



PriceWaterhouseCoopers LLP
400 Campus Dr.
Florham Park NJ 07932
Telephone (973) 236 4000
Facsimile (973) 238 5000
www.pwc.com

July 21, 2008

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



* 1 5 0 0 - 1 0 0 R *

LETTER OF COMMENT NO. 15

Re: File Reference No. 1500-100R

Dear Mr. Golden:

PriceWaterhouseCoopers appreciates the opportunity to provide comments on the Financial Accounting Standards Board's (the "Board") Request for Additional Comments ("RFC") on a potential revision to the October 2006 exposure draft, *Not-For-Profit Organizations: Mergers and Acquisitions* ("M&A ED").

The proposal evidences the Board's understanding that there are unique aspects of not-for-profit transactions which require different accounting considerations than those identified in the FASB's business combinations project, including the need to distinguish mergers from acquisitions. We agree with the Board's conclusion that, pending the deliberation of issues pertaining to fresh start accounting as part of the conceptual framework project, the carry-over basis better represents the substance of a merger transaction in a not-for-profit environment.

Distinguishing mergers from acquisitions will require that significant revisions be made to the proposed standard. We believe that the manner in which that new guidance is incorporated into the proposed standard may be just as important to the clarity, workability, and consistency in application of the new guidance as stating the proposed definition of a merger unambiguously. We would be pleased to discuss with the Board or staff our thoughts on how best to present and describe the proposed guidance.

Our responses to the specific questions included in the RFC are provided below.

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

We generally believe that the definition of a merger would be appropriate for distinguishing mergers from acquisitions. We recommend, however, that the proposed standard also provide a definition of an acquisition as is described in paragraph 7 of the RFC. We also recommend that the definition of a merger clarify that neither organization acquires the other in a merger. For example:

"In a merger, the governing bodies of two or more not-for-profit organizations cede control of those organizations to create a new organization; no one organization acquires the other(s). In an acquisition, one not-for-profit organization obtains control over the net assets of another organization or over an integrated set of assets and liabilities."

See also our response to question 2.



Question 2— *Would the definition of a merger, together with the definition of control, be workable in practice? That is, can it be applied in practice with a reasonable degree of consistency, particularly in distinguishing a merger from the transactions noted in paragraph 6(a) and 6(b)? If not, why, and how might it be improved?*

We believe that the proposed definition of a merger can be applied with a reasonable degree of consistency to transactions involving combinations of entire organizations. With respect to transactions where two or more not-for-profit organizations combine only a portion of their activities (e.g., combining an integrated set of net assets or combining two subsidiaries) to create a new organization, we share the Board's apparent concern that preparers and auditors may be unable to reach common judgments when attempting to apply in practice the ceding of control criterion to transactions that are, in substance, joint ventures.

To enhance the workability of the proposed guidance, we suggest that the definition of a merger articulate a principle that has the following tenets: (1) the entities combine in their entirety; (2) control is ceded to create a new organization; and (3) no single entity acquires the other(s). For example, a new paragraph that provides the definition of a merger and incorporates our recommended merger principle could be located above paragraph 5 of the M&A ED. Coupled with our suggestion in question 1, that paragraph might read:

"In a merger, the governing bodies of two or more not-for-profit organizations in their entirety cede control of those organizations to create a new organization; no one organization acquires the other(s). In an acquisition, one not-for-profit organization obtains control over the net assets of another organization or over an integrated set of assets and liabilities."

For additional clarity, we suggest making the following changes to the joint venture exclusion in paragraph 6(b) of the M&A ED:

- *The language in 6(b) should be revised to reflect the substance of the language in paragraph 2a of FAS 141R, Business Combinations. For example, 6(b) could read "formation of a joint venture." In our view, this would make it clear that the joint venture, its participants, and its sponsors are excluded from the scope of the proposed standard.*
- *It should be emphasized that a merger involves the combination of two or more entities in their entirety. This can be accomplished by stating that a merger results in fewer entities (i.e., two or more not-for-profits in their entirety combine to create a single entity), while a joint venture generally results in the creation of additional entities (i.e., the venture participants continue to exist in addition to the new organization that is created to house the venture).*
- *As acknowledged in paragraph 10a of the RFC, transactions may occur in the not-for-profit environment that "in-substance" create joint ventures. In practice, opinions differ on whether such transactions meet the definition in footnote 3 of APB Opinion No.18 (which is mentioned in footnote 3 to paragraph 6(b) of the M&A ED). We suggest that footnote 3 of the M&A ED be broadened to acknowledge that in the not-for-profit sector, venture-type transactions may have characteristics that differ from traditional ventures involving for-profit venturers. The footnote should then direct the reader to some relevant examples of "in substance" joint ventures (which could be housed in Appendix A). Such examples might include situations where (1) the not-for-profit venturers share control of the venture but have no financial interest in it (similar to paragraph 10a of the RFC) or (2) the not-for-profit venturers share control of the venture's initial board, but thereafter the board is self-perpetuating.*



In addition to clarifying the proposed standard as it pertains to transactions that are joint ventures or "in substance" joint ventures, the Board might consider providing relevant examples in Appendix A to illustrate the application of the merger principle, similar to the illustrations provided in Appendix A of the proposed Statement: *Not-for-Profit Organizations: Goodwill and Other Intangible Assets Acquired in a Merger or Acquisition*. We believe that such illustrations would further enhance the understandability and consistency of application of the proposed guidance.

