guidance could lead to inconsistent and inappropriate results. The guidance should be clear that the determination of whether an entity is a business should not be acquirer-specific; that is, the identification should not depend on whether a specific acquirer can provide inputs and processes. In addition, until the Boards have considered whether additional issues need to be addressed and concluded that business combinations accounting should apply to asset acquisitions, the definition of a business should not be expanded to the extent that it could apply to an asset or asset group.

- provide examples, like the following, to illustrate and clarify the application of the guidance to identify groups of assets and activities that fail to meet the definition of a business:

  To gain an understanding of the proposed guidance, we considered the application of the existing and proposed definitions in the following three scenarios in which a company purchases a legal entity holding:

  1. an investment property portfolio with tenants, staff, and services. We think this entity would be considered a business under the existing and proposed definitions.

  2. an investment property with one tenant but no employees or services. Under both the existing and the proposed definitions, we think it may not be clear whether this entity is a business. We also think that the assessment of this scenario under the existing IASB and FASB definitions could be affected by the differences between them. The purchase could be considered an asset acquisition because the company did not acquire processes/activities. On the other hand, the acquired entity might be considered a business because the existence of the tenancy agreement brings service obligations that can be outsourced.

  3. a completed investment property with no tenants, no employees or services. Under the existing definition, we believe that this purchase would be an asset acquisition because the acquired entity lacks processes/activities and is not producing outputs (generating revenue). For the same reason, the acquired entity could also be considered an asset under the proposed definition. However, the property is capable of generating revenue with outsourced services or services the buyer already has and, therefore, might be considered a business under the proposed definition. We believe the analysis in this scenario could apply to many acquisitions, including, for example, the acquisition of a retail store, a ship, or a technology patent. We also believe that the acquired entity in this scenario is more appropriately identified as an asset than as a business.

We support the Boards’ efforts to converge and clarify the existing definitions of a business in IFRS 3 and Statement 141. However, we believe the examples we provided illustrate that the proposed definition of a business and related application guidance include changes from the existing definitions and guidance that could, in some circumstances, effectively expand the scope of the business combinations standard to include asset acquisitions. We believe
that such changes would not be appropriate until the Boards conclude that business combinations accounting should apply to asset acquisitions.

We do not believe the presumption in paragraph A7, that a particular set of assets and activities is a business if goodwill is present, is useful guidance for identifying a business. Goodwill is defined as “future economic benefits arising from assets that are not individually identified and separately recognized” (paragraph 3). It is measured as a residual, that is, the difference between the values of the identifiable net assets acquired and the fair value of the acquired business. Because the measurement attributes for a business differ from those for an asset acquisition, it might be necessary to know whether the acquired assets and activities constituted a business before determining whether the transaction includes goodwill. To make the presumption more useful, we suggest that the Boards clarify that it could be applied based on a qualitative assessment of whether core goodwill, as described in paragraphs B102 and B105 of FASB Statement 141, exists.

Paragraph A6. We believe paragraph A6 is ambiguous because it may be unclear whether how a set is or will be operated should be considered irrelevant in determining (a) the differences between a business and a nonprofit activity or (b) the differences between an asset group and a business or a nonprofit activity. We note that the second interpretation would be consistent with the corresponding provision in the proposed revision of Statement 141, which is clearly providing guidance relevant to distinguishing between a business and an asset group or asset. We suggest paragraph A6 be clarified.

Identifying an acquirer

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 believe the guidance in the proposed Statement on identifying the acquirer is appropriate. However, as indicated in our response to Question 1, we believe there are some mergers of not-for-profit organizations that clearly lack an acquirer and should therefore be accounted for using fresh start accounting.

Recognizing and measuring the identifiable assets acquired and liabilities assumed

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?

As noted in our response to Question 1, we believe fresh start accounting would be appropriate in certain situations. However, we think the proposed requirement to measure and recognize identifiable assets acquired and liabilities assumed at their acquisition-date values, which is generally their fair value, is appropriate for application of the acquisition method. We believe the following drafting suggestions could improve that guidance.

