



PCPS

PRIVATE COMPANIES PRACTICE SECTION

February 1, 2007



LETTER OF COMMENT NO. 19

Mr. Larry Smith, CPA
Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: October 9, 2006 Exposure Drafts of FASB Proposed Statements of Financial Accounting Standards, *Not-for-Profit Organizations (NPOs)*:

- *Mergers and Acquisitions (Project No. 1500-100)*
- *Goodwill and Other Intangible Assets Acquired in a Merger or Acquisition (Project No. 1500-200)*

Dear Mr. Smith:

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

TIC has reviewed the above Exposure Drafts (EDs), referenced as the M&A ED and the Intangible Assets ED, respectively, and is providing the following comments on selected issues for your consideration.

GENERAL COMMENTS

With the exception of the two issues cited below, TIC supports the theoretical concepts outlined in the EDs underlying the acquisition method for combinations by NPOs and the post-merger accounting for acquired identifiable intangible assets and goodwill. TIC also appreciates the effort that went into seeking cost/benefit alternatives for contribution-based NPOs.





SPECIFIC COMMENTS

Recognition of Goodwill

TIC Proposal for Immediate Write-off of Goodwill for Certain Mission-Oriented Acquisitions

TIC disagrees with the Board's conclusion that an acquirer should recognize goodwill in all acquisitions involving the merger of two not-for-profit entities whenever liabilities assumed plus consideration given (if any) exceed the identifiable assets acquired. TIC contends that these combinations may occur for reasons that do not generate goodwill.

Goodwill, by definition, is an asset that embodies future economic benefits to the entity. As discussed in FASB Statement No. 141, *Business Combinations*, paragraphs B107-B114, the future economic benefits associated with goodwill are more nebulous than the benefits derived from other assets. However, the usual components of goodwill, as outlined in paragraph 48 of the M&A ED, are not always relevant to the acquisition of a contribution-based entity when the motivation for the acquisition is mission-related (such as in combinations involving a net-deficit entity).

A mission-driven NPO may merge with another mission-driven NPO for the sole purpose of "the greater good." In such cases, the boards of the respective NPOs may merge to perpetuate a charity that would otherwise have to shut its doors. The boards are not looking for a specific economic return on their investment. The overriding reason for the acquisition is the acquirer's self-determined moral obligation to continue the good work of another charity for the benefit of the community or society at large. This motivation predominates even though the economics of the merger may not be beneficial to the acquirer. TIC believes such acquisitions do not create an asset simply because the acquisition-date values of the liabilities assumed exceed the acquisition-date values of identifiable assets acquired.

TIC understands that the scenario described in the preceding paragraph differs from acquisitions in the for-profit environment. For-profit acquirers would generally allow the acquiree to discontinue its operations prior to the acquisition. The acquirer would then reopen the business as a new entity and therefore not need to assume the net liabilities of the acquiree. However, TIC's experience with many nonprofit entities, particularly small charities, is that these entities do not always make such decisions using the same for-profit reasoning. Indeed, some charities may believe it wrong or even immoral to ignore the valid liabilities of the acquiree. From a strictly financial viewpoint, some may say that they make unwise decisions as a result. TIC does not believe that an unwise financial decision should lead to the recording of goodwill.





Therefore, TIC recommends that the final M&A standard include an exception to the general rule in paragraph 47 of the M&A ED for recognizing goodwill for all acquired nonprofit entities or activities. TIC advocates an immediate and direct write-off at the acquisition date to the acquirer's Statement of Activities for contribution-based NPOs when the sole reason underlying the acquisition is purely mission-driven (such as in combinations involving a net-deficit entity).

TIC's rationale is based on the belief that "goodwill" may be impaired as of the acquisition date and cannot always be linked to future economic benefits for the acquirer. TIC's approach effectively rolls back the qualitative evaluation approach for goodwill impairment from the Intangible Assets ED to acquisition-date accounting. TIC believes this approach also provides the most transparency to users of the financial statements. The write-off should be accompanied by appropriate disclosure that would allow users to understand the basis for management's decisions in making the acquisition.

If the acquiring NPO is required to capitalize the goodwill that is purely mission-based, future impairment testing will be very difficult. There are no criteria today for testing the impairment of a mission-based goodwill asset. Boards would need to identify triggers for impairment that would be based on highly subjective qualitative measures or arbitrary quantitative measures that would not be consistent among organizations. Triggering events may be easily overlooked by management and Boards and, at best, will be applied inconsistently across organizations. TIC does not foresee any meaningful improvement for financial statement users, especially since its application will decrease comparability among organizations.

TIC Proposal Regarding Valuation of Certain Intangible Assets (Other Than Goodwill)

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?

TIC is concerned that certain identifiable intangible assets, such as donor lists, will present insurmountable valuation challenges. The value of a donor list is directly related to its ability to support the entity's solicitation efforts. A donor list purchased from an acquiree may not be transferable to the acquirer. For example, if the donors to the acquiree had included the organization in their wills, how would the acquirer determine the value of the donors to the new organization? TIC was also uncertain how the separability criterion would be applied





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when donor information is subject to confidentiality agreements.

In most cases, organizations will not have the in-house expertise to perform the necessary valuations and will have difficulty finding the necessary expertise locally. In addition, no established basis exists for the useful life of a donor list. TIC questions the cost/benefit of such valuations given the complex valuation issues that each organization will face. TIC also believes the resulting amortization expense will be arbitrary, since the actual pattern of usage of this intangible asset would not be ratable over time. As a result, TIC recommends that acquired donor lists be included in goodwill at the acquisition date.

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

Sincerely,

Edward J. Knauf, Chair
PCPS Technical Issues Committee

cc: PCPS Executive and Technical Issues Committees