Question 3— *Do the definitions of a merger and control, taken together, make it sufficiently clear that transferring an integrated set of net assets to a newly created joint venture in which the transferor retains shared control is not the equivalent of ceding control? If not, how might the Board clarify the definitions or make it clear that the creation of a joint venture is beyond the scope of the proposal?*

See our response to question 2.

Question 4— *Does the definition of a merger require any additional criteria or guidance to address the concern noted in paragraph 10? That is, in general, will the ceding of control be discernable in practice from the surrounding facts and circumstances, despite the possibility that some entities may attempt to structure the new organization's Board composition, senior management, or charter to disguise circumstances in which one of the governing bodies retains control over the newly created organization?*

Given the efforts involved in structuring a transaction as a merger, and the sacrifices of control that the combining not-for-profit organizations would be required to make to accomplish such a merger, we believe that the ceding of control will be discernable in practice, particularly if the standard incorporates the suggestions in our response to question 2. Additionally, from an auditor's perspective, the critical assessment required to determine whether a merger has taken place should occur when the sponsoring organizations are developing the structure of the transaction. We believe that in most situations, the independent auditors of the successor entity will be involved in assessing the accounting implications of the transaction as part of the structuring process, which should aid in discerning whether control has been ceded.

Question 5— *If one or more parties to a potential combination retains an opt-out clause, would that alone be sufficient evidence to determine that that party has not ceded control? Some respondents asked the Board to consider whether retention of so-called opt-out clauses by the parties to a combination would indicate that a merger or acquisition had not occurred. The staff has been told that such contingent provisions sometimes are included in acquisitions of physician practices by not-for-profit organizations. However, presumably, such provisions could occur in mergers or acquisitions of other private practices, including acquisitions by business entities. The staff thinks that the specific terms of each contractual arrangement need to be assessed to determine whether the definition of a merger or acquisition has been met and would not expect a unique interpretation for mergers or acquisitions by not-for-profit organizations.*

We believe that generally, inclusion of an opt-out clause would be inconsistent with the substance of a merger transaction. Such transactions are extremely time-, labor-, and cost-intensive to structure and execute. For this reason, we do not believe that the parties would be willing to go to such lengths, only to allow the combination to be terminated by invoking an opt-out clause. We believe that the existence of an opt-out clause is a strong indication that the nature of the transaction is an acquisition, as the primary purpose of an opt-out clause is to provide some protection to an acquirer. (To clarify this, it may be helpful to add opt-out clauses to the proposed standard's discussion of indicators of an acquirer.)



Broadly speaking, we reaffirm our comment on the M&A ED that opt-out clauses are an important aspect of not-for-profit combinations that should be considered as a standalone topic in the Board's deliberations. As part of those deliberations, we recommend that the FASB discuss whether its recent amendments to the not-for-profit industry-specific consolidation guidance¹ are linked to any considerations of opt-out clauses in the NPO combinations project. Specifically, we refer to the revisions made by par. 8 of the FSP, which states:

As it relates to health care consolidations, sole corporate membership in a not-for-profit entity, like ownership of a majority voting interest in a for-profit entity, shall be considered a controlling financial interest unless control does not rest with the sole corporate member (for instance, if the other [membership] organization is in bankruptcy or if other legal or contractual limitations are so severe that control does not rest with the sole corporate member).

Prior to issuance of the FSP, we believe that consolidation would have been required in an acquisition structured by designating one organization as the sole corporate member of the other, whether or not an opt-out clause was included in the transaction documents. This change to the consolidation guidance could call into question whether a sole corporate member of an acquiree can consolidate that entity if the acquiree has the ability to opt-out of the acquisition. If the Board intended to link this change to consideration of whether a "consolidating event" has occurred in a combination transaction that involves an opt-out clause, we suggest that the Board make that point explicitly in the final standard. Practice is unlikely to make the connection unless it is highlighted.

Once again, we appreciate the opportunity to express our views. If you have any questions regarding our comments, please contact Jan Hauser (973-236-7216), or Martha Garner (973-236-7294).

Sincerely,

PricewaterhouseCoopers LLP

¹ FSP SOP 94-3-1 and AAG HCO-1, *Omnibus Changes to Consolidation and Equity Method Guidance for Not-for-Profit Organizations*.