Operating leases
Paragraph 28 in the proposed Statement requires recognition of assets and liabilities for leases with terms that are either favorable or unfavorable relative to market terms. According to paragraph B173 of Statement 141, the Board concluded that market rate leases could have value. However, we believe that paragraph 28 is unclear as to whether recognizing a market rate lease at an amount greater than zero would be permitted. We suggest that paragraph 28 provide explicit guidance indicating that at-the-money operating leases are contracts that may have value for reasons other than terms that are favorable to market prices. The Board should also clarify how the asset and liability for a favorable or unfavorable lease differs from the acquisition-date net value recognized in accordance with the first sentence of paragraph 28.

**Measurement period**

The following sentence in paragraph 33 should be revised as follows:

If an organization lacks the information necessary to measure the fair value of an asset acquired or a liability assumed at the acquisition date

**Collections**

Paragraphs A43 and A45. The examples in paragraphs A43 and A45 should state that the acquirer has adopted a policy of not capitalizing collections.

Paragraph B62(a). Paragraph B62(a) characterizes certain collection items and contributed services as assets and liabilities not to be recognized under Statement 116. The treatment of collection items under Statement 116 is an accounting policy election. Although an organization must apply all of its accounting policies consistently, the organization does have the ability to choose to capitalize its collections as a voluntarily change in accounting principles. Therefore, we think it would be more appropriate to say that contributed collection items would not be recognized pursuant to accounting policy elections in accordance with Statement 116, rather than to state that Statement 116 prohibits the recognition of certain collection items. We also suggest clarifying the fact that contributed services would not be recognized unless they meet certain criteria in Statement 116.

Paragraph B83. We suggest revising paragraph B83 as follows:

Consistent with Statement 116, under paragraph 25 of this proposed Statement, an acquirer that has an organizational policy should not to capitalize its collections and meets the conditions in paragraph 11 of Statement 116 should be recognized unless they meet certain criteria in Statement 116.

**Recognition of identifiable assets apart from goodwill and departures from those requirements**

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?

**Contractual-legal and noncontractual donor relationships**

Paragraph A28 in the proposed Statement provides the following guidance:

A donor relationship exists between an entity and its donor if the entity has information about the donor, has regular contact with the donor, and if the donor has the ability to make direct contact with the entity. Donor relationships meet the contractual-legal criterion when
an entity has a practice of soliciting and receiving contributions from its donors regardless of whether a contract or a legally enforceable right exists at the acquisition date. That is, donor relationships generally arise through past contributions received and an entity's ongoing contacts and cultivation and collection efforts related to promised contributions.

Although contributions are, by definition, nonreciprocal transactions, the Board concluded the following in paragraph 99 of Statement 116:

[U]nconditional promises result in equitable or legal obligations; conditional promises may not. Promisors may not feel bound by their conditional promises until the promisee begins meeting the condition or until the condition has been met.

Therefore, for some donor relationships, it seems appropriate to analogize to the guidance on determining when a customer relationship meets the contractual-legal criterion for separate recognition. We understand that customer relationship intangible assets have been among the more difficult intangible assets to identify and value in business combinations. Similar difficulties may apply to donor relationship intangible assets. However, we think that donor relationships that do not meet the contractual-legal criterion do in fact exist, but they may not be separable and could be difficult to measure. In addition, we think it is possible for the same donor to make contributions to an organization both with and without having made a related promise to give. For example, a church collection plate may regularly contain a mixture of payments on annual pledges, contributions from some who regularly attend services but have not made any promise to give, contributions from one-time visitors who will not return, and significant contributions in response to an emergency appeal to help victims of a natural disaster. The emergency donations were not made pursuant to any promises to give, but most of those who made payment on their pledges also contributed to the special appeal. We think the pledges would give rise to contractual-legal donor relationships, the contributions made by regular attendees may give rise to noncontractual donor relationships; and the one-time visitors would not give rise to donor relationships. We are not sure how to consider the effect of emergency contributions made by those who had otherwise made promises to give.

We recommend that the second sentence in paragraph A28 be revised to clarify that the contractual-legal criterion would be met by a practice of soliciting and receiving promises to give contributions. We also suggest that the FASB address how to consider relationships with donors who repeatedly send money in response to solicitation, but never or only sometimes make a promise to give. In addition, we think it would be helpful to include a brief discussion on the difference between a donor base and a donor relationship, similar to the discussion of a customer base in paragraph B165 of Statement 141.

