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LETTER OF COMMENT NO. 20

Ms. Suzanne Bielstein
Director – Major Projects and Technical Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Proposed Statement of Financial Accounting Standards, *Not-for-Profit Organizations: Goodwill and Other Intangible Assets Acquired in a Merger or Acquisition*
(File Reference No.1500-200)

Dear Ms. Bielstein:

Ernst & Young appreciates the opportunity to comment on the above-referenced Exposure Draft. We support the Board's decision to provide specific guidance on goodwill and other intangible assets acquired in mergers and acquisitions of not-for-profit organizations (NPOs). We also support the differences-based approach used by the Board in developing this guidance. However, we believe that any goodwill resulting from a merger or acquisition in which a traditional NPO (i.e., those primarily supported by contributions and returns on investments) is the acquiree should be written off immediately as the goodwill is inherently a contribution made by the acquirer to the seller. We agree with the Board's proposed approach relating to accounting for the goodwill of business-oriented NPOs (i.e., those not primarily supported by contributions and returns on investments) consistent with Statement 142.

Please refer to Appendix A to this letter for our detailed comments and suggestions on the Exposure Draft.

We would be pleased to discuss our comments with Board members or the FASB staff.

Very truly yours,

Ernst + Young LLP

Appendix A

Responses to Questions in the Proposed Statement of Financial Accounting Standards, *Not-for-Profit Organizations: Goodwill and Other Intangible Assets Acquired in a Merger or Acquisition*

Accounting for Identifiable Intangible Assets

Question 1—Are the accounting requirements for intangible assets appropriate, understandable, and sufficient for identifiable intangible assets acquired by a not-for-profit organization in a merger or acquisition? If not, why and what alternative do you suggest?

Yes, we believe the accounting requirements for intangible assets acquired by a NPO in a merger or acquisition are appropriate, understandable, and sufficient.

Accounting for Goodwill

Question 2—Is the departure from the goodwill impairment evaluation in Statement 142 appropriate for reporting units that are primarily supported by contributions and returns on investments? If not, why and how should goodwill be evaluated for impairment?

We believe the qualitative impairment evaluation approach discussed in paragraphs 33 through 36 of the Exposure Draft is too subjective and will be very difficult to apply in practice. Further, given the nature of traditional NPOs, we believe goodwill resulting from a merger or acquisition should be written off immediately. Refer to our response to Question 4 for further discussion of why we believe goodwill should be written off for traditional NPOs.

Question 3—Are the criteria for determining which impairment evaluation to apply appropriate, understandable, and sufficient? If not, why and how should the guidance be modified or clarified?

The criteria for determining which impairment evaluation to apply are appropriate, understandable, and sufficient. However, as discussed in Question 2 we believe the qualitative approach is too subjective and will be very difficult to apply in practice.

Qualitative Evaluation

Question 4—Is the proposed qualitative evaluation operational for the intended reporting units and will it adequately identify an impairment of goodwill in the correct period? If not, why and how should the guidance be modified or what alternative evaluation would capture an impairment of goodwill on a more timely basis?

No. As discussed above, we believe the qualitative evaluation is too subjective and will be very difficult for preparers to apply and for their auditors to challenge. We support immediate write-off of goodwill resulting from traditional NPO mergers and acquisitions.

In our experience, mergers and acquisitions do not occur on a regular basis among traditional NPOs. However, when they do occur, generally they are the result of a desire to pursue a common mission or to provide needed assistance to another NPO (e.g., an NPO whose liabilities exceed its assets). In these situations, and any merger or acquisition in which the acquiree is a traditional NPO, we believe any resulting goodwill is inherently a contribution made by the acquirer to the seller and should be recognized as such, pursuant to FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made* (Statement 116).

Further, as discussed in paragraphs B132 through B138 of the proposed Statement of Financial Accounting Standards, *Not-for-Profit Organizations: Mergers and Acquisitions*, the recognition of goodwill by traditional NPOs does not enhance the decision usefulness of their financial statements. The primary users of the financial statements of traditional NPOs' include current and prospective donors and creditors. Recorded goodwill will be of limited use to donors (and at worse, confusing to them) and generally is ignored by creditors. While we recognize the Board's position that goodwill meets the definition of an asset, we believe the lack of its decision usefulness and concerns with the qualitative evaluation method expressed support that the immediate write-off of goodwill relating to traditional NPO mergers and acquisitions.

Question 5—Is the guidance for identifying the triggering events appropriate, understandable, and sufficient? If not, why and how should the guidance be modified and are there additional examples that should be included?