Donor relationships arising from contributed service

We suggest the FASB address donor relationships arising from contributed services. An organization often has information about, and regular contact with, volunteers who may promise to provide specific services or adhere to specific schedules. Promises to contribute services would appear to give rise to donor relationships that could meet the contractual-legal criterion for recognition as described in paragraph A28. However, Statement 116 does not require an organization to determine the value of contributed services that do not meet recognition criteria. Therefore, we think it might be difficult to determine the fair value of the donor relationship arising from unrecognized contributed services without also incurring the incremental cost and effort of valuing the services. Alternatives for consideration include the following:
We believe the proposed departures from recognition and measurement at fair value are appropriate. The proposed Statement would require assets held for sale to be measured at acquisition-date fair value, rather than at fair value less cost to sell. We support applying the Board’s tentative conclusion to mergers and acquisitions by not-for-profit organizations.

Assembled workforce. The following sentence in paragraph 29 should be revised as follows:

For purposes of this Statement, an assembled workforce shall not be recognized as an intangible asset separately from goodwill.

Identifiable intangible assets. According to the definition in paragraph 17, in a merger or an acquisition, an intangible asset is identifiable if it arises from contractual or other legal rights (the contractual-legal criterion) or if it is separable (the separability criterion). Because separable is used to describe only one of two criteria that define identifiable, it would be inconsistent to use separable to mean identifiable or recognized separately from goodwill. Therefore, we suggest the following revisions:

- In paragraph B64(b)
  If the item is an intangible asset, it must be identifiable in order to be recognized separately separable from goodwill at the acquisition date.

- Heading before paragraph B66
  Acquired intangible assets that are recognized apart separable from goodwill
Recognizing and measuring goodwill acquired and contribution received

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?

Goodwill recognition

We agree that goodwill acquired in a merger or acquisition by a not-for-profit organization would meet the definition of an asset. We also share the Board’s concern about the potential cost and difficulty of determining the fair value of acquirees and transactions that are not designed to maximize a return to investors and of reporting units that lack the characteristics of a business. Therefore, we support the proposal to measure and recognize only the amount of goodwill purchased. However, as discussed in our comment letter dated January 29, 2007, on proposed Statement, Not-for-Profit Organizations: Goodwill and Other Intangible Assets Acquired in a Merger and Acquisition., we recommend the immediate write off of goodwill that would be assigned to reporting units primarily supported by contributions and returns on investments.

Remeasurement of consideration transferred and in step acquisitions

Paragraph 40 would require an acquirer to remeasure, at acquisition-date fair value, assets and liabilities transferred as consideration. For consideration transferred that is itself a business or nonprofit activity, we recommend that the Board clarify what is being remeasured. Would the acquirer be required to remeasure the full fair value of the business or nonprofit activity transferred as consideration, including goodwill, or would remeasurement be limited to the identifiable assets and liabilities transferred? Measurement of the full fair value of a business or nonprofit activity transferred as consideration, including goodwill, would require the kind of valuations for which the Board has proposed measurement exceptions—that is, the valuation of the acquiree.

Paragraph A75 requires remeasurement at acquisition-date fair value of the parent’s previously acquired noncontrolling ownership investment in a subsidiary acquired in a step acquisition. We recommend the Board clarify the following:

- What is being remeasured? Would the acquirer be required to determine the fair value of the previously acquired noncontrolling interest, including goodwill, or would remeasurement be limited to the noncontrolling ownership interest in the identifiable assets and liabilities of the acquiree?

- Do the exceptions to fair value measurement and recognition that apply to the identifiable net assets acquired also apply to the remeasurement of the previously acquired noncontrolling interest? We believe they do because, on consolidation, the consolidated financial statements will reflect the full acquisition date values of the identifiable net assets acquired.

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?
We support the proposed measurement and recognition of an inherent contribution in the application of the acquisition method by a not-for-profit acquirer.

Paragraph 4(h) in the proposed Statement defines contribution and inherent contribution as follows:

A contribution is an unconditional transfer of cash or other assets to an entity or a settlement or cancellation of its liabilities in a voluntary nonreciprocal transfer by another entity acting other than as an owner. An inherent contribution is present if an entity voluntarily transfers assets to another or performs services for another in exchange for assets of substantially lower value and no unstated rights or privileges are involved. This Statement requires that an acquirer measure an inherent contribution received as a residual.

We think the second sentence implies that an inherent contribution is different conceptually than any other contribution, which raises such questions as whether an inherent contribution exists if the assets exchanged are of lower, but not substantially lower, value. We believe this first sentence, which is identical to the definition of contribution in Statement 116, is the definition of any contribution. What may be unique about a contribution inherent in a merger or acquisition is how it is measured. Therefore, we recommend that the second sentence in paragraph 4(h) be replaced with the following:

The contribution inherent in a merger or acquisition by a not-for-profit organization is measured as the amount by which (i) the acquisition-date value of the identifiable assets acquired exceeds (ii) the acquisition-date values of consideration transferred, if any, and liabilities assumed.

Measurement period

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?

We believe the proposed measurement period is both reasonable and appropriate.

We recommend that the list of items in paragraph 52 for which additional time might be required to obtain necessary information include the acquisition-date value of noncontrolling ownership interests in the acquiree that were held by the acquirer immediately before the acquisition date (for a step acquisition, as described in paragraph A75).

Assessing what is part of a merger or acquisition

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?

We agree with the proposed requirement to determine what should be accounted for as part of the acquisition accounting. However, we believe the application guidance in paragraph A69 should be clarified. To determine whether arrangements to pay for employee services should be considered part of a merger or acquisition, paragraph A69 states that

[It is important to understand whether the transaction includes payments or other arrangements for the economic benefit of the acquirer or resulting combined organization with little or no benefit received by the acquiree or its former owners. [Emphasis added.] ]
With respect to compensation arrangements with former owners of the acquiree, we think that it
would be difficult to conclude that former owners that are employees of the combined organization
would ever receive little or no benefit, regardless of whether or not the arrangement was clearly
payment for the acquisition. We suggest paragraph A69 be revised as follows:

[It is important to understand whether the transaction includes payments or other
arrangements primarily for the economic benefit of the acquirer or for the resulting
combined organization. Is little or no benefit received by the acquiree or its former owners.]

Disclosures

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?

We agree with the proposed disclosure objectives. However, we believe the following disclosures
should be clarified:

- **Paragraph 65(e)(2).** The disclosure should be consistent with the measurement requirements
  for consideration transferred (see our request for clarification of the measurement of
  consideration transferred under Question 10)

- **Paragraph 65(k).** We suggest replacing paragraph 65(k) with a broader, more general disclosure
  of the elements of the transaction that are not included in the acquisition accounting. Preexisting
  relationships are not all significant and may not be more significant than other elements of the
  transaction.

- **Paragraph 65(l).** We suggest clarifying which disclosure is required for the acquirer's previously
  acquired noncontrolling ownership interest in the acquiree. Is it a qualitative description of the
  interest, the preacquisition carrying amount, or the acquisition-date fair value including goodwill?
  If disclosure of the acquisition-date value is required, the disclosure description in paragraph
  65(l) should be consistent with the measurement guidance in paragraph A75 (see our comment
  on paragraph A75 under Question 10).

- **Paragraph 66(b).** Impracticability is defined by reference to paragraph 11 of Statement 154.
  We suggest this definition be moved to paragraph 4 because the term is also used outside of
  paragraph 66(b)

Disclosures by public entities

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 agree with requiring the additional disclosures for public entities. However, we believe the
proposed disclosures should be revised:

- **Paragraph 67(b) and (c).** We understand the purpose of the proposed disclosures is to provide
  information that would help financial statement users to differentiate organic growth from the
  effects of acquisitions on the amounts reported in the parent not-for-profit organization's
  consolidated financial statements. Therefore, we believe it would be unnecessarily burdensome,
  inappropriate, and of limited usefulness to require the disclosures in paragraphs 67(c), because
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they are not applicable to the parent’s reporting model. For example, not-for-profit organizations do not report net income or earnings per share. In contrast, paragraph 67(b) would require information in terms of how it is reported in the consolidated financial statements. We recommend eliminating paragraph 67(c), and in paragraph 67(b) eliminating the phrase “For an acquiree that is not a not-for-profit organization.” We also recommend revising paragraph 67(b) to clarify what amount of changes in net assets should be disclosed. We think the proposed disclosure could have various meanings, such as the amount of net changes in net assets by net asset classification or the amount of each line item of changes in net assets by net asset classification.