No. We believe the guidance will result in confusion and inconsistency in practice. This is demonstrated by paragraphs A13 and A14 of the Exposure Draft. Paragraph A13 notes that "if an identified impairment event is the loss of a key executive, the negative consequence of the loss may be mitigated if the organization hires a qualified replacement. Evaluating whether an impairment event has occurred requires the application of judgment. For example, an organization identifies the acquisition of five key employees as one of the primary reasons why goodwill rose. If the organization loses some but not all five of those key employees, that organization would need to apply its judgment in determining whether that loss signifies that in impairment event has occurred."

In the situations above, one organization may conclude that an impairment event exists while another may not. We believe this approach is asking traditional NPOs to exercise too much judgment, again supporting our position that goodwill should be written off immediately.

Finally, paragraph A14 appears to be inconsistent with paragraph A13. While paragraph A13 allows for judgment in determining whether the identification of an impairment event will result in negative consequences, paragraph A14 indicates that if *any* of the identified impairment events has occurred, all of the recognized goodwill is considered impaired and should be written off.

Question 6—If an identified triggering event occurs, do you agree with the measurement of the impairment loss (equal to the carrying amount of goodwill related to the acquisition within the reporting unit)? If not, why and what alternative do you suggest?

Yes. All goodwill should be written off if a triggering event occurs. However, as indicated above, the application of the guidance in the proposed Statement will be difficult and result in inconsistencies in practice.

Changes in the Nature of a Reporting Unit's Primary Support

Question 7—Is the guidance for determining what method of impairment should be applied when there is a change in the nature of a reporting unit's primary support appropriate, understandable, and sufficient? If not, why and how should the guidance be modified or clarified?

Yes, we believe the guidance for determining what method of impairment should be applied when there is a change in the nature of a reporting unit's primary support is appropriate, understandable, and sufficient.

Benefits and Costs of the Proposed Requirements

Question 8—What costs do you expect to incur if the requirements of the proposed Statement were issued as a final Statement? What benefits do you expect? How could the Board further reduce the related costs of applying the requirements of the proposed Statement without significantly reducing the benefits?

As noted in Question 4, our experience is that mergers and acquisitions do not occur on a regular basis among traditional NPOs. Mergers and acquisitions by business-oriented NPOs are more common. For those traditional NPOs undertaking mergers and acquisitions that result in goodwill, costs of applying the proposed Statement would be significant. The primary costs incurred would be establishing and monitoring the triggering events (for traditional NPOs) and performing the annual impairment tests (for business-oriented NPOs).

We believe the benefits of applying the requirements of the proposed Statement outweigh the costs for business-oriented NPOs. We believe accounting for mergers and acquisitions and related goodwill for these entities should be consistent with business enterprises. However, for the reasons discussed in our responses to the questions above, we believe the costs of applying the proposed Statement to traditional NPOs outweigh the benefits. The costs could be reduced significantly (and financial reporting improved) by allowing the immediate write-off of goodwill by these NPOs.

Other Comments and Suggestions

We have the following other comments and suggestions for the Board's consideration.

Scope

To avoid diversity in practice, we believe the Board should clarify the appropriate accounting guidance to be applied when a for-profit subsidiary of a not-for-profit parent acquires or mergers with another entity. In this situation, some might apply the provisions of Statement 142 because the acquirer is a for-profit entity. Because the resulting accounting can be significantly different under the model in the proposed Statement compared to Statement 142, we suggest that the Board require that the transaction be accounted for based upon the guidance that is applicable to the ultimate parent.

Primary Support

Paragraph 8 lists the four steps that describe how to evaluate goodwill for impairment. Paragraph 8c. requires the organization to "determine the appropriate method of evaluating goodwill for impairment by determining a reporting unit's primary support." We believe the Board should define *primary support* in paragraph 8c. as support over 50%.

Also, paragraph 22 requires that NPOs consider conditional promises to give in determining the reporting unit's primary support. We believe paragraph 22 should clarify that the consideration of conditional promises in determining a reporting unit's primary support should include a probability assessment of the likelihood that the conditional promises will be realized.

Financial Statement Presentation of Impairment Losses

For NPOs reporting under the Health Care Guide, we suggest that paragraph 50 state that impairment losses should be reported within the performance indicator and that for any NPO that presents an intermediate measure of operations, impairment losses should be reported within that intermediate measure.

Application of FASB Statement No. 131 in Determining Reporting Units

Paragraph B17 notes that the proposed Statement would require an NPO to apply the guidance in Statement 131 in determining its reporting units. Statement 131 excluded NPOs from its scope due to their unique characteristics. Because there has been no history of NPOs applying Statement 131, there may be unforeseen practice issues relating to its application (especially by traditional NPOs). Therefore, we believe the application of Statement 131 by NPOs in the context of the Exposure Draft requires further study. Refer to the example described in our response to Question 3.