- **Paragraph 67(d).** In paragraph 67(d), we recommend clarifying which changes in net assets should be disclosed. We think the proposed disclosure could be interpreted as anything from net changes in net assets by net asset classification to each line item of changes in net assets by net asset classification.

- **Paragraph 68.** We recommend that the guidance on determining pro forma amounts clarify how to treat the classification of temporarily restricted net assets for which the acquisition satisfied the restriction on the acquisition date.

**Noncontrolling ownership interests in a subsidiary**

**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?**

We support the issuance of proposed guidance on accounting for and reporting noncontrolling ownership interests, but with certain clarifications and revisions for consistency with Board decisions and the not-for-profit financial reporting model.

**Clarification of scope**

Paragraph D5 in Appendix D of the exposure draft provides the following scope exceptions:

This Statement does not apply to a not-for-profit organization that has:

a. A less than complete voting interest in another not-for-profit organization. Footnote 9 to paragraph 11 of AICPA Statement of Position (SOP) 94-3, Reporting of Related Entities by Not-For-Profit Organizations, provides guidance for a not-for-profit organization that has a less than complete voting interest in another organization (for example, a not-for-profit organization may appoint 80 percent of the board of the other not-for-profit organization). As required by that Statement, organizations that meet the requirements of that SOP shall not reflect a noncontrolling interest for the portion of the board that the reporting not-for-profit organization does not control because the rights to appoint the remaining 20 percent of the board are not ownership interests in the subsidiary.

b. A subsidiary that has no ownership interests, such as an interest in another not-for-profit organization.

c. A subsidiary that is wholly owned.
We do not think paragraph D5 appropriately describes the applicability of Appendix D, which, for example, would apply to a not-for-profit organization with a wholly owned subsidiary when it sells part of its ownership interest. Therefore, we recommend that the proposed guidance in paragraph D5 be replaced in its entirety with guidance on the applicability of noncontrolling ownership interest requirements, such as the following:

The guidance in this appendix applies only to ownership interests. Therefore, this guidance does not apply to:

- A parent not-for-profit organization’s accounting and reporting for subsidiaries that have no ownership interests. Paragraph 5 of SOP 94-3 describes various ways that ownership of a not-for-profit organization may be evidenced. However, many not-for-profit organizations do not have ownership interests.

- A noncontrolling interest that is not an ownership interest. For example, a not-for-profit organization would not report a 20 percent noncontrolling interest its consolidated subsidiary for the 20 percent of the subsidiary’s Board members appointed by an outside party that has no ownership interest in the subsidiary.

Changes in ownership interests in a subsidiary

Paragraph D10. Except for the last sentence, much of paragraph D10 appears to be inconsistent with Statement 117, the Board decisions at its January 26, 2005, meeting, SOP 94-3, and the AICPA Health Care Guide. We believe most of our concerns about the proposed guidance reflect the difficulty of adapting the language used in a standard designed for the business reporting model to not-for-profit organizations. For example, the equity transactions described in paragraph D10 would not bypass the statement of activities in the consolidated financial statements to be recorded directly into the net asset accounts. Also, as appropriately illustrated in Exhibit 2 in Appendix D, the amount reported in the statement of activities is the total change in net assets (that is, the full amount of proceeds received on sale or the consideration paid for purchase). Such presentation would be consistent with paragraph 18 of Statement 117, which requires that in the statement of activities, the change in net assets articulate to the net assets or equity reported in the statement of financial position. Finally, footnote 14 to paragraph D10 incorrectly states that paragraph A75 on step acquisition would apply only to subsidiaries that meet the definition of a business. We suggest paragraph D10 and footnote 14 be revised as follows:

Once control of a subsidiary is consolidated obtained, changes in ownership interests in that subsidiary that do not result in a loss of control and deconsolidation shall be accounted for as equity (net asset) transactions (investments by owners and distributions to owners acting in their capacity as owners), reported as a separate line item in the consolidated statement of activities, consistent with the presentation of the equity transactions described in FASB Statement No. 136, Transfers of Assets to a Not-for-Profit Organization or Charitable Trust That Raises or Holds Contributions for Others, (as illustrated in Exhibit 2). The carrying amount of the noncontrolling interest component of net assets shall be adjusted to reflect the change in its ownership interest in the subsidiary’s net assets. Any difference between the amount by which the noncontrolling interest is adjusted and the fair value of the consideration paid or received, if any, shall be recognized directly in equity (net assets) attributable to the controlling interest (for example, additional paid in capital). Changes in ownership that do not result in a loss of control and deconsolidation shall be reported as a separate line item in the consolidated statement of activities, consistent with the presentation.
of the equity transactions described in FASB Statement No. 136, Transfer of Assets to a Not-
for-Profit Organization or Charitable Trust That Raises or Holds Contributions for Others.

A decrease in a parent’s ownership interest in a subsidiary that results in the parent losing control of
that subsidiary is accounted for under paragraphs D12–D15 of this Statement.

Deconsolidation

Paragraph D13. The guidance on deconsolidation should include the following decision on
measuring the retained interest in a not-for-profit organization, as described in the minutes of the
January 26, 2005, Board meeting:

If there is a change in the ownership interest in a consolidated subsidiary that results in
deconsolidation of that subsidiary, but the NFP parent retains an ownership interest in that
subsidiary, the retained interest would be remeasured to fair value upon deconsolidation, except as follows:

a. If the subsidiary is a not-for-profit organization, any retained ownership interests would be
remeasured to an amount that equals the sum of (1) the interests’ ownership share in the
deconsolidation date fair value of the subsidiary’s net identifiable, recognizable assets and (2)
the carrying amount of any goodwill allocated to the retained interests in accordance with
the guidance for allocating goodwill upon the disposal of a portion of a reporting unit.

Determining whether multiple arrangements are a single transaction

Paragraph D15. We agree with the principle that a series of transactions should be accounted for as
a single transaction if it reflects the economic substance of the events. However, the proposed
Statement uses language that suggests the criteria listed are both necessary and sufficient for
determining whether a series of transactions should be accounted for as a single arrangement.
However, we think other factors could be present that would indicate that a series of transactions is a
single event. Therefore, we suggest that the guidance in paragraph D15 be clarified accordingly.

Illustration

Illustration of the presentation requirements. We believe that paragraphs D23, D24, and the
Exhibits incorrectly use the term controlling ownership interest instead of controlling interest. If
the parent not-for-profit organization does not itself have owners, then the acquisition and
consolidation of a subsidiary in which the parent holds an ownership interest does not change the
character of the parent organization’s net assets into ownership interests. That is, although the not-
for-profit organization holds a controlling ownership interest in a subsidiary, no entity or person
holds an ownership interest in the parent organization. Therefore, we suggest removing ownership
from controlling ownership interest in references and captions throughout the illustration.

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?
See our responses to Question 16.

**Benefits and costs of the proposed requirements**

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?

**Cost of applying the acquisition method or fresh start accounting**

For mergers involving only small not-for-profit organizations and no exchange of consideration, we are sympathetic to concerns about the incremental accounting and valuation cost, as well as the expertise required to apply either the proposed acquisition method or fresh start accounting. Such organizations might find it difficult to obtain contributions to support the incremental accounting costs if donors prefer funding program activities. We think the use of carryover-basis accounting could be justified for such organizations, based on a comparison of costs and benefits. However, we acknowledge that any bright-line established to define small would be arbitrary.

**Other comments**

**Objective of financial reporting**

The objective of financial reporting in paragraph B20 appears to have been drawn from the FASB’s Preliminary Views, Conceptual Framework for Financial Reporting: Objective of Financial Reporting and Qualitative Characteristics of Decision-Useful Financial Reporting Information, rather than from Concepts Statement 4, Objective of Financial Reporting by Nonbusiness Organizations. We believe that a final standard on mergers and acquisitions by not-for-profit organizations should be based on financial reporting objectives applicable to not-for-profit organizations that the Board has adopted on completion of full due process.

**Pooling guidance carried forward**

Paragraphs A91–A93. We realize that the guidance on dispositions of assets after a merger or acquisition accounted for using the pooling method is carried forward without reconsideration. However, we suggest that paragraph A91 at least acknowledge that the condition for pooling on which this guidance is based (as described in the last sentence of paragraph A92) is not relevant to pooling by not-for-profit organizations.

We would be pleased to discuss our comments and recommendations with Board members or staff. Please direct your questions or comments to Joseph Graziano at (732) 516-5560 or Ann McIntosh at (612) 677-5257.

Sincerely,

/s/ Grant Thornton LLP